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External Debt and Its Impact on the Economic Growth of Nigeria

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Abstract

The relevant of external debt to the economy of developing countries whose domestic resources are limited cannot be overemphasized. However, if these debts are not channeled into productive investments, their continuous acquisition could retard the economy. The debate on whether external debt impacts meaningfully or negatively on the growth of the economy is yet to be resolved and this present study joins the ongoing debate. Consequently, the focus of the present article is to contribute to this debate in Nigeria and the study covers the period from 1983-2022. The ARDL estimation technique was adopted for the estimation of the parameters and findings indicate that external debt exerted a negative impact on economic growth even though the results are not significant. The authors are of the opinion that much as external debt accumulation is necessary, caution should be exercised to avoid the debts spiraling into debt overhang. This is more so considering the continuous depreciation of the country's exchange rate. It is therefore suggested that accumulated debts should be channeled into productive ventures.

Keywords: *External debt, Economic growth, Exchange rate, ARDL.*

JEL Classification: *F43, F31, C22.*

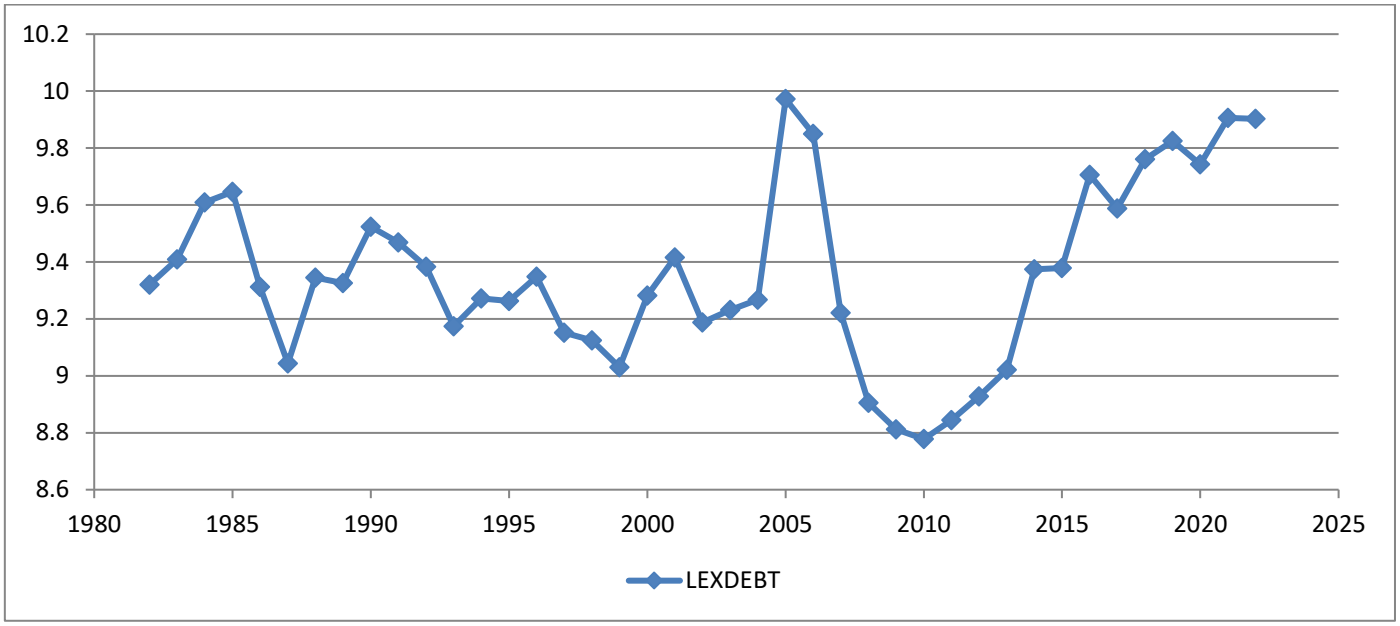
1. INTRODUCTION

Foreign or external debt has always been considered as a veritable source of raising funds to finance the development needs of a country, especially for developing countries that are often confronted with limited resources. As observed by Ogunmuyiwa (2010), developing countries suffer from inadequate domestic savings, a situation that necessitates borrowing. Even when a country has the opportunity to borrow internally, preference is always given to external borrowing because of the tendency of domestic borrowing to crowd out private investment. Much as external debt is necessary, it could be inimical to growth if wrongly applied. This is a typical phenomenon in developing countries where excessive debt has been noted to pose a serious impediment to economic prosperity and poverty reduction. In particular, Sub–Saharan African countries often suffer from unsustainable external debts that result in economic crisis. Debt repayment obligations often erode the resources meant for the provision of basic facilities, resulting in an increase in the rate of poverty. Meeting repayment obligation has been observed not to be feasible for poor countries and this has the potential to aggravate the economic problems (Elkhalfi *et al.*, 2024).

