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Impact of Public Debt on Nigeria’s Economy

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ABSTRACT

Nigeria is in a stage where public debt burden is a challenge to the economic growth and development of the Nation. This does not actually portray public debt as a bad economic step, but in Nigeria’s situation, government borrow to finance its expansionary fiscal measures, such as providing basic infrastructure for enhanced economic activities which will lead to growth. But such borrowed funds are never used for it, which creates a wide gap in the economic apparatus that affects the future and make Nigerians benefit insignifiancantly from its total revenue, since a greater chunk of the said revenue is required annually to service both domestic and external debts. Hence, this work examined the impact of public debt on Nigeria’s economy with the aim of assessing the impact of public debt on economic growth in Nigeria; The research recommended that the nation should manage the nation’s rising debt profile, so as to avoid future debt trap.

Keywords: Public debt, Economy, Debt management, Nigeria.

INTRODUCTION

The impact of public debt on the performance of any economy has been a case of study for most nations [1,2,3,4]. According to [1], public debt is how much a country owes to lenders outside of itself; it is the accumulation of annual budget deficts, hence higher expenditure to revenue ratio [5,6,7]. In Nigeria, Debt Management Office (DMO) was established on 4th October, 2000 to centrally coordinate the management of Nigeria’s debt [8,9]. The need for the creation of a public debt management office was aimed at achieving positive impact on overall macroeconomic management, including monetary and fiscal policies as well as consciously avoiding debt crisis and achieving an orderly growth and development of the national economy [10,11,12].Similarly, good debt management practices make positive impact on economic growth and national development, particularly in reducing debt stock and cost of public debt servicing in a manner that saves resources for investment in poverty reduction programs; just as it improves the nation’s borrowing capacity and its ability to manage debt efficiently in promoting economic growth and national development [13,14]. Prudently raising financing to fund government deficits at affordable costs and manageable risks in the medium- and long-term equally depicts the positive impacts of public debt management office, in that it projects and promotes a good image of Nigeria as a disciplined and organized nation, capable of managing its assets and liabilities; as well as providing opportunity for professionalism and good practice in nation building [2]. As a result, [3], opined that countries borrow for two broad categories: macroeconomic reasons; (higher investment, higher consumption (education and health) or to finance transitory balance of payments deficits (to lower nominal interest rates abroad, lack of domestic long-term credit, or to circumvent hard budget constraints) [15,16,17,18]. This implies that economy indulges in debt to boost economic growth and reduce poverty. He further stated that once an initial stock of debt grows to a certain threshold, servicing them becomes a burden, and countries find themselves on the wrong side of the debt-laffer curve, with debt crowding out investment and growth [19,20,21].

Similarly, report from the [2], indicates that Nigeria’s total debt to Gross Domestic Products (GDP) ratio as of 2016 was 18.60 percent of the country's Gross Domestic Product while the total debt profile of the country was $57.39bn as at Feb 17, 2017. Going by the figures, it meant the nation was heading toward a debt trap which will affect its credit worthiness. This record, therefore, calls for the need to analyze the impacts and efficiency of public debt on the Nigerian economy [22,23,24].

Accordingly, Nigeria is in a stage where public debt burden is a challenge to the economic growth and development of the Nation [25,26].This does not actually portary public debt as a bad economic step, but in Nigeria’s situation, governemnt borrow to finance its expansionary fiscal

measures, such as providing basic infrastructure for enhanced economic activities which will lead to growth. But such borrowed funds are never used for it, which creates a wide gap in the economic apparatus that affects the future and make Nigerians benefit insignifiancantly from its total revenue, since a greater chunk of the said revenue is required annually to service both domestic and external debts. Hence, there is the need for a study to be carried out to ascertain the impact of public debt on the economy of Nigeria.

