TITLE PAGE

THE EFFECT OF EXTERNAL DEBT ON ECONOMIC GROWTH OF NIGERIA(1981-2010)

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EZENWA CHINELO SOPHIA

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DEPARTMENT OF ECONOMICS

FACULTY OF MANAGEMENT AND SOCIAL SCIENCES

CARITAS UNIVERSITY

EMENE

ENUGU

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APPROVAL PAGE

This project work has been approved as meeting the requirements of the Department of Economics, Caritas University, Amorji-Nike, Emene, Enugu for the Award of Degree (B.Sc).

Mr J.C. Odionye **Date..……..**

Supervisor

Barr. Onwudinjo P.C **Date…..…….**

Head of Department

Dr. C. Umeh **Date…….……..**

Dean of Faculty of

Management and Social Sciences

External Examiner **Date……..……..**

DEDICATION

I dedicate this work to Lord Almighty who gave me the wisdom, courage and strength to finally accomplish this task.

To my parents, Mr & Mrs M.O Ezegbolu Ezenwa, my siblings and friends also.

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My sincere gratitude goes to Almighty God for His guidance, protection and favour towards the successful completion of this work.

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You all are very special to me and I pray that Lord Almighty will meet you all at your individual points of need.

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ABSTRACT

This work evolved out of the need to provide an in-depth understanding of the economics of debt in Nigeria. This study aims at analysing the effectiveness of external debt on economic growth within a span of 1981-2010. The broad objective of this work is specified to evaluate the impact of external debt stock and debt servicing on economic growth. In all, the models were to show the growth relationship between the independent variables-inflation rate, exchange rate, interest rate, government expenditure, external debt stock and external debt service and the dependent variable-gross domestic product (GDP). The data were collected from CBN Statistical Bulletin 2010 and the Debt Management Office (DMO) quarterly report. The Engle & Grenger Cointegration and Ordinary Least Square (OLS) were employed in the cause of this study. The Augmented Dickey Fuller test (ADF) shows that the variables are stationary and reliable for forecasting. The choice of OLS is most appropriate for the study in terms of goodness of fit and significance of regression coefficients. The result of the analyses showed that rising external debt stock inhibits the pace of economic growth of Nigeria by increasing the cost of its servicing beyond the debt sustainability limit while external debt servicing was found not to impair economic growth.

Summary and policy recommendations were presented in line with our stated objectives and facts then conclusions were made. It was found that external debt stock rises rapidly due to accrued compound interest and loans were secured for dubious projects. Part of the policy recommendations were that Nigeria should increase its export base by investing borrowed funds in productive ventures and she should also seek fixed interest payment, varying amortization schemes and multi-year rescheduling.

CHAPTER ONE

INTRODUCTION

1.0 BACKGROUND OF THE STUDY

It is generally expected that developing countries, facing a scarcity of capital, will acquire external debt to supplement domestic saving (Malik et al, 2010; Aluko and Arowolo, 2010). Besides, external borrowing is preferable to domestic debt because the interest rates charged by international financial institutions like International Monetary Funds (IMF) is about half to the one charged in the domestic market (Pascal, 2010). However, whether or not external debt would be beneficial to the borrowing nation depends on whether the borrowed money is used in the productive segments of the economy or for consumption. Adepoju et al (2007) stated that debt financed investment need to be productive and well managed enough to earn a rate of return higher than the cost of debt servicing

The main lesson of the standard "growth with debt" literature is that a country should borrow abroad as long as the capital thus acquired produces a rate of return that is higher than the cost of the foreign borrowing. In that event, the borrowing country is increasing capacity and expanding output with the aid of foreign savings. The debt, if properly utilised, is expected to help the debtor country's economies (Hameed et al, 2008) by producing a multiplier effect which leads to increased employment, adequate infrastructural base, a larger export market, improved exchange rate and favourable terms of trade. But, this has never been the case in Nigeria and several other sub-Saharan African Countries (SSA) where it has been misused (Aluko and Arowolo, 2010). Apart

from the fact that external debt had been badly expended in these countries, the management of the debt by way of service payment, which is usually in foreign exchange, has also affected their macroeconomic performance (Aluko and Arowolo, (2010); Serieux and Yiagadeesen, (2001).

