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Domestic Debt and Economic Growth Nexus: The Nigeria Evidence

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Abstract: Propelled by the need to promote growth in the economy, the study evaluates the effects of Domestic Debt and Economic Growth in Nigeria over the period 1981 - 2019. Secondary data were sourced from the Central Bank of Nigeria Statistical Bulletin. Domestic Debt is captured using indicators such as Federal Government Domestic Debt, Domestic Debt Servicing. Government Expenditure and Lending, while Economic growth was proxy by Gross domestic product in Nigeria. The study employed the Stationarity Test, Johansen Co-integration Test and the Parsimonious error correction model in evaluating the nature of the prevailing relationship between the underlying variables. The result revealed that the Federal Government Domestic Debt, and Domestic Debt Servicing exhibited positive and significant influence on economic growth in Nigeria. While Government expenditure is seen to have negative and insignificant influence on Gross domestic product. Lending rate showed positive and insignificant influence on economic growth in Nigeria within the period of this study. In light of the observed findings, the study recommends that projects to be financed with government borrowing should be properly appraised and their technical feasibility, financial viability and economic desirability ascertained before the funds are committed. Government should improve more on capital expenditures such as infrastructures since they are the key to growth and will reduce the cost of production and investment. Also, government and the Debt Management Office should draw up guidelines to limit the growth of future domestic debt. Effective mechanism should be put in place to ensure that any new borrowing is judiciously utilized to contribute to economic growth.

Key Words: Domestic Debt, Federal Government Domestic Debt, Government Expenditure.

Introduction

Economic theory suggests that reasonable levels of borrowings by a developing country is likely to enhance its economic growth (Pereira and Xu, 2000). When government revenues fall short of its expenditure, governments borrow. Thus, domestic debts occurs when government borrows from various sources within the country, spanning from individual to corporate sources, with the use of instruments such as bonds and treasury bills to mention but few which are repayable in the domestic currency thereby leading to a redistribution of income and wealth within the country (Nwinee & Torbira 2012). This was also the position of Oshadami (2006), as cited by Fayose, (2018), where domestic debts was defined as "debts instrument issued by the Federal government and denominated in local currency". Thus, the fact still remains that internal debt is sourced from within the same economy thereby posing a zero burden on the economy as the funds circulates within the same community while the interest thereon serves as inflow

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to the lenders thereby boosting their per capita income. Dalton as cited in Jhingan (2011) posit that a loan is said to be internal or domestic if the transaction is done within the area which is controlled by the public authority which raises the loan. Domestic debt is therefore a serious means by which governments fund public expenses and budget deficit, particularly when it is difficult to raise taxes and reduce public expenditure. In the past, this method has left most governments with massive outstanding debts. Reasonable borrowings to finance public and infrastructural development are the key to facilitate economic growth. However, superfluous borrowings without proper investment plan may lead to substantial debt burden and interest payment, which may in turn lead to several undesirable effect on the economy (Joy & Panda, 2020). To expedite economic growth, developing countries like Nigeria are encouraged to borrow to beef up their inadequate stocks of capital and to complement the domestic savings- investment gap. Where such funds are proficiently reinvested into the economy in fruitful investments, it will help to fast track the chance of development and in turn raise the standard of living of the people. (Egbetunde, 2012).

Recently, the amount that has been borrowed by Federal Government from internal sources has been enormous even at high concessionary interest rates with the hope of accelerating economic development and thus foster economic growth. It is therefore clear that Nigeria's debt profile has gone beyond a reasonable limits for it realize the desired goals and constitute less burden which will enhance economic growth and alleviate the poverty level. Meanwhile, financial statistics has shown that Nigeria's debt profile had being on the increase in recent time. According to the Debt Management Office, debt stock stood at N7.421 trillion bringing the total public debt to N8.5 trillion excluding state government debts, which stood at N1.6 trillion as at December 2013 and N7.42 trillion as at June 2014 compared to N7.18 trillion as at the first quarter of 2014, representing 3.3 percent upsurge in the first half of the year. This planetary increase has continued persistently as the debt rose to N12.58 trillion and N12.83 trillion in 2017 and 2018 respectively. Despite Nigeria's continued penchant for loans, the economy is still one of the lowest in terms of per capita income in the world with high unemployment, dwindling economy, inadequate basic amenities, poor infrastructural development, and falling GDP. In fact, the 2016 and 2017 recession which the nation's economy slipped into would have been avoidable except that it was a testimony of poor management of borrowed funds. The dependence of the federal government on borrowed fund from the banking industry, mostly by the CBN, for the purposes of financing large and unsustainable budget deficits has affected the expansion of the Nigerian economy undesirably. This has delayed the attainment of macroeconomic stability and sustainable economic development in Nigeria. In addition, it has jam-packed the private sector from the credit market, thereby delaying investment and output development.