In Nigeria, the growing need to provide vital facilities and other needs of the citizens amidst dwindling income has necessitated the need to borrow externally. Nigeria's economy is tied to the vagaries of fluctuating oil revenue as the country solely depends on the income from the oil sector. The country's budget is always benchmarked on revenue from crude oil sale and when the oil price at the international market falls, meeting the provisions of the budget becomes a problem. This is among the reasons why the country has been forced to accumulate external debt over the years. Prior to 2005, the level of external debt accumulation was so high but after reaching a deal with the external creditors that resulted into cancelling a large part of the debt, the county had a breathing space. However, in recent times Nigeria has been forced back into another episode of high external debt accumulation

indicated in the trend of external debt in Fig.1. It is observed from the Figure that there is a drastic drop in external debt in 2005 and which continued till 2011 when the trend assumed an upward trajectory.

Fig. 1 Trend in External debt in Nigeria



Source: World Development Indicators
Note: LEXDEBT – external debt in log form

In this study, the emphasis is on assessing the contribution of external debt in Nigeria. In literature, the nexus between external debt and the growth of the economy has been widely debated among scholars. While some are of the opinion that external debt improves the economy as it arguments domestic resources, others argue that it can retard growth particularly when it is applied wrongly. The debate on the actual role of external debt has struck the attention of some scholars for some time. Despite the huge interest in this area, there is yet a convergence in the findings. While some findings support the growth-led external debt, some are of the opinion that external debt retards development. It is on this note that the discussion on the role of external debt is an ongoing debate in Nigeria. To study used the auto regressive distributed lag (ARDL) bound test framework to estimate the parameters of the model.

3. LITERATURE REVIEW

3.1 Theoretical Review

The main theory that guided this study is the dual-gap theory developed by Chenery and Strout (1966). This theory is an extension of the Harrod-Domar growth model which saw its development in 1948. It is noted that a country's investment and growth is constrained by either the extent of domestic saving or import capacity. On the other hand, the volume of domestic savings needed to enhance the expansion of the economy is limited in emerging countries and this is the reason for the savings gap. To enable an economy finance its development needs, there is need for a country with low levels of savings to source funds abroad. The dual-gap theory is limited by its inability to stipulate at what point a country should stop accumulating debts in so as not to run into the problem of debt overhang. The theory provide the reason why a country needs to borrow but does not elaborate on the dynamics involved in such borrowing such as the repayment ability, debt servicing capacity and potential effect of external debt accumulation on the economy. Notwithstanding the theory's shortcomings, this present study adopted it on grounds of the low savings in Nigeria and the need to borrow to expand the economic base of the country.

3.2 Empirical Review

There has been much work carried out on the role of external debt on economy in different countries. Even within the same country, the results often differ, implying that the actual influence of external debt on the economy is yet established. In a study involving the Middle East, East Asia and South Asia, Zafar *et al.* (2015) indicated that external debt improved the economy in a significant way. This result finds corroboration in another cross-county study by Jarju *et al.* (2016) which observed that rising external debt service arising from an increase in external debt adversely affected the economy of the West African Monetary Zone (WAMZ). More so, in a study involving Sub-Saharan Africa (SSA), Senadza *et al.* (2018) noted that external debt impacted economy

negatively. In Kenya, Marwa (2019) revealed that different sources of external debt exerted negative impact on the economy. A study in Portugal by Silva (2020) also reveals that external debts were not properly allocated in a way that they exert positive influence on the economy. In another study involving African countries, Epaphra and Mesiet (2020) found that low external debt-to-GDP ratio impacted economic growth positively, while high levels of external debt retards economic growth. In Pakistan, Safdar *et al.* (2021) confirmed that external debt impacted economic growth adversely, thus supporting the outcome of previous studies.

