

PUBLIC DEBT AND THE NIGERIAN ECONOMY: AN EMPIRICAL REVIEW

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Abstract

Borrowing is a public finance tool used to stimulate the economy to higher economic growth through productive investment. However, borrowing when not prudently managed will lead to debt problem which leads to slow economic growth and development in a country. Public debt has been a scene in Nigeria since 1980s. This study thus, investigates the impact of public debt on Economic growth and development in Nigeria. Using the Ordinary Least Square regression method, domestic and external debts were used as explanatory variables to check their impact on economic growth in Nigeria. The result confirmed the existence of a significant negative effect of public debt on economic growth, as government borrowing, in the long run, has negative effects on the economy through high debt servicing. Prudent borrowing and judicious use of borrowed funds should be watch word to avoid falling deeper into debt problem.

Introduction

In Nigeria, debt has been a feature of national scene for more than three decades. It is hard for many Nigerians to believe that despite the country' oil wealth, the Nigerian economy is facing a deep seated crisis of huge public debt and has become a conspicuous indicator of a distressed economy and perhaps a feature of less developed economies in the world.

Public debts internal or external, are debts incurred by the government through borrowing in domestic and international markets in order to finance domestic investment (Anyanwu 1993). They are claims held by the private sector of the economy or by foreigners whether interest bearing or not (Modigliani 1961). All forms of unsettled commitments of government fall within this domain. It could be loans raised from domestic markets whether short or long term facilities (Anyanwu 1993).

Debt plays a pivotal role in economic development. When managed prudently, it can be an instrument for propelling a nation's economic development. The United States of America and England when they were industrializing young nations, relied heavily on capital provided by the wealthy experienced Amsterdam Financial Community. Economic theory suggests that reasonable levels of borrowing whether domestic or external by developing nations are likely to enhance their economic growth (Bhatia 1987). At early stage of development, countries have small stock of capital and are likely to have small investment opportunities with rates of return higher than those in advanced economies. As long as these borrowed funds are used for productive investment and the country does not suffer macroeconomic instability, distorted economic incentives policies or sizeable adverse shocks, growth should increase and allow for timely debt repayment (Pattillo, Helene & Luka, 2002). Borrowing is mostly done for economic, social and political reasons such as increasing population with the need to cater for it, expansion of government facilities; ministries, government departments, etc, to provide employment, improve standard of living and well being of the citizens, to meet emergencies such as flood, drought, disease outbreak etc, finance budget deficit, to maintain public utilities.

Nigeria's journey into debt dates back to 1948 (Gbosi 2008) when the first development stock of five hundred thousand naira was floated. But the treasury bills and certificates worth eight million naira and twenty million naira, respectively were issued in 1960 and 1968. The total debt outstanding of Nigeria in 2014 was put at about 8.8 trillion naira with external debt put at 1.46 trillion naira despite the debt relief in 2005 and domestic debt 7.421 trillion with a debt ratio of 12.51 to the GDP (Omoh 2014). Despite the relief, Nigeria's external debt stock has again risen. From a relief of \$30,447 billion in 2005, to \$ 3,544 billion in 2006, external debt rose to \$6,527 billion in 2012 (DMO 2013).

However, according to Nwankwo of the DMO, the debt ratio which stands at 12.51% to the GDP was much lower than 56% of other low income countries. He stated that “we have used debt to leverage development of private sector and it has helped to raise money to boost the real sector such as manufacturing, solid minerals, agriculture and electricity”.

This has not been the case in Nigeria as the huge debts incurred have never had any correlation with the country’s development, growth, infrastructural facilities and other basic necessities of life. Analyses have showed that the country is ravaged by poverty, income inequality, low capacity utilisation rate, which has transcended into the manufacturing sector contributing less than 10% to total GDP on the average standing at 4.16% in 2012. In Nigeria, agriculture is still crude, and power supply is erratic.