In light of the aforementioned, the study seeks to determine how domestic debt influence growth in developing country like Nigeria. More especially, the objectives of this paper are to evaluate the different indicators of domestic debts such as; the Federal Government Domestic Debt, Domestic Debt Servicing. Government Expenditure and Lending Rate and their various implication on Gross domestic product. The theoretical and empirical clarifications are presented in the next section.

Theoretical Framework

This section presents the baseline theory of domestic debt and it effect on the economic as presented as follows;

The debt overhang hypothesis

Debt overhang theory implies that large borrowing leads to high debt, debt traps and slowing down of economic growth. According to the debt overhang hypothesis, if there exists the likelihood that in the

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future government debt will be larger than the country's repayment ability, expected debt service costs will discourage further domestic and foreign investment. Potential investors would be discouraged on the assumption that, the more there is production, the more they will be taxed by governments to service the public debt and thus they will be less willing to incur investment costs today for the sake of increasing future output (Gordon & Cosimo, 2018). The theory holds that both the stock of public debt and its service affect growth by discouraging private investment or altering the composition of public spending. Debt service may discourage growth by squeezing the public resources available for investment in infrastructure and human capital (Coccia, 2017). The theory further suggests that public debt may have non-linear effects on growth, either through capital accumulation or productivity growth.

Debt crowding-out Hypothesis

According to the debt crowding out hypothesis, higher debt service payments can increase a country's budget deficit, thereby reducing public savings if private savings do not increase to offset the difference. This, in turn, may either drive up interest rates or crowd out the credit available for private investment, thereby depressing economic growth. When government increases borrowing to fund higher spending, or reduce taxes, it crowds-out private sector investment through higher interest rates. If increased borrowing leads to higher interest rates by creating higher demand for money and loanable funds and thus higher prices, the interest rate sensitive private sector will likely reduce investment due to lower rate of returns. A fall in business- fixed investment will hurt long-term supply-side economic growth, that is, potential production growth. This crowding-out effect is weakened by the fact that government spending through the multiplier increases the demand for private sector products, thereby stimulating fixed investment via the acceleration effect (Joy & Panda, 2020).

Empirical Framework

The work of Okwu *et al* (2016) employed relevant econometric models to examine the effects of domestic debt on economic growth in Nigeria during the 1980 to 2015 periods. Variables of analytic interest were real gross domestic product (RGDP) as economic growth proxy, and domestic debt stock (DDS) and domestic debt servicing expenditure (DDSE) as explanatory variables; with government expenditure (GEXP) and banks' lending rates (BLR) as moderating variables. On individual merits of the explanatory variables, the results presented evidence of significant short- and long-run positive effect for DDS; negative effect for DDSE but insignificant, and negative effect for BLR. The variables jointly explained significant effect, and considerably high power in explaining variations in growth of the economy during the period of the study. Bakare, et al (2016) in their empirical study investigated the extent to which domestic debt influence the economic growth of Nigeria. It draws on quantitative research methodological framework and specifically employed the Ordinary Least Square Regression (OLS) technique to test the relationship between Gross Domestic Product, interest rate, domestic debt, budget deficit and domestic credit to private sector. Findings of the study revealed that there was a positive relationship between domestic debt and economic growth of Nigeria.