Prior to the $18 billion debt cancellation granted to Nigeria in 2005 by the Paris Club, the country had external debt of close to $40 billion with over $30 billion of the amount being owed to Paris Club alone (Semenitari, 2005a). The history of Nigeria's huge debts can hardly be separated from its decades of misrule and the continued recklessness of its rulers. Nigeria's debt stock in 1971 was $1 billion (Semenitari, 2005a). By 1991, it had risen to $33.4 billion, and rather than decrease, it has been on the increase, particularly with the insurmountable regime of debt servicing and the insatiable desire of political leaders to obtain loans for the execution of dubious projects (Semenitari, 2005a).

Before the debt cancellation deal, Nigeria was to pay a whopping sum of $4.9 billion every year on debt servicing (Aluko and Arowolo, 2010). It would have been impossible to achieve exchange rate stability or any meaningful growth under such indebtedness. The effect of the Paris Club debt cancellation was immediately observed in the sequential reduction of the exchange rate of Nigeria vis-à-vis the Dollar from 130.6 Naira in 2005 to 128.2 Naira in 2006, and then 120.9 in 2007 (CBN, 2009). Although the growth rate of the economy has been inconsistent in the post-debt relief period as it plunged from 6.5% in 2005 to 6% in 2006 and then increased to 6.5% in 2007 (CBN, 2008), it could have been worse if the debt had not been cancelled.

However, the benefits of the debt cancellation, which was expected to manifest after couple of years, was wiped up in 2009 by the global financial and economic crisis, which was precipitated in August 2007 by the collapse of the sub-prime lending market in the United States. The effect of the crisis on Nigeria's exchange rate was phenomenal as the Naira exchange rate vis-à-vis the Dollar rose astronomically from about N120/$ in the last quarter of 2007 to more than N150/$ (about 25% increase) in the third quarter of 2009 (CBN, 2009). This is attributable to the sharp drop in foreign earnings of Nigeria as a result of the persistent fall of crude oil price, which plunged from an all-time high of US$147 per barrel in July 2007 to a low of US$45 per barrel in December 2008 (CBN, 2008).

Available statistics show that the external debt stock of Nigeria has been on the increase after the debt cancellation in 2005. The country's external debt outstanding increased from $3,545 million in 2006 to $3,654 million in 2007, and then to $3,720 million and $3,947 in 2008 and 2009 respectively (CBN, 2009). It is therefore imperative to examine the effect of external debt of the country on her economy for us to appreciate the need to avoid being back in the group of highly indebted nations.

1.1 STATEMENT OF THE PROBLEM

The huge external debt stock and debt service payments of African countries and Nigeria in particular prevented the countries from embarking on larger volume of domestic investment, which would have enhanced growth and development (Clements, etal. 2003). External debt became a burden to most African countries because contracted loans were not optimally deployed, therefore returns on investments were not adequate to meet maturing obligations and did not leave a favourable balance to support domestic

economic growth. So, African economies have not performed well because the necessary macro-economic adjustment has remained elusive for most of the countries in the continent. The main interest of this study then is to empirically investigate the effect of external debt on the economic growth of Nigeria.

1.2 OBJECTIVES OF THE STUDY

The study will focus on the following objectives:

(i) Empirically investigate the effect of external debt on the growth process of the country;

(ii) To determine the impact of external debt service payment on economic growth of Nigeria.

1.3 STATEMENT OF HYPOTHESIS

HYPOTHESIS I

The following hypotheses are tested in this study:

Ho: That the external debt stock does not have impact on the economicgrowth of Nigeria.

HYPOTHESIS II

Ho: That the external debt service payment does not have an impact on economic growth of Nigeria.

1.4 SIGNIFICANCE OF THE STUDY

This study is focused on providing alternative measures to tackling external debt management problems. It will also serve as a tool in revamping government policies towards loan procurement and debt servicing in Nigeria. This work may also serve as a yardstick for further research and documentation on Nigeria's external debt crisis.

