Nigeria’s External Debt: The Perceived Pros and Cons

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DOI - http://doi.org/10.37502/IJSMR.2022.5622

Abstract

A vast majority of countries exist that are unable to self-finance themselves in terms of infrastructure, education, social amenities, and other major projects. As such, they embark on a debt-creating act. With low tax revenues, the government does not want to jeopardize macroeconomic stability by printing additional money. Hence, borrowing is an appealing option for funding infrastructure development projects. Public borrowing happens in both domestic and international markets. External debt is the debt due to non-residents that are repayable in foreign money, food, or services. Nigeria's external debt is on the increase and it is of great concern. This mini review seeks to highlight the impact of external debt on Nigeria. With the right policies, laws, government apparatus, and lack of corruption, External debt can be a great tool in achieving economic growth.

Keywords: Debt, External Debt, Nigeria, Economic Growth

1. Introduction

There are a large number of nations that are unable to finance their infrastructure, education, social amenities, and other big initiatives. Hence help is sought from, outside the state, machinery of the state, citizenry, and beyond the geographical borders that define it. Governments do not exist individually, they are usually in one form of association and /or relationship with other countries of the world. There is no such thing as an island government. To function properly, it would require some type of external assistance. Foreign borrowing is an important source of external support (Yerima & Tahir 2020).

Borrowing is a debt-creating act. As a result, debt refers to the financial resources used by an organization that was not supplied by its owners and does not in any other way belong to them (Udoka and Ogege, 2012). Debt could be Domestic or external. Internal debts are those incurred within the country, whereas external debts are those incurred outside the country's borders (Ndubisi, 2017).

When tax revenues are low and the government does not want to jeopardize macroeconomic stability by printing additional money, borrowing is an appealing option for funding infrastructure development projects, which happens in both domestic and international markets (Ogunmuyia, 2010; Manasseh et al., 2022).

2. External Debt
External debt is defined as a debt due to non-residents that are repayable in foreign money, food, or services, according to the World Bank (2004). The financial responsibility that binds one party (debtor country) to another is referred to as external debt (lender country). It usually refers to debt that is payable in a currency other than the debtor country. The reason for external debt is that countries, particularly developing economies, do not have enough internal financial resources, necessitating the need for outside aid (Yerima & Tahir 2020). Presently, foreign loans are organized international credit negotiated between two countries on terms that are acceptable to them. The lender countries are typically the advanced industrialized countries of Europe, Asia (Japan), and North America, while the borrowing countries are the poor underdeveloped countries of Africa, Asia, and Latin. (Udoka et al., 2010). The external debt is typically owed to foreign creditors such as multilateral agencies like the Africa Development Bank, World Bank, and Islamic Development Bank, as well as bilateral sources like the China Exim Bank, French Development Bank, Japanese Aid Agency, or private creditors like investors in our Eurobonds. "Many of the multilateral loans have zero interest rates, a 40-year maturity, and a 10-year repayment period." Other overseas loans have interest rates of less than 3%. (Manasseh et al., 2022).

3. History of Nigeria’s External Debt

Nigeria received its first external debt in 1958 when the Nigerian government borrowed US$28 million from the World Bank to fund railway construction. (Udoka et al., 2010). External loans were acquired after the oil boom, which lasted from 1971 to 1977, to keep the pace of economic growth and development that had already been set by the oil boom. The necessity for the first jumbo loan, according to the Debt Management Office, emerged from the depletion of our foreign resources and a scarcity of foreign cash required for capital goods imports. Because oil is the country's main foreign exchange earner, the foreign exchange shortfall was caused by a sharp drop in the price and demand for oil on the global market; as a result, the government's income decreased. It was therefore reasoned that investing the borrowed cash would increase the government's income, and the advantages would assist to cover the loans and interest payments. As a result, in 1978, a $1 billion jumbo loan was obtained from the International Capital Market, bringing total foreign debt to $2.2 billion (Debt Management office Nigeria, 2000). Following that, more external borrowing was done from the Paris Club, the London Club of Creditors, as well as bilateral and international organizations. Nigeria had debt difficulties sooner than planned, which have persisted to this day in Ogbonna and Okosu (2019). State governments also entered into external loan contract commitments, causing a surge in borrowing. Nigeria's external debt outstanding was N17.3 billion in 2003, according to the Debt Management Office (DMO). Nigeria was forced to implement a World Bank/International Monetary Fund (IMF)-sponsored Structural Adjustment Programme (SAP) in 1986 to restructure the economy and improve the country's debt serviceability (Ayadi and Ayadi, 2008). (Yerima & Tahir 2020).