Ewubara, Nteegah & Okpoi (2017) examined the effect of public borrowing on the growth of the Nigerian economy over the period 1980–2015. The study employed the ARDL method in the analysis. The result of the study indicated that external debt had direct and significant impact on growth, while domestic debt significantly retarded growth in Nigeria both in the long and short runs. Total debt services stock was found to be negative and insignificant to the economic growth, whereas net foreign direct investment and foreign exchange reserves impacted on economic growth positively and was both significant at 5% level at lag 3. Though the goodness of fit was robust and reasonable in explaining changes in growth, the non-significance of the error correction term implies that economic growth reacts slowly to changes in public debts dynamics in Nigeria.

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Thao (2018) analysed the effect of government debt on economic growth in six ASEAN countries, namely, Indonesia, Malaysia, Philippines, Singapore, Thailand and Vietnam over the period 1995– 2015. The General Method of Moments (GMM) estimation technique was adopted to measure the effect of government debt indicators on economic growth. The findings revealed a significant and positive impact of public debt, Foreign Direct Investment (FDI), GFCF and real effective exchange rate on economic growth while population growth had a significant negative effect on the growth rate of these countries. However, the study was based on ASEAN countries data whose findings cannot be directly applied to Nigeria.

Akhanolu et al. (2018) examined the effect of public debt on economic growth of Nigeria using annual data from 1982 to 2017 and two-stage least square regression technique. The study modelled GDP as a function of internal debt, external debt, savings and capital expenditure. The results revealed that external debt had a significant negative impact on growth while internal debt showed a positive impact. However, the study suffered from significant variable omission bias and the methodology used was inadequate in accounting for complex relationship between the study variables. The result showed that internal debt positively affects the economy. The study is consistent with the study of Tamunonimim (2013) who investigated the relationship between domestic debt and the rate of poverty in Nigeria and found that long-run relationship exist between poverty and domestic debt in Nigeria. He also found that the domestic debt had positive impact on bank credit and the impact is highly significant.

Fasoye, (2018) examined the Nigeria's Domestic Debt Profile for the period 1980 to 2017 using the pooled OLS regression technique on secondary data on loans from CBN, Commercial banks, Merchant Banks and Non-Banking public sourced from the CBN statistical bulletin as its variables. The result indicated that all the variables were statistically significant and that all the available domestic debts instruments are pivotal to the country's development adding that they should be handled with caution as they portends a serious fiscal crisis unless the government will access greater domestic loans from the entire Banking system in Nigeria. The study therefore, recommend that, Nigerian should carefully re-examine her local borrowing culture in order to prevent fiscal crisis.

Mhlaba et al. (2019) employ the ARDL method and quarterly data from 2002 to 2016 to examine the long-run and short-run effects of public debt on economic growth for South Africa. The study modelled GDP as a function of gross and net debt, investment, inflation and terms of trade. The empirical results indicated a significant negative impact of public debt on economic growth. The study was based on South African data and provided a basis to examine the impact of government debt on economic growth from a Nigerian-specific perspective. Saungweme and Odhiambho (2019) explored the causal relationship between government debt, debt servicing and economic growth in Zambia for the period 1979 to 2017 using a dynamic multivariate ARDL approach. To achieve this objective, RGDP was modelled as a function of stock of public debt, fiscal balance and savings as a share of GDP. The empirical results indicated a unidirectional causal relationship from economic growth to public debt in Zambia. The study findings supported the hypothesis that the pace of economic growth matters in defining the level of public sector indebtedness. The study setting was in Zambia thereby creating a geographic gap and the need for a Nigerian- specific study.

Nwikina, Gbarato and Meekor (2020) analyzed the Nigeria Debt Nexus from 1981 -2019; using the Error Correction Model, and was discovered that, although debt servicing exerts negative relationship with economic growth, it is obvious that debt financing in Nigeria is a blessing as external and domestic debt stocks all exert positive influence on economic growth. However, only domestic debt stock is efficient enough to spur economic activities, which suggests that prudent employment of domestic debt which is not affected by exchange rate is a strong catalyst for rapid increase in economic activities in Nigeria the

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study recommends the choice for internally borrowed fund as the best benign financing option as well as its optimal utilization for meaningful commensurate economic activities.