For Asian developing and transition economies, finding by Dawood (2022) revealed that public and private external debts retarded the economy of the selected countries. In Nigeria, John (2023) observed that **e**xternal debt had significant influence on the economy and this supports the earlier findings. Another study in Nigeria by Akanbi *et al.* (2022) found that external debt had no significant impact on the economy even though the relationship is positive and this is not in line with the finding by John (2023). In another study in SSA, Manasseh *et al.* (2022) revealed that external debt had negative and significant impact on the economy; corroborating the finding by Senadza *et al.* (2018). However, In Nigeria, Ubogu and Ejiofor (2023)**,** in their study did not find any link between external debt and economic growth. Finding by Oyeoka *et al.* (2024) however, indicated that external debt impacted negatively and significantly on the economy which finds support in earlier study by John (2023)**.** In the Economic Community of West African States (ECOWAS), Ashakah *et al.* (2024) found that even though external debt service adversely affected the economy, the result was not significant. In Cameroon by Nguep *et al.* (2024) found that domestic debt improved the economy more than external debt. Supporting the evidence of an adverse role of external debt on the economy of Nigeria, finding by Kolawole (2024) revealed that external debt impacted negatively on the economy of the country. In a study that involves 96 countries, Dau *et al.* (2024) indicated that while public external debt exerted negative impact on the stability of the economy, private external debt did not have known impact. In ten African countries, namely: Zambia, South Africa, Ethiopia, Ghana, Côte d'Ivoire, Botswana, Cameroon, Lesotho, Burundi and Mauritius, Mohammed (2025) found that a positive correlation exists between external debt and economic growth. This result does not support the outcome of previous studies in Africa.

4. METHODOLOGY

This study used yearly data spanning from 1983-2022 to examine the role of external debt on Nigeria's economy. The dependent variable is the gross domestic product (GDP) which is measured in current US Dollars, while the independent variables are external debt measure in current US Dollars, exchange rate (expressed as the exchange rate of naira to US Dollar), inflation rate (expressed in percentage), M2 (measured in current local currency unit) and trade openness (expressed as the ratio of the sum of export and import to the GDP). Data for all the series were sourced from the data bank of the World Development Indicators (WDI).

The study conducted some pre-diagnostic tests as a way of to identify how the variables behave. The tests include the descriptive statistics, correlation matrix and unit root tests. The unit root test was conducted using the augmented Dickey-Fuller and Philip-Perron rests were used. The ARDL bounds assisted in the test for the cointegration. It was also used to estimate the coefficients of the parameters. The justification for adopting the ARDL are one, in testing for the existence of cointegration, it can be applied to the model no matter the order of integration of the variables Second, the co-integration approach is appropriate even in small sample (Pesaran & Shin, 1999). Third, it provides a simultaneous method of examining both the short and long-run effects (Bentzen & Engsted, 2001). After estimating, the parameter coefficients, post-diagnostic tests equally carried out to investigate if the series suffer from the problems of serial correlation, heteroskedasticity as well as testing whether the parameter estimates of the model are stable over time and whether the error terms are normally distributed.

4.1 Model Specification

The baseline model that guided the study is specified as follows:

$$LGDP_t = (LEXTDEBT_t, EXCHR_t, INFLR_t, LM2_t, TOPEN_t)$$

The ARDL form of equation 1 is expressed by modifying the work of Kolawole (2024) as follows:

$$\Delta LGDP_t = \eta_0 + \sum_{j=1}^{k}\eta_1 \Delta LGDP_{t-1} + \sum_{j=1}^{k}\eta_2 \Delta LEXTDEBT_{t-1} + \sum_{j=1}^{k}\eta_3 \Delta EXCHR_{t-1} + \sum_{j=1}^{k}\eta_4 \Delta INFLR_{t-1} + \sum_{j=1}^{k}\eta_5 \Delta LM2_{t-1} + \sum_{j=1}^{k}\eta_6 \Delta TOPEN_{t-1} + \lambda_1 LGDP_{t-1} + \lambda_2 LEXTDEBT_{t-1} + \lambda_3 EXCHR_{t-1} + \lambda_4 INFLR_{t-1} + \lambda_5 LM2_{t-1} + \lambda_6 TOPEN_{t-1} + \mu_t \quad (2)$$

Where

GDP = Gross domestic product (a proxy for economic growth). $EXTDEBT$= external debt, $EXCHR$ = external debt, $INFLR$ = inflation rate, $M2$ = broad money supply and $TOPEN$ = trade openness