Theoretical Framework

The relationship between public debt and economic growth has occupied a central position in Keynes analysis of fiscal policy instrument. In examining this on Nigeria's data, the study will utilize Keynes theory. The application of this theory, however, has been extended and augmented to incorporate the economic variables such as Gross Domestic product Growth Rate , Domestic Debt, External Debt outstandng, Exchange Rate, Inflation and Interest Rate.

LITERATURE REVIEW

Abula and Mordecai [4] analyzed the impact of public debt on economic development in Nigeria, with the aim of assessing the individual effects of the country's debt stocks and service payments on economic development (Proxied with GDP Per Capita) in Nigeria. They employed ADF, Johansen Co-Integration test, ECM and the Granger Causality test. They found out that External debt stock and external debt servicing have insignificant negative relationship with economic development in Nigeria, and Domestic debt stock has a direct and significant relationship with economic development while domestic debt service payment was significant but inversely related to economic development in Nigeria. Similarly, [5] worked on Empirical Analysis of the Macroeconomic Impact of Public Debt in Nigeria, using Vector Autoregressive framework, the Granger causality test, impulse response, and variance decomposition of the various innovations to study the impact. Using domestic debt stock, external debt stock, real GDP, average CPI and prime lending rate as variables, they found out that external debt stock increases prime lending rate, but with a lag, also that the level of external and domestic debt over the period of the study has no significant impact on the general price level and output. Adedoyin *et al*, [6] did a work on External Debt and Economic Growth: Evidence from Nigeria, with the aim of showing the relationship between external loan and the economic growth of Nigeria. They employed Co-integration among the underlying variables using Auto-regressive Distributed Lag (ARDL) model after conducting preliminary statistical test to ascertain the normality of the variables as well as stationary of the data set, using descriptive and unit root tests. The variables used were Real Gross Domestic Product, external debt, exchange rate and consumer price index. The research found out that there is no causal relationship between external debt and economic growth. In the same vein, [7] researched on the Impact of Government Debt on the Economic Growth of Ghana, the aim of the study was to examine the inadequate government infrastructure and the ineffective management of domestic and external debt in Ghana and to analyze the structure and the dynamics of domestic, external and total debt, bringing out emerging vulnerabilities and future threats. They employed the simple Ordinary Least Squares method. Using Private Consumption Expenditure, Investment expenditure, Domestic Savings, Import, Government Consumption expenditures,, National Savings, Inflation, Growth, Domestic Debt and External Debt as variables for the study. The research found out that there is a negative relationship between debt (domestic and external) and growth in the economy of Ghana, and recommended that government debt borrowing should be discouraged while increasing the revenue base; hence tax reform programs should be encouraged. Blake [8] did a research termed Investigating the Impact of Public Debt on Economic Growth in Jamaica. The paper employed an autoregressive distributed-lag model method. The variables used for the research are change in real GDP, ratio of debt to GDP, investments, inflation, labour, and openness. From the result, it implies that debt has a statistical and significant inverse relationship with economic growth at high levels in Jamaica. That is, the greater the level of debt, the more the economy growth decreases. Going further, [9] investigated the Impact of External Debt on Economic Growth in Nigeria, using the ARDL Bound Testing Approach. They aimed at proffering appropriate policy measures that will reduce the adverse effect of external

debt and with positive implication on poverty. The variables in the research are growth rate of real GDP, ratio of external debt to GDP, ratio of debt service stock to GDP, ratio of national expenditure to GDP, real exchange rate and trade openness. The research found that External debt impacts negatively significant on output, that there is a unidirectional causality between external debt and economic growth. Consequently, the study recommends, government should embark on prudent borrowing and encourage export-oriented growth. Khan *et al,* [10] researched on the Impact of Public Debt on Economic Growth of Pakistan. The study employed Autoregressive Distributed Lag (ARDL) technique with Real GDP, public debt, private investment, population growth and Human capital as variables for the research. Results of the study suggest that public debt and economic growth has positive but statistically insignificant relationship.