Once incurred, debt must be serviced and managed through payment of interest and amortization charges. The rapid increase in the volume of public debt in Nigeria had with it corresponding increase in service payments. Starting at a figure of about 84 million naira in 1970, debt service payment stood at 1.6 billion naira in 1984 and 712 billion naira in 2014.

1.1 Statement of the Problem

The Nigerian economy is undergoing debt crisis. As with other developing countries, her crisis is of accumulation, which has resulted in a marked deterioration in aggregate performance of the balance of the productive sectors of the economy, yawning gap between government revenue and expenditure, the collapse of social services and infrastructure, balance of payment problem, inflation problem, foreign exchange crisis and the burden of debt management.

Since independence, the indebtedness of Nigeria has been on the increase despite efforts to control it. Her case calls for concern as her debts have accumulated in excess of her ability and capacity to repay. Standing at N8.8 trillion in June 2014, it negates on the economy as funds channelled for rescheduling and servicing could be channelled into more productive use in the country. The debt service has jumped almost 100%, from N283.6 billion in 2009 to N591.76 billion in the 2013 budget (DMO 2014). This huge service implies heavy domestic debt burden. There is also the concern that in spite of these huge borrowing the country has very little to show for it in the area of infrastructure consolidation. It would also be naive for the nation to expect aggregated economic growth if huge amount of her budget is dedicated to service debts. In comparison, the N591.76 billion set aside for debt servicing in the year 2013, is more than allocation for education (N426.53 billion), health (N279.23 billion), power (N74.26 billion) and agriculture and rural development (N81.41 billion) respectively. The irony remains that the ability to pay the debt and stimulate the economic recovery is directly a function of the nation’s ability to encourage domestic activity through local production. Servicing domestic debt does not alter national income (Nnamocha 2002). Nnamocha (2002) further stated that domestic debt servicing effects is simply on income distribution between public creditors and other citizens, while the case of external debt situation is different. For instance interest and principal payments amount to transfer of income from taxpayers of the country to other countries. This reduces the income of the debtor country which further worsens the situation of the debtor countries and adds to what they owe if unable to pay when due. Thus the debt continues to accumulate and clearing such debt becomes more difficult.

However, in the process of achieving greater output and productivity so as to stimulate the economy, borrowing becomes a public finance tool used by the government. It then becomes important to look into the public debt management and strategies employed by the country, moreover, the need to investigate the public debt incurred by the country and how it has impacted on the Nigeria economy.

Objectives of the Study

The broad objective of the study is to evaluate the impact of public debt on the Nigeria economy. The study focuses on the following specific objectives:

- Provide a profile of Nigeria’s public debt.

- Identify the extent to which the growth of the country is being influenced by the public debt stock and debt servicing.

1.2 Research Hypothesis

The study was guided by the following null hypothesis

H₀: There exists no significant relationship between public debt and the economic growth of Nigeria. The study covered thirty two years and analysed the relationship between GDP and public debt in the economy between 1981 and 2012.

2.0 Literature Review

2.1 Nigeria Debt Situation

The Nigeria's high debt stock according to the Debt Management Office (DMO) began to occur from 1983. Misrules and recklessness of rulers contributed towards the high stock of debt today (Soludo 2003). Buoyed by the oil revenue and the quest for development, many contracts were awarded which later became difficult to meet due to oil revenue fluctuation. Priorities of the 1970s and early 1980s resulted in the accumulation of debt without generating any additional income to finance them. The priority was clearly to press ahead with development spending as the windfall from oil revenue would allow without savings for rainy days. For instance, the construction of the new capital territory at Abuja may have been a laudable political initiative but its scale has been far too extravagant for the available resources. The creation of new states resulted in further economic burden of providing new bureaucracy, buildings, universities and even radio and television stations, etc. The result of the headlong rush for development was inevitably that the nation's management resources were stretched beyond the level at which they could maintain quality control in both the selection and execution of projects. With the collapse of the global oil market, government finances dwindled remarkably hence alternative sources were sought in borrowing both domestically and externally. Unfortunately, despite the nose diving of oil prices and government revenue, no serious attempts to streamline expenditure were made, rather unbridled deficit financing to fill the financial gap and offset the impact of falling oil revenue was pursued. With expenditure maintaining its momentum in the face of decelerating revenue, government budget deficit widened.