In equation 2, the parameters of the short-run coefficients are: η_1, η_2, η_3, η_4, η_5 and η_6 while the parameters of the long-run coefficients are: λ_1, λ_2 , λ_3, λ_4, λ_5 and

λ_6. If a long-run relationship is found to exist among the variables, the following error correction model (ECM) is specified:

$$LGDP_t = \eta_0 + \sum_{j=1}^{k} \eta_1 \Delta LGDP_{t-1} + \sum_{j=1}^{k} \eta_2 \Delta LEXTDEBT_{t-1} + \sum_{j=1}^{k} \eta_3 \Delta EXCHR_{t-1} + \sum_{j=1}^{k} \eta_4 \Delta INFLR_{t-1} + \sum_{j=1}^{k} \eta_5 \Delta LM2_{t-1} + \sum_{j=1}^{k} \eta_6 \Delta TOPEN_{t-1} + \phi ECM + \mu_t \quad (3)$$

ECM_{t-1} = error correction model

$\prod$ = coefficient of error correction model

5. FINDINGS AND DISCUSSIONS

The descriptive statistics results in Table 1 indicate that inflation has a high mean value of 18.90 with a standard deviation of 16.65 while the trade openness has a low mean value of 1.845007 with a standard deviation of 0.05. Findings also indicate that the mean and medium of each variable is close which is an indication that the variables maintain symmetry. With inflation rate exhibiting a very high range, it suggets that it has the highest rang and this is followed by exchange rate. Apart from external debt and inflation rate which are positively skewed (skewed to the right) the rest of the variables are negatively skewed (skewed to the left). All the variables are heavy-tailed because their values are positive.

Table 1: Descriptive Statistics

	LGDP	LEXTDEBT	EXCHR	INFLR	LM2	TOPEN
Mean	11.21	10.53	3.75	18.90	12.09	1.84
Median	11.24	10.52	4.77	12.87	12.19	1.86
Maximum	11.75	11.01	6.05	72.83	13.71	1.89
Minimum	10.64	10.07	-0.39	5.38	10.22	1.67
Std. Dev.	0.37	0.20	1.93	16.65	1.17	0.05
Skewness	-0.04	0.44	-0.86	1.86	-0.20	-2.02
Kurtosis	1.44	3.18	2.57	5.33	1.63	6.34
Jarque-Bera	4.16	1.41	5.40	33.02	3.45	47.19
Probability	0.12	0.49	0.06	0.00	0.17	0.00
Sum	459.75	431.8	154.00	774.9	496.06	75.64
Sum Sq. Dev.	5.68	1.73	149.62	11097.83	54.84	0.10
Observations	41	41	41	41	41	41

In Table 2 findings reveal that the GDP has low and positive correlation with external debt and trade openness, while having low and negative correlation with inflation rate. In another vein, external debt is shown to have relatively low and positive correlation with the broad money supply while its correlation with trade openness is low and also positive. However, its correlation with inflation rate is negative and low. Equally revealed is that inflation rate has low correlation with other variables just like trade openness.

Table 2: Correlation Matrix

	LGDP	LEXTDEBT	EXCHR	INFLR	LM2	TOPEN
LGDP	1	0.48	0.75	-0.37	0.87	0.04
LEXTDEBT	0.41	1	0.81	-0.005	0.67	0.10
EXCHR	0.75	0.81	1	-0.29	0.87	0.31
INFLR	-0.37	-0.005	-0.29	1	-0.31	-0.24
LM2	0.87	0.67	0.87	-0.31	1	0.29
TOPEN	0.04	0.10	0.31	-0.24	0.29	1

In Table 3, the unit root results under the ADF reveal that at level only inflation rate achieved stationarity (without unit root), while other variables are not stationary. Under the PP test, both inflation rate and trade openness are stationary at level. However, when the variables were first differenced, they all became stationary. The results suggest that after the variables were first

differenced, they became integrated of order one, that is; they became *I(1).*

Table 3: Unit Root Results

	ADF		PP	
Variables	Level (t-Stat/p-value)	First Diff. (t-Stat/p-value)	Level (t-Stat/p-value)	First Diff. (t-Stat/p-value)
LGDP	-2.93(0.84)	-2.93(0.00)	-2.93(0.81)	-2.93(0.00)
LEXTDEBT	-2.93(0.72)	-2.93(0.00)	-2.93(0.63)	-2.93(0.00)
EXCHR	-3.52(0.99)	-3.52(0.00)	-3.52(0.99)	-3.52(0.00)
INFLR	-2.93(0.00)	-2.95(0.07)	-2.93(0.05)	-2.93(0.00)
LM2	-2.94(0.59)	-2.93(0.01)	-2.93(0.70)	-2.93(0.02)
TOPEN	-2.93(0.10)	-2.93(0.00)	-2.93(0.08)	-2.93(0.00)

The result of the ARDL cointegration test in Table 4 shows the computed F-statistic is 7.50, while the upper critical bounds at the 5% level is 4.25. Since the computed F-statistic is higher than the upper critical bounds, the conclusion is that the series are cointegrated or have a long-run relationship at the selected level of significance.