Akpansung, & Gidigbi, (2020), examine the causal relationship between the two variables, as well as identifying the structural breaks in the variables. The study utilized Nigerian annual time-series data stretching from 1981–2018. Data were analysed using Johansen-Juselius cointegration, vector error correction modelling, Granger causality, Augmented Dickey-Fuller and Bai-Perron's multiple structural breaks procedures. The result provides convincing support for the existence of stable short-run and long-run relationships between public domestic debt and economic growth. The study neither found any causal relationship between public domestic debt-to-GDP ratio and real GDP growth rate nor established any lagged effect of domestic debt-to-GDP ratio on the growth rate of the gross domestic products in Nigeria. Bai-Perron's test found strong evidence of five structural breaks in the variables, with identifiable economic and political shocks in the country during the sampled period.

Yusuf and Mohd, (2021) investigated the effect of government debt on Nigeria's economic growth using annual data from 1980 to 2018 and the Autoregressive Distributed Lag technique. The empirical results showed that external debt constituted an impediment to long-term growth while its short-term effect was growth- enhancing. Domestic debt had a significant positive impact on long-term growth while its short-term effect was negative. In the long term and short term, debt service payments led to growth retardation confirming debt overhang effect. The findings suggested that the government should direct the borrowed funds to the diversification of the productive base of the economy. This will improve long-term economic growth, expand the revenue base and strengthen the capacity to repay outstanding debts as at when due.

Victoria, *et al.* (2021) investigates the effect of Nigeria's domestic debt on economic development of Nigeria spanning from 1981-2018. The secondary data used in the study were sourced from Central Bank of Nigeria Statistical Bulletin, Debt Management Office of Nigeria, World Bank Development Indicators and United Nations Development Program. The study made use of Ordinary Least Square Regression tools to determine the statistical relationship between Nigeria's domestic debt profile and Human Development Index as well as private sector investment. The outcome of the study in the first model showed that domestic debt servicing and state governments' domestic debts are significantly related to economic development. On the other hand, Federal domestic debt and State domestic debt are significantly related to private sector investment.

Mba, et al. (2013) analysed the importance of domestic debt on economic growth of Nigeria. The objective of the study is to investigate the relationship between government domestic debt and economic growth and policy that is likely to improve private sector investment and break growth resistance problem. To empirically determine the relationship between domestic debt and some macroeconomic variables, we employed the error correction model procedures following an examination of properties of the time series using unit root and co-integration test. Findings show that domestic debt and credit have a significant and direct relationship with GDP and that debt servicing has inverse relationship with GDP and also government expenditure has a direct but not significant relationship with GDP. The implication of the findings concludes that domestic debt should be invested in productive sector of the economy and more specifically in the real sector and further productivity gain will be achieved in the improvement on capital project expenditure.

Methodology

Research design

This study adopts the ex-post facto research design as it deals with event that had taken place and secondary data were readily available for collection. Gross Domestic Product in Nigeria was adopted as

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the dependent variable, while Federal Domestic Debt, State Domestic Debt and Domestic Debt Servicing were employed as independent variables spanning from 1981-2020. The secondary data were used, and collected from various sources including Central Bank of Nigerian Statistical Bulletin (2019).

Operational Measures of Variables

Gross Domestic Product is the total monetary or market value of all the finished goods and services produced within a country's borders in a specific period of time usually a year. Federal Domestic Debt are debt instruments issued by the Federal Government and are denominated in local currency. Domestic Debt service is the cash that is required to cover the repayment of interest and principal on a debt for a particular period. Government Expenditure refers to the purchase of goods and services which include public consumptions and public investments and transfer payments consisting of income transfers and capital transfers. Lending Rate is measured as the difference between the interest income generated by banks or other financial institutions and the amount of interest paid out to their lenders relative to the amount of their (interest-earning) assets

Model Specifications:

Following Okwu, *et al.* (2016), with slide modifications, the study presents its model as follows;

$GDP = \alpha_0 + \alpha_1 FDD + \alpha_2 DDS + \alpha_3 GE + \alpha_4 LR + \mu$

FDD = Federal Domestic Debt

DDS = Domestic Debt Servicing

GE = Government Expenditure

LR = Lending Rate

α_0 = Constant Parameters

α_{1-4} = Estimation parameters

μ = Error term

In order to ensure that the results on a priori, the study expects a positive relationship between the employed variables within the relevant range.