4. Effect of External Debt

Most indebted countries of the developing world are trapped on a debt treadmill as they are forced to take new loans to pay old ones and run the risk of economic collapse. Most African countries, paid more debt servicing between 1990 and 1993 than they spent on basic societal
needs like education and health care (Ogbonna and Okosu (2019). This translates to lack of good roads, health care and lack of schools. Nigeria's debt crisis has been a significant impediment to economic growth, particularly after 1980. Nigeria's economic growth is jeopardized as a debt-ridden country, as some macroeconomic indicators such as unemployment, balance of payments, inflation, poverty, terms of trade, and so on are severely impacted. Excessive debt has been a barrier to long-term economic progress and poverty reduction, and as a result, many developing countries, notably those in Sub-Saharan Africa, have experienced major economic crises as a result of their crushing debt burden. (Hadlek et al., 2014). Evidence has revealed that public debt owing to non-residents repayable in foreign currencies has a higher severity of debt burden than private debt (World Bank, 2018). Foreign loans are ostensibly for the aim of development, industrial growth, or enhancing the quality and quantity of food production. The most important goal is to raise the general population's standard of living. Although the author agreed with existing views that foreign borrowing is used to finance production and encourage growth, he failed to mention how it has benefited Nigerians in terms of democratic service delivery (Nweke, 1990). Nigeria, like most developing countries throughout the world, relies heavily on external finance to fund development projects such as iron and steel factories, roads, and power plants. External loans are the most common kind of external funding. (Adegbite and colleagues, 2008).

Nigeria's external debt crisis has become a source of increasing concern in recent years. During this time, the country has accumulated a significant amount of external debt. This is a severe problem for the country's progress. According to the Budget Office, the country's debt-servicing burden has reached critical proportions, as seen by the significant amount of debt service and payback in the 2017 Nigeria Federal Budget, which accounts for almost 24 percent of the annual budget. Nigeria's official debt climbed from US$4.1 billion at the end of 1980 to US$24.6 billion by the end of 1986 due to external debt in the early 1980s. This was owing to a drop in global oil prices, which caused government spending to exceed government earnings. To fund its industrial projects, the government had to borrow.

Nigeria had a foreign debt of US$28.4 billion in 1999, with debt service payments totaling US$1.72 billion and payment arrears totaling US$19 billion. At the end of December 2003, the stock of foreign debt was US$32.92 billion, while external debt service payments were at US$2.0 billion. Nigeria's external debt profile was around $30 billion in 2000, despite the fact that she had paid 200 percent on debt servicing alone over the total sum borrowed.

Nigeria's foreign debt profile garnered unprecedented attention in 2005, when the Paris Club agreed to forgive $18.0 billion of the $30.0 billion owing to Nigeria. This came as a comfort to the government and the people, as the nation's long-term growth strategy might be jeopardized by inconsistent and uneven debt demands and repayments (Abdulkadir & Abdulazeez, 2019).

Since 2005, the external debt stock has continued to expand; in 2010, it was US$4.6 billion; in 2014, it was US$9.7 billion; in 2015, it was US$10.7 billion; in 2016, it was US$11.4 billion; and in 2017, it was US$18.9 billion.
Most African countries' debt burden has hampered their growth and development, as well as exacerbated their poverty levels, and lowered their living standards. In 2012, 33 nations in Sub-Saharan Africa were designated as extremely indebted poor (World Bank 2020).

According to the International Labour Organization (ILO), Sub-Saharan Africa's massive debt burden is a major impediment to job creation and growth because investment resources that should be employed for productive purposes are diverted to fulfill external debt service commitments (Manasseh et al., 2022).

The increase in external debt stock is being driven by an enormous increase in foreign debt, according to the Central Bank of Nigeria. Increased public spending, particularly on capital projects, loans from the international community at non-concessional interest rates, and an over-reliance on imports, which leads to trade arrears, are all considered major causes of Nigeria's debt situation while rising interest rate movements influenced the size of the external debt stock (Manasseh et al., 2022).