1.5 SCOPE AND LIMITATIONS OF THE STUDY

The scope of this study shall cover the external debt trend of Nigeria over the years to date. The general overview of the debt cancellation shall be taken with certain issues raised and discussed.However, the empirical investigation of the effect of external debt on the economic growth of Nigeria shall be restricted to 1981 and 2010. This restriction is unavoidable because of the non-availability of some data.

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CHAPTER TWO

2.0 LITERATURE REVIEW

Theoretical Framework

Nigeria is characterized by inadequate internal capitalformation arising from the vicious circle of low productivity, low income, and low savings.This scenario calls for technical, managerial and financial support from abroad to bridge theresources gap. The accesses to external finance strongly influence the economic developmentprocess of nations. It is an important resource needed to support sustainable economic growth.

Ordinarily, economic growth should depend largely on domestic capital formation andaccumulation, but due to severe limitations it requires imports of capital goods andcomplementary raw materials that are not domestically available. These foreign imports arenecessary for various reasons. Balanced growth calls for substantial investment ininfrastructures – roads, ports, dams, transportations and so on. Foreign debt is needed to cover two types of gaps in the developing process. They include;

(a). The foreign exchange gap which is the payment of deficit a country faces when it hasreduced its external reserves to a minimum compared with projected import requirements.

(b) The investment –saving gap which is the foreign capital needed to supplement domesticsavings for financing real investment levels.External financial supports, when used productively accelerate the pace of economicdevelopment. It will not only provide foreign capital but will also give managerial know-how,technology, technical expertise as

well as access to foreign markets for the mobilization of anation's human and material resources for development purposes. Specifically, loans can beused in areas such as increasing agricultural production of goods for export, mineralexploration, industrialization, transport and communication, rural and urbandevelopment, heath care services, balance of payments, tourism, infrastructural development, etc (Anyanwu et al 1997).

2.1 HISTORY OF NIGERIA'S DEBT CRISIS

The phenomenon of external debt by Nigeria dates back to the colonial period precisely in 1958 when the sum of US$28 million was contracted for railway construction (Adepoju et al, 2007). Between 1958 and 1977, debts contracted were the concessional debts from bilateral and multilateral sources with longer repayment periods and lower interest rates constituting about 78.5 per cent of the total debt stock (Adepoju et al, 2007). AFRODAD (2007) noted that Nigeria's external debts have been increasing over time because of a proportional shortage of foreign exchange to meet her developmental needs. The fall in oil prices in the late 1970s had a devastating effect on government expenses. It therefore became necessary for government to borrow in 1978 for balance of payment support and project financing. As a result of this, government promulgated Decree No 30 of 1978 which limited the external loans the Federal Government could raise to 5billion Naira.

In the same year government made the first "jumbo loan" of US$1 billion from the International Capital Market. This increased the nation's debt profile to US$2.2 billion (AFRODAD. 2007). Given this, Nigeria's external debts skyrocketed from the million-dollar category to that of billion dollars. Nigeria's external debt stock increased

to US$13.1 billion in 1982 (CBN, 2003). Two factors led to this sharp increase: one, the entrance of state governments into external loan obligation and two, there was a substantial decline in the share of loans from bilateral and multilateral creditors and a consequent increase in borrowing from private sources at stiffer rates.

Nigeria's inability to settle her import bills resulted in the accumulation of trade arrears amounting to US$9.8 billion between 1983 and 1988. The insured components were US$2.4 billion while the uninsured were US$7.4 billion (Adepoju et al, 2007). The insured component was rescheduled at the Paris Club, while the uninsured was reconciled with the London Club. This reconciliation which took place between 1984 and 1988 reduced the amount to US$3.8 billion (Adepoju et al, 2007). The accrued interest of US$1.0 billion was recapitalised. This brought the amount to US$4.8 billion in 1988 and the debt was eventually refinanced. In 1990, Nigeria's external debt rose again to US$33.1 billion (CBN, 2003). After a brief decline to US$27.5 billion in 1991, it rose steadily to US$32.6 billion at the end of 1995. As at 1999, Nigeria's external debt stock was US$28.0 billion. 73.2 per cent of this was owed to the Paris Club while the rest was owed to the London Club, the multilateral creditors, promissory note holders and others. (CBN, 2003).