Table 4: ARDL Cointegration Test

Test Statistic	Value	K
F-statistic	7.50	5
Critical Value Bounds		
Significance	I0 Bound	I1 Bound
10%	2.75	3.79
5%	3.12	4.25
2.5%	3.49	4.67
1%	3.93	5.23

The estimated ARDL results in Table 5 reveal that in both the long-run and the short-run, external debt impacted negatively on the GDP even though the impact is not significant. This outcome is in line with the results of previous works in Nigeria such as Akanbi *et al.* (2022). However, it is not in line with some studies also carried out in Nigeria which revealed a significant negative impact on GDP (John, 2023; Oyeoka *et al.*, 2024; Kolawole, 2024). Across Africa, a negative impact of external debt on GDP has equally being recorded such the work of Manasseh *et al*. (2022) carried out in sub-Saharan Africa and that of Ashakah *et al. (*2024) in the ECOWAS. For the discrepancies in the results for Nigeria, one plausible reason could be due to the different time period in which the studies were carried out. Another plausible reason for the discrepancy could be due to the differences in the measurement of the variables. However, the fact that external debt accumulation has been shown to exert a negative influence on the GDP brings to the front burners the constant fears expressed by Nigerians on the penchant of the political class to embark on external debt spree. After the exit of the country from external debt debacle in 2005 through debt forgiveness, one would have expected the country's external debt to maintain a downward trajectory. However, few years after this the country embraced unbridled and unsustainable external debt accumulation. The main reasons for the adverse effect of external debt on the economy is that these debts are hardly channeled into productive ventures just as larger part of the debt is embezzled.

Evidence from the results shows that exchange rate adversely impacted on the GDP in a significant way. It is shown that if exchange rate the depreciation of exchange rate by one Dollar led to a marginal fall in GDP by 0.003 unit. This result finds support in the result of previous studies done in Nigeria. Such studies include the work of John (2023) which found that exchange rate impacted negatively and significantly on GDP in the short-run and the work of Kolawole (2024) even though Kolawole's finding was not significant. Within Africa, empirical evidence also supports the negative impact of exchange rate on the GDP **(**Epaphra & Mesiet, 2021). Exchange rate depreciation has being a recurrent phenomenon in Nigeria

with an adverse effect on the economy. The depreciation of the exchange rate has made the cost of imported inputs and materials used in production to be high and this has affected productivity in the country. In recent times, the government has liberalized the exchange rate and this policy has been among the reasons why cost of production has risen. In the long-run, inflation is shown to contribute negatively to the GDP and the result is significant. This result finds support in the study by Mohammed (2025). The result shows that if inflation rose by one percent, the GDP fall marginally by 0.008 unit. This outcome is in line with apriori expectation since rising inflation is inimical to growth through its transmission to savings, cost of production and investment. Rising inflation is another phenomenon in Nigeria and this has been worse since the country implemented the policies on fuel subsidy removal and exchange rate liberalization. The result shows that trade openness had an adverse effect on the GDP in the short-run. It is shown that a unit rise in trade openness resulted in a fall in the GDP by 0.88 unit. This result differs from the finding by Kolawole (2024). The discrepancy could be because of the different time horizons. The result reveals that the coefficient of the ECM is negative and significant which further supports the existence of cointegration. This suggets that about 29 percent of errors generated in each period is corrected automatically by the system in the later period.