Presentation of Results

This section is presented under the following subheads for clarity;

Stationarity Test Output

Unit Root Test (Augmented Dickey Fuller).

We therefore intend to capture the stationarity of the employed variables, since a stationary variable is useful in forecasting and predicting and has a great possibility of the effect if shock to die out gradually, while non-stationary data are not suitable for long run test.

Table 1: ***Result of Stationarity (Unit Root) Tests:***

Variable	ADF t-statistics	Critical Value 5%			Order of Integration	Prob.
		1%	5%	10%		
D(GDP)	-7.115934	-3.626784	-2.945842	-2.611531	I (1)	0.0000
D(FDD)	-3.949280	-3.646342	-2.954021	-2.615817	I (1)	0.0046
D(DSS)	-3.481671	-3.699871	-2.976263	-2.627420	I (1)	0.0166

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D(GE)	-9.632605	-3.626784	-2.945842	-2.611531	I (1)	0.0000
D(LR)	-8.903894	-3.639407	-2.951125	-2.614300	I (1)	0.0000

Source: *Extraction from E-view 10*

The Unit Root test results in Table 4.1 show that the time series values of the variables are stationary their first difference I (1)

Table 2: Johansen Co integration Result

Date: 01/16/22 Time: 07:07
Sample (adjusted): 1983 2017
Included observations: 35 after adjustments
Trend assumption: Linear deterministic trend
Series: GDP FDD DSS GE LR
Lags interval (in first differences): 1 to 1

Unrestricted Cointegration Rank Test (Trace)

Hypothesized No. of CE(s)	Eigenvalue	Trace Statistic	0.05 Critical Value	Prob.**
None *	0.772828	128.6033	69.81889	0.0000
At most 1 *	0.656280	76.73151	47.85613	0.0000
At most 2 *	0.466347	39.35408	29.79707	0.0030
At most 3 *	0.373724	17.37374	15.49471	0.0258
At most 4	0.028028	0.995003	3.841466	0.3185

Trace test indicates 4 cointegrating eqn(s) at the 0.05 level
* denotes rejection of the hypothesis at the 0.05 level
**MacKinnon-Haug-Michelis (1999) p-values

Unrestricted Cointegration Rank Test (Maximum Eigenvalue)

Hypothesized No. of CE(s)	Eigenvalue	Max-Eigen Statistic	0.05 Critical Value	Prob.**
None *	0.772828	51.87174	33.87687	0.0001
At most 1 *	0.656280	37.37743	27.58434	0.0020
At most 2 *	0.466347	21.98034	21.13162	0.0379
At most 3 *	0.373724	16.37874	14.26460	0.0228
At most 4	0.028028	0.995003	3.841466	0.3185

Max-eigenvalue test indicates 4 cointegrating eqn(s) at the 0.05 level
* denotes rejection of the hypothesis at the 0.05 level
**MacKinnon-Haug-Michelis (1999) p-values

Source: *E-view 10 Output*

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The above Johansen co-integration is conducted to examine whether there is long-run relationship between the regressor and regressand, the result rejects the null hypothesis of no co-integration among the variables at none with the probability of 0.0001 which is less than the 5% critical probability at the 'At most' cointegration estimate. The result shows that there is a long-run equilibrium relationship among the employed variables as also shown by the trace statistics (four co-integrating equation). Based on this, we will proceed to ascertaining the speed of adjustment using the parsimonious error correction method.

Error Correction Model

To correct for variation and adjust for errors in the long and short run, the study proceeds to carry out the parsimonious error correction.