Furthermore, servicing and rescheduling of debt became problematic for Nigeria from around 1985 when its external debt rose to up to US$19 billion. Before then, Nigeria had experienced boom in oil revenue which was followed immediately by an unexpected decline. In 1980, Nigeria earned $25 billion from oil export. In 1982, it declined to $12 billion and further to $6 billion in 1986 (CBN, 2003). Government spending had remained high within this period and much of the projects were financed

through external borrowing. Since Nigeria was an OPEC member, it was not qualified for the soft-loan financing provided by multilateral and bilateral aid agencies to other countries at that time. As at the end of 2004, Nigeria's debt stock had reached almost $36 billion out of which $31 billion was owed to the Paris Club of Creditors while the rest was owed to multilateral, commercial and other non-Paris Club of creditor (Riefel, 2005).

According to AFRODAD, (2007) debt service payment for Nigeria's debts started on a soft, tolerable level in 1958 until it became a hard bargain years later. Matters came to a head in 2003 when one of Nigeria's creditors, the Paris Club, demanded $3 billion annually for debt service payment. Dr. NgoziOkonjo-Iweala considered the payment economically unsustainable (Semenitari, 2005). She therefore negotiated with the club. The $18 billion debt cancellation for Nigeria in 2005 by The Paris Club and subsequent settlement of some outstanding debts reduced the total external debt of the country substantially.

2.2 EXTERNAL DEBT MANAGEMENT IN NIGERIA

2.2.1 External Debt Management Strategies.

In the 1980, the management of the external debt became major responsibility of the Central Bank of Nigeria (CBN). This necessitated the establishment (setting up) of a Department in collaboration with Federal Ministry of Finance to the management of external debt. Although, the debt management strategies and measures varied from time to time since the early 1980s when the external debt became pronounced. The following measures were used by the Government as guidelines to external borrowing. Economic sector should have positive Internal Rate of Return (IRR) as high as the cost of borrowing i.e. interest.

External loans for private and public sectors projects with the shortest rate of returnshould be sourced from the international capital market while loans for social services or infrastructure could be sourced from confessionals financial institutions.

- State Government, Parastatals, Private sectors borrowing receive adequate approval from the Federal Government so as to ensure that the borrowing conforms to the national objectives.

- Projects to be financed with external loan should be supported with feasibility studies which include loan acquisition, deployment and retirement schedule.

- State Governments and other agencies with borrowed funds should service their debts through the foreign exchange market and duly inform the Federal Ministry of Finance for record purposes. Any default will attract deduction (in Nigeria equivalents) at source before the release of statutory allocations.

- Private sector, industries that are export – oriented are expected to service their debt from their export earnings while others should utilize the Foreign Exchange Market facilities for debt servicing. The government over the years adopted the under listed strategies and measures to deal with the debt problem. They include:

1 Embargo on new Loans and Directives to State Government to restrict external borrowing to the barest minimum: The embargo was to check the escalation of total debt stock and minimize additional debt burden. However, these have not been particularly effective as indiscriminate quest for external loans have not been adopted. Although rescheduling has conferred short term relief or debt service obligations, the debt over-hang has however hardly been abated as the debt stock has continued to increase significantly.

2 Limit on debt service payments: This requires setting aside portion of export earnings to allow for internal development.

3 Debt Restructuring: This involve the reduction in the burden of an existing debt through refinancing, rescheduling bring back, issuance of collateralized bonds and the provision of new money.

The Federal Government in year 2001 established a semi – autonomous debt management office under the Presidency. The creation of DMO (Debt Management Office) consolidated the debt management functions in a single agency, ensuring proper coordination of the country's debt recording and management activities, including debt service forecast, debt service repayments, and advising on debt negotiation as well as new borrowings.