Table 5: Estimated ARDL Results

Variable	Coefficient	t-Statistic	Prob.
Short-run Results			
D(LEXTDEBT)	-0.13	-1.48	0.15
D(EXCHR)	-0.003	-7.39	0.00
D(INFLR)	0.0001	0.18	0.86
D(INFLR(-1))	-0.002	-3.27	0.00
D(LM2)	0.03	0.39	0.69
D(TOPEN)	-1.28	-5.96	0.00
D(TOPEN(-1))	-0.88	-3.01	0.00
CointEq(-1)	-0.29	-5.37	0.00
Long-run Results			
LEXTDEBT	-0.45	-1.64	0.11
EXCHR	0.000007	0.007	0.99
INFLR	0.008	2.43	0.02
LM2	0.11	0.38	0.70
TOPEN	0.19	0.26	0.79
C	13.42	2.40	0.02

The post-diagnostic results in Table 6 revealed that the model is well specified since at the 5% level of significance, the null hypothesis stating that the model is well specified is accepted. Also, at the 5% level of significance, the null hypotheses of an absence of heteroskedasticity and serial correlation are accepted. In Fig. 2, finding indicates that the errors are normality distributed since the p-value of the Jarque-Bera test is higher than 5%. Finally, evidence shows that the parameter estimates are stable as the plots of cumulative sum (CUSUM) and the cumulative sum of squares (CUMSUM of Squares) in Figures 3 and 4 reveal that the plots lie inside the critical bands of the 5% confidence interval.

Table 6: Post-Diagnostic Results

Test	P-value
Ramsey RESET Test	0.07
Heteroskedasticity Test: Breusch-Pagan-Godfrey	0.53
Breusch-Godfrey Serial Correlation LM Test:	0.08