Other factors that accelerated Nigeria's domestic debt are the escalation of public sector wages and salaries resulting from higher minimum wages and upward salary/benefits review, the pursuance of unsound economic policies which resulted in bad investment, bad management and minimal productive capacities, rising inflationary trend making the cost of projects to escalate, consumption oriented expenditure and lack of probity and budgetary discipline in the public sector Odozi (1996). Adofu and Abula (2009) pointed out that Nigeria's debt problem arose due to budget deficit financing, monetary policy implementation through the buying and selling of treasury bills in the open market and development of the financial sector.

While the foreign debt is contracted from bilateral and multilateral agencies like the Paris Club, London Club, China Exim bank and Eurobond, etc, Nigeria's domestic debt is mainly contracted through the issuance of treasury bills, treasury certificates, bonds, development stocks, ways and means advance and trade debt. Treasury bills rose from N556 million in 1980 to N456,535.7 million in 2000 and stood at N2,122,926.96 in 2012 (CBN 2012). Since 1980, with the declining revenue position, there has been a marked shift in the portfolio of government debt instrument (treasury bills). The dominance of short-term debt instrument had led to a situation of rapidly increasing debt service obligation even when the projects so financed are still uncompleted.

2.2 Theoretical Framework

Gurley and Shaw (1956) posited that for every government planning for a market - oriented economy, debt is a necessary feature of a strong and healthy financial structure of an economy. Therefore, public borrowing is a veritable tool of economic development. Many scholars have theorized the impact of debt in an economy.

The modern theory of public debt which was initiated with the publication of J. M. Keynes' book titled "General Theory of Employment, Interest and Money" in 1936 following the great depression

brought about a change in the role of public borrowing. According to the Keynesian theory, a huge public debt is a national asset rather than a liability and that continuous deficit spending is essential to the economic prosperity of the nation. The Keynesian thought held the view that increases in public debt through multiplier effect would raise the national income; it is because Keynes correlated public borrowing with deficit financing. Keynes emphasized the expansionary effect of debt-financing of government expenditure. He posited that with a fixed price level and less than full employment, the increase in government expenditure through the use of borrowed money causes an upward shift in aggregate expenditure; this expands output (Ahuja 2013). Keynes posited that government should borrow for all purposes so that effective demand in the economy may increase which will ultimately increase employment and output. To Keynes, borrowing for consumption will be as desirable as borrowing for investment in productive goods because consumption expenditure will induce investment to rise (Lal 1978).

The balanced growth theory pioneered by Ragnar Nurkse (1907–1959), hypothesized that governments of underdeveloped countries need to invest largely in a number of industries simultaneously in the industrial and agricultural sectors of the economy, so as to enlarge the market size, increase productivity, and provide an incentive for the private sector to invest as each of these sectors provides a market for the products of the other and in turn, supplies the necessary raw materials for the development and growth of the other (Debraj 2009). According to Nurkse, underdeveloped countries are characterized by low purchasing power which means low real income and as such, domestic demand for commodities is low. Since money income is low, an increase in money supply will improve purchasing power, however, expanding the supply of money will only generate inflationary pressure. Neither real output nor real investment will rise (Debraj 2009). Thus, he advocated for investments in various sectors at the same time. Since underdeveloped economies are characterized by small stock of capital, borrowing for increased productivity becomes an option.