Table 3: Parsimonious ECM

Dependent Variable: GDP
Method: Least Squares
Date: 01/16/22 Time: 07:15
Sample (adjusted): 1982 2017
Included observations: 36 after adjustments

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-4123.680	1989.104	-2.073134	0.0468
FDD	8.036409	0.557566	14.41338	0.0000
DSS	8.978156	1.144861	7.842133	0.0000
GE	-2.565423	2.114233	-1.213406	0.2344
LR	51.70265	28.13156	1.837888	0.0760
ECM (-1)	0.484996	0.194878	2.488718	0.0186

R-squared	0.997349	Mean dependent var	25548.02
Adjusted R-squared	0.996907	S.D. dependent var	34536.63
S.E. of regression	1920.597	Akaike info criterion	18.10967
Sum squared resid	1.11E+08	Schwarz criterion	18.37359
Log likelihood	-319.9741	Hannan-Quinn criter.	18.20179
F-statistic	2257.525	Durbin-Watson stat	1.739468
Prob(F-statistic)	0.000000		

Source: *Extracts from Eviews 10*

Following the result of error correction model above, ECM significantly stood at 0.484996, which implies that approximately 48% disequilibrium in gross domestic product can be corrected with the changes in our independent variables over a year and this constitute a reasonable dynamics and speed of adjustment.

Also, the Coefficient of determination (R-squared) which shows by its output of 0.997349 that the predictor variables account for 99% of variations in the criterion variables in the long run, while the f-statistics of 2257.525 at a probability level of 0.000000 shows a very viable and significant model coupled with the Durbin Watson of 1.739468 showing the absent of a positive serial correlation and is seen to be within the relevant range.

From the above ECM output in table 4.3, it can be observed that Federal Domestic Debt and Domestic Debt Servicing exhibited positive and significant relationship on economic growth in Nigeria which is

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proxied by Gross Domestic product. While Government expenditure is seen to have negative and insignificant influence on Gross domestic product. Lending rate showed positive and insignificant influence on economic growth in Nigeria within the period of this study.

Summary, Conclusion, and Recommendations

This paper has examined the impact of domestic debt in Nigeria during 1981-2019 based on available data sets. The main caveat of this paper is that it considers domestic debt, which is just a fractional part of public or government debt. However, based on relevant and appropriate analysis, the results revealed that domestic debts and domestic debt servicing enhanced growth of the economy. These findings support the study of Yusuf & Mohd, (2021), Akpansung, & Gidigbi, (2020), Nwikina, Gbarato and Meekor (2020), Akhanolu et al. (2018) Okwu *et al* (2016) and Bakare, *et al* (2016) that internal debt positively affects the economy growth.

While Government expenditure is seen to have negative and insignificant influence on Gross domestic product. The implication of this means that government lacks capacity to profitably manage public funds especially borrowed ones. Lending rate showed positive and insignificant influence on economic growth in Nigeria within the period of this study. This implies that a percentage increase in lending rate is expected to cause a decline in economic growth. This goes against the McKinnon (1973) and Shaw (1973) hypothesis which suggested that a high interest rate would increase savings and bank credit thereby stimulating economic growth

Conclusions

Economic theories strongly support and recommend that borrowing for investment smoothens the progress of economic growth and development especially in less developed economies. Nigerian economy has mostly been modeled and planned its fiscal policies leveraging on the support of borrowed funds. Interestingly, the findings of this study indicate that these funds have promoted economic growth in Nigeria, as it was shown that domestic borrowings positively and significantly impacted on Gross Domestic Product. Thus, this study concludes that domestic debt plays an important role to promote growth in the Nigerian economy.

Recommendations

In light of the observed findings, the study recommends that projects to be financed with government borrowing should be properly appraised and their technical feasibility, financial viability and economic desirability ascertained before the funds are committed. This would help to restore financial discipline and curtail the misapplication and inefficient management of public debts. Government should improve more on capital expenditures such as infrastructures since they are the key to growth and will reduce the cost of production and investment. Also, government and the Debt Management Office should draw up guidelines to limit the growth of future domestic debt. Effective mechanism should be put in place to ensure that any new borrowing is judiciously utilized to contribute to economic growth.

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