2.2.2 Nigeria External Debt Servicing

The major challenge faced by the debt management office is ensuring that a reasonable level of resources are earmarked for debt servicing to avoid the risk of default and to maintain conducive relations for debt relief negotiations with the creditors. Also, the DMO faces the challenge of ensuring that budget resources are release in time to effect debt service payment since much of Nigerian's debt stock build – up was accounted for by the capitalization of interest arrears and penalties for default. Debt service payments to the World Bank are due every 15 days while ADB (African Development Bank) service payments occur frequently. The debts are not subject to debt relief or rescheduling and in case of default, they carry stiff consequences with sanctions coming 30 days after due date. The implications for default include.

I. Prohibition of borrower/guarantor from signing new loan or guarantee agreement with the background.

II. Suspension of disbursement in respect of all Bank group loans granted to the borrower/guarantor and lastly.

III. Suspension of the granting of any new loans by the Bank group to the borrower/guarantor. The impositions of the above sanctions adversely affect the credit – worthiness of a Country as well as access to further foreign credits or loans. It is therefore to be avoided by all means.

A Paris club: Failure of our debt service obligation will undermine Nigerian's effort to obtain substantive debt relief over the medium term coupled with the inability to benefit from normal credit facilities as Export credit agencies in Paris club creditor countries in default of debt service payment. Also business and government agencies from such debtor countries seeking to import goods and services are required to pay the full 100% upfront, even against deliveries that will take several months and at times years.

B Bilateral: Defaulters in this category incur penalty charges in the form of late interest, which are usually about 1-3% above the normal interest charged.

C London Club: The consequences of defaulting are stiff as the instruments carry legal obligations e.g. If par bonds on promissory notes payment is not received as at when due, creditors could acquire the assets of the Central Bank of Nigeria CBN and Nigerian NationalPetroleum Corporation NNPC anywhere in the world, as Nigeria has expressly waived her sovereign immunity under the terms of the agreement. In line with the desirable consequencesof default in debt service payments the best arrangement must

be put in place from time to time in response to changes in the economy and the polity. In order to facilitate the implementation of a new debt service arrangement, the DMO has agreement with the debtors on the nation's external debt stock and debt service obligation so that levels of government and their agencies that contracted the loans would know their respective stock of debt and the required amount for servicing.

2.2.3 Nigerian External Debt Rescheduling and Restructuring

Debt Rescheduling involves the postponement, extension and re-orderings of the repayment of the existing debt. An agreement between creditors (government authorities and the commercial banks acting as a group) and the debtor to roll over payment due to the former from the later over a certain period and under new terms and conditions falls under either debt rescheduling or refinancing. This involves the provision of new money to replace maturing debt. The four elements of loan restructuring are:

I Rescheduling of the principal of a part or all of an existing loan by postponing repayment i.e. rearranging maturities and grace periods involves the rescheduling of the interest payments.

Il Refinancing of an existing loan by raising fresh or complementary fund to meet existing obligation that is making provision for new credit's with proceeds to be used to repay outstanding loans;

Ill Restoring of trade –related bank credit lines; and

IV Persuading the financial community to restore inter-banks lines of credit to a certain minimum level. Official debt restructuring under Paris club- This involves the rescheduling of both official medium term andlong term debt falling due in a given period including those in arrears. The rescheduling terms under Paris Club are generally

non-concessionary. Moreover, Paris Club is extremely reluctant to reschedule payments on short term debt with an initial maturity of one year or less.

In Nigeria efforts on debt rescheduling, the country held a first round of talks with the Paris club on rescheduling of her debt in October, 2000 while the second help in December 2000 resulted in an agreement to reschedule Nigeria's debt under Houston Terms. Rescheduling of Nigeria's Paris club debt totaling US$20.5 Billions in 2000 over an 18-20 year period. Credits are to be rescheduled over 20 years at concessional interest rates and enjoy 10 year's grace periods. Commercial credits are to be rescheduled over 18 years at market based interest rates, including a three year moratorium interest of about US $1.063 Billion which was capitalized. It was agreed that debt service payment in 2001 should be kept at $1 billion. Nigeria made bilateral negotiations with about fourteen creditor countries on the specific details of each agreement. Nigeria confirmed her stand with the Paris club in the Agreement minute in Dec. 2000 for a further negotiation after July 31, 2001 the agreement was however subject to a good track of record in implementing the IMF –supported stand; negation of as follow-up medium term programme supported by the IMF and lastly satisfactory implementation of the 2002. Paris club agreed minutes including timely debt servicing.