The dual-gap theory provides the cause of or reason for foreign debt accumulation (Obadan 1991). The condition for national income to be in equilibrium according to the theory is that domestic investment plus exports must equal imports plus domestic savings. Any increase in investment that is unaccompanied by an equal shift in the savings schedule must be financed in part by borrowing from abroad. The general case for borrowing is to add to total resources, not just to acquire specific resources (Kindleberger 1965). Foreign borrowing performs two roles in development. First, it can increase resources available for investment by supplementing domestic savings. Second, it can augment foreign exchange resources by supplementing export earnings. A country's borrowing, therefore depends on its total

Expenditure in relation to its total domestic production. This means that the need for foreign borrowing overtime is determined by the rate of investment in relation to domestic savings.

2.3 Empirical Framework

Public indebtedness is a complex phenomenon since it is beneficial in certain situation and not in others. The idea of growth and development has driven governments to borrow from different sources both for productive and unproductive purposes. High indebtedness has caused economic crisis and problems to many economies. This has led to public debt being an issue of discussion both in the academic and government circles

Ghosh (1988) argued that the increased public debt and the burden of interest charges have become a major hindrance to development planning both in the public and private sector.

Froot and Kringman (1990) asserted that external debt burden reduces investment activities as higher debt service payments associated with high external debt reduces fund available for investment.

Oshadami (2006) in a study on the impact of domestic debt on Nigeria's economic growth concluded that the growth of domestic debt has affected negatively the growth of the economy. This situation is premised on the fact that majority of the market participants are unwilling to hold longer maturity and as a result the government has been able to issue more of short term debt instruments. This has

affected the proper conduct of monetary policy and affected other macroeconomic variables like inflation, which makes proper prediction in the economy difficult.

Qureshi and Ali (2010) investigated the impact of high public debt burden on the economy of Pakistan and concluded from their findings that there exists a vast negative impact of public debt on the economy of Pakistan.

Ngerebo-a and Agundu (2010) argued that public debt has had no significant effects on the growth of the Nigeria economy as the borrowed funds were either channeled into non-productive ventures or diverted out rightly into private purses.

Rengarajan, Anupam and Narendra (1994) described the seriousness of Indian public debt by analyzing and exploring the dynamic nexus between government deficits and different modes of financing them. They examined the macro economic implications of domestic debt accumulations and also the dangers of resorting to RBI financing, causing a vicious circle of deficit and inflation.

Hassan and Akhter (2012) studied the effect of public debt burden on the economic growth of Bangladesh using various econometric techniques. Their findings revealed that there is no significant negative relationship between external debt and economic growth while domestic debt has a negative impact on growth with little statistical significance.

Ogunmuyiwa (2011) investigated the relationship between external debt and economic growth in Nigeria. His study reveals that no causality exist between external debt and economic growth as causation between debt and growth was also found to be weak and insignificant in Nigeria.

3.0 Research Methodology

This research work made use of secondary data sourced from the statistical bulletin of the Central Bank of Nigeria and reliable statistical websites to analyze the relationship between economic growth in Nigeria and incurred public debt by the government. The period covered was from 1981 to 2014 and data would be analyzed using the ordinary least square regression method.

3.1 Model Specification

Guided by the perceived functional relationship between the matrix of economic growth (GDP) and public debt, a link is forged between the GDP as a proxy for economic growth and some selected explanatory variables. From sub-macro and micro economic perspectives, the model for this work states that economic growth (GDP) depends on public debt. Thus, the functional relationship and the resultant models are as specified below.

$$\text{GDP} = f(\text{DD}, \text{EXD})$$

$$\text{Econometrically, } \text{GDP} = a_0 + a_1\text{DD} + a_2\text{EXD} + \mu$$

Where:

LogGDP= Log of Gross Domestic Product

LogDD = Log of Domestic Debt

LogEXD= Log of External Debt

μ = Error Term

a_0 = Intercept

a_1 & a_2 = Parameters of the explanatory variables.