5. Effect of Nigeria’s External Debt on Agriculture

The Nigerian economy was primarily agrarian when the country gained independence in 1960, with agriculture accounting for 63.8 percent of GDP. However, agriculture's contribution to output has decreased over time (Fowowe et al., 2019).

Nigeria occupies a land area of 923,768 kilometers, thus providing ample land for agricultural production (Fowowe et al., 2019).

Agriculture provides food which is one of the basic needs of man and a nation at large. In any nation that produces enough to feed its citizenry and also export to other nations, its agricultural sector contributes significantly to its gross domestic product. Conceptually, agriculture is the production of food, feed, fiber, and other goods fiber the systematic growing and harvesting of plants and animals. Agriculture’s contribution to the gross domestic product (GDP) has remained stable at between 30% and 42% and employs about 75% of the labor force in Nigeria (Amaefula, 2019).

Agriculture contributed 41.2% to GDP in 1970, but this had dropped to 20.6% in 1980. Although it rose to 37% in 1990, it had fallen to 27% in 2000. New figures based on the rebased GDP show that agriculture’s contribution to GDP had fallen further to 23.8% in 2010, 20.2% in 2014, and 21.42% in 2018 (Central Bank of Nigeria, 2019). The primary trigger of the decline in agricultural output was the discovery of oil. The country has moved from being self-sufficient in food production to becoming an importer of food (Fowowe et al., 2019).

Growth in agricultural output can fuel growth in the non-agricultural economy through a variety of mechanisms, some directly and others indirectly (Yerima & Tahir 2020).

Ebhotemhen & Umoru, (2019). Empirical study results reveal that external debt failed to yield an increase in output returns in agricultural productivity by its inverse association with agricultural output. The acquired external loans for agriculture within a period of study were not optimally utilized for the same the required purpose (Ebhotemhen & Umoru, 2019).

Review of Articles on the Effect of External Debt on Nigerian Economy.
It has been opined by Senadza et al., (2018), that external debt has a greater negative impact on developing economies, such as those in Sub-Saharan Africa, than on western economies (Senadza et al., 2018).

Odubuasi et al. (2018) investigated Nigeria's external debt and economic growth from 1980 to 2013. They used Augmented Dickey-Fuller (ADF) to test for data stationarity, Granger Causality to obtain the cause-effect relationship among variables, and Error Correction Model to test the short and long-run relationship. Their findings show that external debt and government capital investment have a positive and considerable impact on Nigerian economic growth, however, external debt service has little bearing on economic growth. (Odubuasi and colleagues, 2018).

They employed Autoregressive Distributed Lag (ARDL) modeling on Time series data from 1980 to 2013 to analyze the influence of external debt on the growth and development of capital formation in Nigeria. They stated that savings are an important component of capital formation and that it should be fostered and prioritized internally in order to accelerate the rate of capital formation in the Nigerian economy. (Muhammad et al., 2016)

From 1981 to 2014, Ijirshar, et al (2016). Looked at the relationship between external debt and economic development in Nigeria. In examining the time series data generated, they used descriptive and econometric approaches. The findings reveal that there is a long-term association between external debt and Nigerian economic growth, but that external debt servicing has both a long-term and short-term negative impact on Nigerian economic growth. As a result, they recommended that the external loan stock borrowed be effectively managed because it boosts the rate of growth. (Ijirshar et al., 2016).