Fig. 2: Normality Result

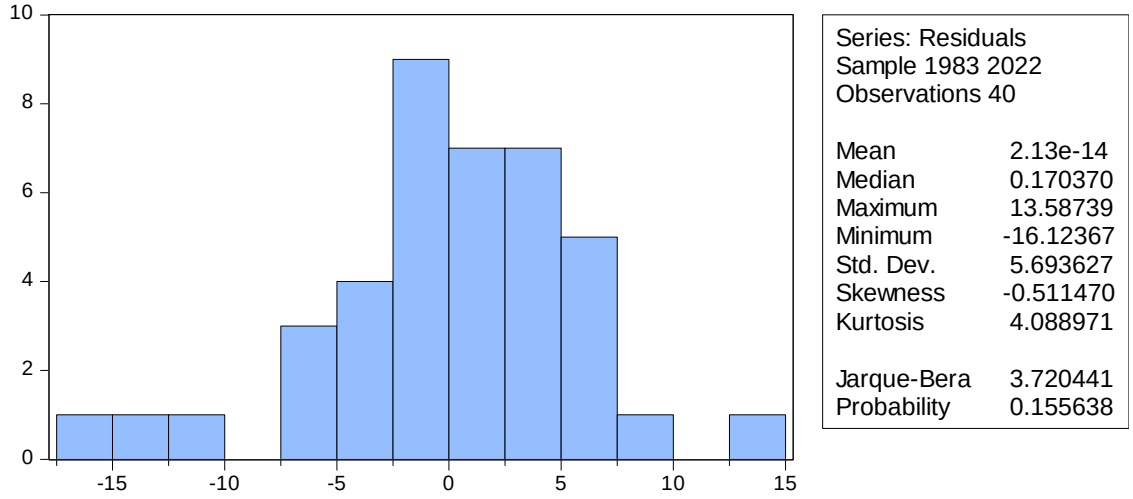


Fig. 3: CUMSUM Test for Stability

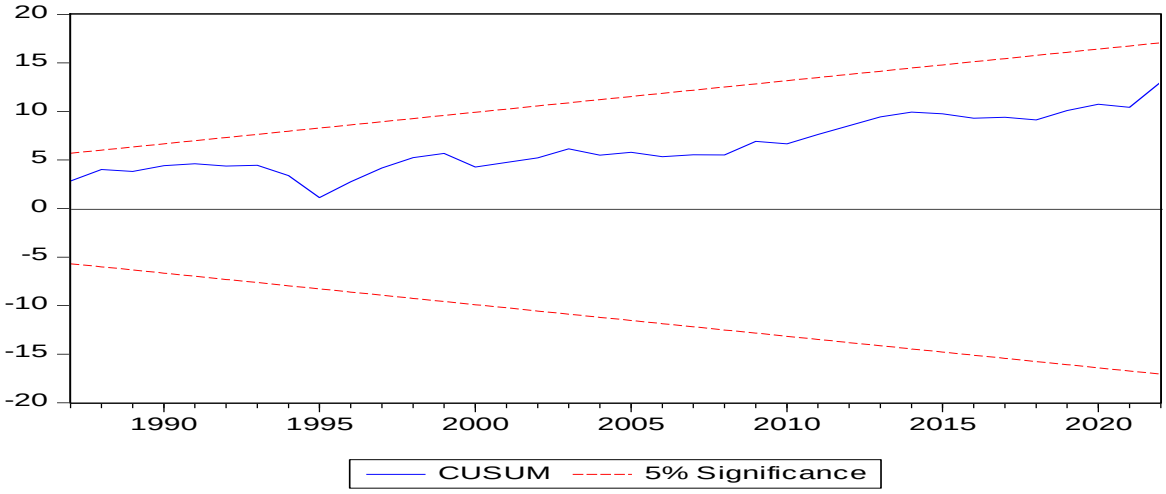
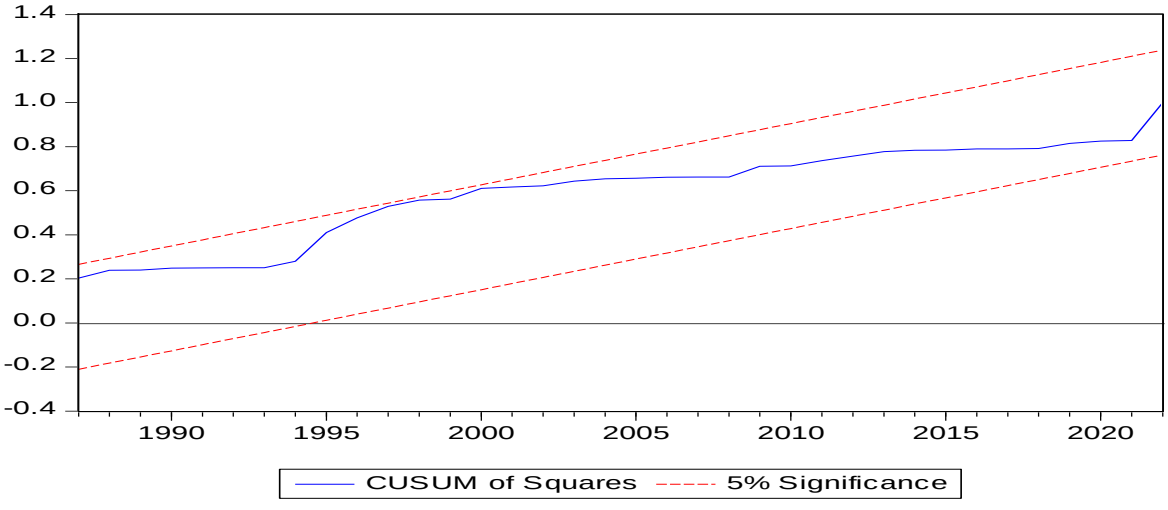


Fig. 4: CUMSUM of Square Test for Stability



CONCLUSION

In this study, the emphasis is on examining the impact of external debt on the economic growth of Nigeria. The study found that in both the short-run and the long-run, external debt exerted a negative influence on economic growth even though the impact is not significant. The negative impact of external debt on economic growth finds support in the outcomes of previous studies in Nigeria and within the African region. The outcome of the study has implications for Nigeria. Among the implications is that much as external debt is necessary to augment the shortfall in domestic resources, such debt accumulation could be counter-productive if not properly channeled. Most African countries and Nigeria in particular are faced with serious debt overhang due to wrong application of the proceeds of debts. In most cases, the accumulated debts are used to service recurrent expenditure instead of channeling them to productive investments. Worst still, the depreciating value of the domestic currency which has assumed a serious dimension in recent times due to the policy of exchange rate liberalization has made external debt repayment to be expensive. The citizens suffer from this ugly development in various ways. First, the adverse impact of external debt on the economy means that investments and employment are equally adversely affected. Second, the repayment of the debts reduces the resources that should been used to improve the wellbeing of the citizens through an improvement in social infrastructure. In most cases, taxes are raised in an attempt to raise funds to service the debts with an adverse impact on the welfare of the people. Consequently, this study suggets that much as external debt accumulation is necessary for the country to raise the needed funds for development, caution should be exercised in accumulating external debts beyond sustainable limit. The use of debt to GDP ratio as a measure for debt sustainability which has been among the reasons for increased debt accumulation should be reconsidered since such measure overlooks other indices that are equally relevant in measuring debt sustainability.

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