Tawfiq and Abdullah [11] investigated the Impact of Public Debt on the Economic Growth of Jordan. They aimed at examining the impact of public debt and debt service on the economic growth of Jordan through statistical and economic methods. The study employed least squares method, while the variables used are External Debt, Domestic Debt, Total Public, Debt Gross Domestic, Product Public Debt % of GDP and Public Debt per capita in Jordan. The results of the analysis indicate that there is a negative impact of total public debt, especially the external debt on economic growth. Atul and Sal [12] also examined the impact of public debt on the economic growth of 23 OECD countries. Using OLS method with rate of growth of real GDP, rate of capital accumulation, rate of export growth, public debt to GDP ratio, growth rate of investment and growth rate of employment as variables, they found that the marginal impact of debt is negative but very small and statistically insignificant in almost all cases. Jernej *et al*, [13] researched on the the Impact of Growing Public Debt on Economic Growth in the European Union, aimed to explore the transmission mechanism regarding the short term impact of public debt and growth, and to evaluate the direct effect of higher indebtedness on economic growth for countries in the EU, which are in the epicenter of the sovereign debt crisis. They employed panel estimation on a generalized economic growth model, augmented with a debt variable; results across all models indicate a statistically significant non-linear impact of public debt ratios on annual GDP per capita growth rates. They concluded that the threshold value for the 'new' member states is lower than for the 'old' member states.

Furthermore, [14] examined the effects of public debt on economic growth in Kenya, with the aim of investigating the impact of external and domestic debt and its productiveness on the Kenyan economy. Using regression method, they employed External Debt, Internal Debt and Productive debt as variables. They found out that, there was a negative relationship between external public debt and economic growth, a significant positive relationship between internal public debt and economic growth and a positive relationship between productive debt and economic growth in Kenya. Ahlborn and Schweickert [15] investigated public debt and economic growth as it relates to economic systems in Scandinavia, with the aim of proving their argument that different degrees of fiscal uncertainty, at comparable levels of public debt between those economic systems, constitute a major source of heterogeneity in the debt-growth relationship. Using econometrics research method, they used level of initial income, population growth, investment as gross fixed capital formation, foreign direct investment, Openness, public debt and inflation rate as variables for the study. The result of their findings supports their assumption; Continental countries face more growth reducing public debt effects, than especially Liberal countries. There, public debt apparently exerts neutral or even positive growth effects, while for Nordic countries a non-linear relationship is discovered, with negative debt effects kicking in at public debt values of around 60% of GDP. Lastly, [16] investigated the relationship between Public Debt and Economic Growth in Bangladesh. The aim of the study was to analyze the trend and patterns in public debt, and its relationship with investment and growth in Bangladesh, observe the direct relationship between public debt and economic growth and to observe the potential influence of public debt on investment. The study used OLS method with Total investment (as proxied by gross capital formation), Total public debt, Gross domestic product, Openness to international trade (as proxied by, export and import), Real interest rate, Remittance inflow, Money supply and Total debt service

as variables. Results show that public debt is positively related to both investment and economic growth. These findings thus suggest that public debt has an indirect positive effect on growth, through its positive influence on investment.

CONCLUSION

Borrowing of funds to finance expansionary fiscal policy measure of a state is not detrimental to the economic viability of such state, but when such debts are not properly utilized, it becomes a big problem. Hence, it can be established that there exist long run relationship between Nigeria's Public debt and economic growth. Also, the international acceptable Debt to GDP ratio should also be taken into consideration as the nation's debt profile increases.

Accordingly, this paper recommends that the nation should ensure stable exchange rate value of Naira. Such should be achieved through the Central bank of Nigeria monetary policy instruments. The analysis shows a negative relationship between exchange rate and economic growth. Hence the volatility of the nation's exchange rate affects overall economic activities of the country negatively, and should be addressed. To achieve high Naira to Dollar ratio, the nation should consider interest rate manipulation to attract foreign funds, selling foreign assets, reduction of inflation and investment in the real sector to discourage importation.

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