From the model, going by theories, the apriori expected signs of these parameters are

$$a_1, >0, a_2, >0$$

We start this analysis by first examining the stationarity of our variables. A non-stationary time series has a different mean at different points in time, and its variance increases with the sample size. A characteristic of non-stationary time series is very crucial in the sense that the linear combinations of these time series make spurious regression. In the case of spurious regression, t-values of the coefficients are highly significant, coefficient of determination (R^2) is very close to one and the Durbin Watson (DW) statistic value is very low, which often lead investigators to commit a high

frequency of Type 1 errors. In that case, the results of the estimation of the coefficient became biased. Therefore, it is necessary to detect the existence of stationarity or non-stationarity in the series to avoid spurious regression. For this, the unit root tests are conducted using the Augmented Dickey-

Variables	Level test I(0)	Critical values		
	T Statistic.	1%	5%	10%
LogRGDP	2.686335	-3.661661	-2.960411	-2.619160
LogDD	-1.039920	-3.661661	-2.960411	-2.619160
LogEXD	-2.028372	-3.670170	-2.963972	-2.621007
	Level test I(1)	Critical values		
	T Statistic.	1%	5%	10%
LogRGDP	-3.782354*	-3.670170	-2.963972	-2.621007
LogDD	-5.503169*	-3.670170	-2.963972	-2.621007
LogEXD	-4.275606*	-3.670170	-2.963972	-2.621007

Fuller test statistic (ADF). If a unit root is detected for more than one variable, we further conduct the test for

cointegration.

To avoid the problem of autocorrelation, the equation was transformed into the logarithm form as:

$$\text{Log GDP} = a_0 + a_1 \text{LogDD} + a_2 \text{LogEXD} + \mu$$

4.0 ANALYSIS AND PRESENTATION OF RESULT

Table 4.0: Stationarity test of the variables

Author's Computation, Reviews 3.1 Output

*Denotes Level of Stationary

Table 4.0 above presents the summary of unit root tests results gotten at both levels and first difference. The Augmented Dickey Fuller test were conducted on all the variables and the result gotten, showed that all variables are stationary at first difference at 1%, 5% and 10% critical value. The T Statistics values at first differencing for all variables are greater than the critical value at 1%, 5% and 10%. This allowed us to conduct cointegration test on the first difference for the variables.

4.1 Co-Integration Test

A co-integration test using the Johansen co-integration test was carried out so as to ascertain if there exists a long run relationship between variables in the study. The result gotten is presented in table 4.1 below.

Table 4.1

Sample: 1981 2013

Included observations: 31

Test assumption: No deterministic trend in the data

Series: LOGRGDP LOGDD LOGEXD

Lags interval: 1 to 1

Eigenvalue	Likelihood Ratio	5 Percent Critical Value	1 Percent Critical Value	Hypothesized No. of CE(s)
0.490826	28.32358	24.31	29.75	None *
0.178732	8.074587	12.53	16.31	At most 1
0.069699	2.167413	3.84	6.51	At most 2

*(**) denotes rejection of the hypothesis at 5%(1%) significance level

L.R. test indicates 1 cointegrating equation(s) at 5% significance level

From the result in table 4.1 above, the likelihood ratio test showed that the hypothesis of no cointegration among the variables can be rejected as at least one cointegrating equation at 5% exists as 28.32358 is greater than its 5 percent critical value of 24.31. We therefore, reject the null hypothesis and conclude that there exists long run equilibrium relationship among the dependent and independent variables.

4.2 Granger Causality Test

Table 4.2

Pairwise Granger Causality Tests

Sample: 1981 2013

Lags: 2

Null Hypothesis:	Obs	F-Statistic	Probability
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LOGDD does not Granger Cause LOGRGDP	31	0.82231	0.45095
LOGRGDP does not Granger Cause LOGDD		1.67608	0.20745
LOGEXD does not Granger Cause LOGRGDP	31	0.36832	0.69559
LOGRGDP does not Granger Cause LOGEXD		0.27657	0.76067
LOGEXD does not Granger Cause LOGDD	31	0.80761	0.45722
LOGDD does not Granger Cause LOGEXD		0.05643	0.94525

The Granger causality analysis presented in Table 4.3 showed that at 5% significance level, no causality was seen as the variables do not cause each other under pairwise Granger Causality test. That is there was no bidirectional or unidirectional causality running between the variables.