External debt and Economic Growth: the Nigerian Experience was researched by Udeh, S.N et al. from 1980 to 2013. The variables used were GDP as a measure of economic growth and a dependent variable, while External Debt Stock, External Debt Service Payment, and Exchange Rate were independent variables. For the analysis, the researchers employed Ordinary Least Square. The Augmented Dick Fuller Unit Root Test, Co-integration, and Error Correction Model were used to conduct diagnostic testing. External Debt has a favorable link with GDP in the short term, but a negative relationship in the long run, according to the findings. External Debt Service Payment, on the other hand, had a negative relationship with GDP, whereas Exchange Rate had a positive association with it. The finding was that exchange rate fluctuations had a favorable impact on the Nigerian economy, however foreign debt stock and debt service payments had a negative impact. The study's recommendations include, among other things, that Nigeria's debt management agency (Debt Management Office) put in place mechanisms to ensure that foreign loans are used for the purposes for which they were obtained and that states and federal governments have a borrowing ceiling based on well-defined criteria. (Udeh and colleagues, 2016). Mbah et al. (2016) investigated the influence of external debt on Nigerian economic growth. The data used was time series and spanned the years 1970 to 2013. To analyze the data, the researchers used the ARDL bound testing approach, Johansen co-integration, and an econometric error correction model. The Granger Causality result reveals a unidirectional causal relationship between debt and economic development. It also demonstrates that the variables had long-term correlations. External debt, on the other hand, is
determined to have a large negative impact on GDP. They, therefore, concluded that Nigeria has not reaped the benefits of external borrowing dividends, which are supposed to close the savings-investment gap. (Mbah et al., 2016).

James. (2014). Are examines the relationship between external debt and economic growth, as well as the debt sustainability of Nigeria. The conclusions of the study, which used an analytical method, showed that debt reduction would have a favorable influence on investment and growth. In addition, the study suggests that the government should improve its economic performance and use concessional debt with reduced interest rates to keep the debt at a manageable level. (James. 2014).

Bamidele.T. B and Joseph. A.I investigated the impact of the financial crisis and external debt management on Nigeria's economic growth, using GDP as an endogenous variable and exogenous variables such as external debt, external reserve, Foreign Direct Investment (FDI), inflation, and exchange rate proxies as exogenous variables. Data from 1980 to 2010 was used in the study. The Granger causality test, the Augmented Dickey-Fuller (ADF) unit root tests, and the ordinary Least Square (OLS) unit root tests were used in the investigation. The findings revealed that FDI and economic growth have a positive association, whereas external debt and economic growth have an inverse relationship (Bamidele & Joseph., 2013).

Huge debt servicing obligations create a number of limits on a country's ability to thrive. It depletes an economy's scarce resources and prevents the necessary infrastructure development from being funded. Due to the illiquidity and disincentive effects of large debt servicing payments and debt burdens, they might stifle investment and consequently economic growth. External debt in Nigeria has had a significant impact on important variables such as external debt (EXDT), external debt service (EXDS), and exchange rate (EXCHR) (Ogbonna & Okosu, 2019)

Okonjo-Iweala. N, the country's then-Coordinating Minister for the Economy and Minister of Finance, estimated the country's external debt to be $6.67 billion (about N1.035 trillion). "As of present, our external indebtedness is as low as $6.67 billion, or roughly 3% of our Gross Domestic Product, GDP," she said. Foreign creditors, such as multilateral agencies like the Africa Development Bank, the World Bank, and the Islamic Development Bank, are often owing the external debt. As well as other bilateral sources such as the China Exim Bank, the French Development Bank, or the Japanese Aid Agency, or private creditors such as our Eurobond investors.” Many international loans have zero interest rates, a 40-year term, and a 10-year moratorium period. Other overseas loans have interest rates of less than 3%.

Ogbonna and Okosu are two names for the same person (2019). The study examines the impact of external debt on Nigeria's economic growth from 1980 to 2017 using secondary data. Statistics/annual briefings from the Central Bank of Nigeria and the Debt Management Office for various years. To estimate the multivariate regression model, the Autoregressive Distributed Lag (ARDL) method is used. External Debt (EXDT), External Debt Service (EXDS), and Exchange Rate (EXCHR) were employed as independent variables in the data analysis against the dependent variable of Real Gross Domestic Product (RGDP), which is a proxy for economic development. The study's findings revealed that foreign debt has an
insignificant and positive linear association with economic development in Nigeria, with an increase in external debt of one unit increasing the economic growth of 0.091 units. This indicates that Nigeria's external debt can boost the country's economic growth. The servicing of external debt has no significant but favorable impact on Nigeria's economic growth. This is unsurprising given that money from foreign loan investments in self-liquidating projects is utilized to service the debts. In Nigeria, the exchange rate has no significant and positive impact on economic growth. According to the conclusions, economic managers in the country should use foreign loans exclusively for profitable capital investments that can be liquidated rather than recurrent expenditure. This would lessen the Nigerian economy's debt crowding out effect and debt overhang. To minimize an undue debt burden on the economy, the country should only seek out external loans with favorable terms and circumstances. Only low-cost overseas loans should be sought after a thorough analysis, not based on a pressing need to decrease debt costs. Measures to stabilize the country's exchange rates should be implemented to mitigate the negative effects on the economy. Despite this, they saw their debt load treble. Poverty and environmental devastation are on the rise in Nigeria as the government struggles to obtain foreign money to pay off its mounting debt. The government was under increasing pressure to provide basic services, so it decided to borrow. Despite the fact that the debt overhang models do not directly examine the consequences of debt on growth, the assumption remains that huge debt stocks drain growth by partially lowering investment, with a negative impact on poverty. However, the incentive effects associated with debt stocks tend to decrease the advantages expected from policy reforms such as trade liberalization and fiscal adjustment that would improve efficiency and growth. In this case, the government will be wary of spending additional costs if it believes that future output improvements will mostly benefit foreign lenders Ogbonna and Okosu (2019).

The influence of debt on investment and growth was studied by Ajayi. L.B and Oke. M.O. On variables such as External Reserves, Debt Service Payment, National Income, and Interest Rate, it used OLS regression analysis on secondary data received from the CBN, Economical and Financial Review, Business Times, Financial Standard, and other important Nigerian publications. The findings of the study show that the weight of external debt has a negative impact on the nation's income and per capita income. According to the report, debt service obligations should not be permitted to expand faster than foreign exchange gains, and the loan should be invested in a viable company that can create sufficient funds for debt servicing and repayment. (Ajayi & Oke, 2012).

With an error correction model, Ezeabasili et al (2011), investigated the relationship between Nigeria's external debt and economic development from 1975 to 2006. External debt has a negative link with economic growth in Nigeria, according to error correction results. (Ezeabasili et al., 2011).

Were, (2001) opined that external debt stifles economic growth due to a lack of information about the debt's structure, nature, and scale, as well as difficulty in servicing debt commitments, according to the report. In contrast, (Onyekwelu & Ugwuanyi, 2014) suggested that in most Sub-Saharan African nations, high debt burdens result in an unsustainable balance of payment deficits as well as large budget deficits (Fosu, 1999). Foreign debt has a detrimental influence
on economic growth, according to his empirical analysis of the impact of external debt on economic growth for 35 countries in Sub-Saharan Africa. The debt overhang concept is supported by this outcome. The availability of external funding has a significant impact on the economic development process of any country, according to descriptive statistical analyses of the data obtained. Their conclusion was that, in reaction to changes in the economy and polity, the best debt payment plan should be put in place from time to time. If the debt is correctly managed, it can be productive and rewarding if the rate of return exceeds the cost of debt servicing. (Adepoju et al., 2007). According to Demchuck et al (2000), Demchuck, a fictitious character in the film with the Debt Cum-Growth model was combined with the Investment model, and econometrics analytical techniques of multiple regressions were utilized to investigate the nonlinear impact of foreign debt on economic growth. According to his research, external debt has a beneficial impact on GDP. (Demchuck et al., 2003)

6. Conclusions and Recommendations

External debt encourages economic growth, but it can also discourage investment due to the crowding-out effect of rising interest rates, which can lead to a considerable fall in overall private investment spending. The initial boost in total investment spending is dampened by this decrease in private investment. Furthermore, evidence has revealed that public debt owing to non-residents repayable in foreign currencies has a higher severity of debt burden than private debt (World Bank, 2018).

External debt could be a strong instrument of economic growth. At the same time, it could be an agent of economic stunted growth or death. External death can be an instrument of growth or a weapon of economic destruction if not properly used. There are myriads of factors that could militate against the proper use of external debt: Chief of which is corruption. Indeed most countries, especially the developing countries will not attain their desired economic growth with the aid of external debt. Nigeria with its attendant attributes, can make good progress with foreign debts if properly used. There must be policies and laws in place that will ensure that funds borrowed are used for the right purpose. External debt, used for the right purposes, with the right policies and laws in place will surely lead to economic growth which will definitely have a trickle-down effect on all sectors.

Reference