4.3. Model Estimation

In estimating the model, the ordinary least square method was used to identify the nature of relationship that existed between GDP and the explanatory variables domestic debt and external debt in the study.

Table 4.3

Dependent Variable: LOGRGDP

Method: Least Squares

Sample: 1981 2013

Included observations: 33

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	4.587060	0.054353	84.39397	0.0000
LOGDD	-0.245749	-0.015499	-15.85541	0.0000
LOGEXD	-0.062576	0.015387	-4.066724	0.0003
R-squared	0.941014	Mean dependent var	5.601401	
Adjusted R-squared	0.936946	S.D. dependent var	0.173523	
S.E. of regression	0.043573	Akaike info criterion	-3.339714	
Sum squared resid	0.055059	Schwarz criterion	-3.202301	
Log likelihood	56.43542	F-statistic	231.3203	
Durbin-Watson stat	1.431198	Prob(F-statistic)	0.000000	

Source: Author's Computation Review 3.1

The interpretation of the model based on the selected economic variables as shown in table 4.3 above, shows that R^2 of 0.941 indicates that 94.1% of total variation in the dependent variable can be explained by the explanatory variables. The adjusted R^2 of 0.937 or 93.7%, showed that the explanatory variables were robust in explaining the variation in economic growth (GDP) within the period.

The test of significance from our result showed that all variables were statistically significant for the period under review at 5% level of significance. This is due to the fact that their T probability values of 0.0000, 0.0000 and 0.003 are all less than 0.05 (5% level of significance).

The F Stat test, which shows the significance of the entire regression model from our result, was significant as the Prob(F-statistic) value of 0.000 is less than 0.05 (5% level of significance) which further confirms the value of the R^2 .

The coefficient of domestic debt (-0.245749) appeared with a negative sign and did not conform to expectations. This is in line with the work of Rabia and Kamran (2012), Onyeiwu (2012). A 1% increase in domestic debt reduces economic growth by 0.25%.

The coefficient of external debt (-0.062576) did not show the expected positive sign. The coefficient shows a negative sign but is statistically significant. This is in line with the work of Ishola, Olaleye, Ajayi and Giwa (2013). A 1% increase in external debt reduces economic growth by 0.06%.

4.4 Discussion of Findings

The result gotten attempted to show the effects of public debt on the Nigerian economy. The result showed that economic growth is affected by public debt. The variables employed in the study include Domestic Debt, External Debt and GDP.

The R^2 of 94% indicates the extent to which the explanatory variables explain the variation in the dependent variable. The t statistic test confirms the significance of the coefficient of the variables employed while the F statistic confirms that the model is fit.

Evidence from the result suggests that the variables did not conform to apriori expectation as both had negative signs. This then suggests that public debt is yet to attain what it ought to take its required position towards economic growth in Nigeria.

This stem from the negative impact associated with debt in Nigeria. High external debt has affected economic growth as it hampers investment activities. This is so because debt servicing associated with external debt cuts down available fund needed for investment. Also domestically, borrowing for unnecessary projects, corrupt leaders siphoning borrowed funds for personal gains etc, have all contributed towards the negative impact of debt on the Nigerian economy.

5. Conclusion and Recommendations

From our findings, Nigeria is deeply rooted in a debt crisis. The analysis provided an empirical result which confirms that an excessively high stock of debt and debt servicing depresses the economic performance of the country. The study shows that the effect can be frightening in the long run, and as such, articulated strategies of debt reduction should be implemented so that the high debt stock and associated debt servicing burden would not impact negatively on economic growth. Also, prudent borrowing and judicious use of borrowed funds should be watch word to avoid falling deeper into debt problem.

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