However, Nigeria's debts, like that of most other developing countries, appeared to be on a ceaseless and perpetual increase. The more we paid, the more it seems we owe. Doubtful deals, dud projects (white elephants) and dubious debts; Nigeria was neck-deep in the debt trap. Debt became a burden on Nigeria's neck, jeopardized her economic growth; undermined the capital market development and compromised her social development. The country spent a lion's share of her national income servicing debts

leaving little money for social services and infrastructural developments, and even still much less for investment. In the process, we have paid more than we originally borrowed, yet our debt – like a cruel virus – continues to multiply.Nigerians, victims of many years of belt-tightening and austerity measures are worried stiff while President OlusegunObasanjo cried himself hoarse appealing to the Western creditors to loosen the debt noose through outright cancellation, interest forgiveness and debt-for-development-assistance-swap.

Before the debt cancellation, with an external debt of over $US30 billion, servicing of debt was a major economic challenge and a critical development issue. Nigeria was spending about one third of its budget, three times its sectoral budget for education and nine times its health budget on servicing outstanding debts. This saddled away investable fund that would have been available in the economy. The chapter shall be devoted to different views on external debt and its impact on growth and development.

2.3 OPINIONS ON EXTERNAL DEBT MANAGEMENT OF NIGERIA

The Federal Government in year 2001 established a semi-autonomous Debt Management Office (DMO) under the Presidency. Adepoju et al (2007) opined that the creation of DMO consolidated the debt management functions in a single agency, ensuring proper coordination of the country's debt recording and management activities, including debt service forecast, debt service repayments, and advising on debt negotiation as well as new borrowings.

According to Owasanoye (2005), the establishment of debt management office (DMO) is regarded in contemporary times as a best practice in view of the importance of external debt management to development. He maintained that a new approach to debt

management is needed. This will ensure that borrowing is resorted to only when necessary and excessive borrowing should be avoided, the legislature should wake up to its duty to set the expenditure limits in collaboration with the executive, something similar to what obtains in US a debt ceiling is set for government by the congress. It should also insist that all request regarding borrowing are accompanied with a cost-benefit analysis, conduct public hearings on requests for the borrowings and ensure that borrowed funds are judiciously invested in purposes for which the approval was sought.

Muoghalu et al (2007) investigated how and the extent to which investment burden is affected by exchange rate conditions and external debt crisis in Nigeria, in the light of international oil prices movements using two different methods namely; the OLS and Exact Maximum Likelihood (EML) techniques. They found that a positive association exists between external debt and investment burdens. They therefore concluded that it will not be an appropriate policy for a developing economy such as Nigeria to lavishly encourage both foreign investment participation (and associated remittances) and increased accumulation of external debt (and attendant burden). They recommended that policy makers must have to strike a balance between the two and determine the optimal levels and timing of both activities in order not to unnecessarily increase the overall external sector burdens.

According toYilanci and Ozcan, (2008) external debt sustainability is a country's ability to meet its foreign debt obligations. Ajayi (1991), after analyzing the external debt of Nigeria within a general macroeconomic framework, found that the country had macroeconomic policies that led to the accumulation of debt in excess of what was sustainable as judged by her export performance. He found out that for the entire period

between 1970 and 1988, macroeconomic policy coupled with inadequate trade policy led to a rate of borrowing that was not sustainable by Nigeria.

Adepoju et al (2007) further noted that a huge external debt without servicing as it was the case for Nigeria before year 2000 constituted a major impediment to the revitalization of her shattered economy as well as the alleviation of debilitating poverty. They revealed that the much needed inflow of foreign resources for investment stimulation, growth and employment were hampered because without credit cover, Nigerian importers were required to provide 100 percent cash covers for all orders and this therefore placed them to a competitive disadvantage compared to their counterparts elsewhere.

Clements etal. (2003) argued that debt affect growth via its effect on the efficiency of resource use, rather than through its depressing effect on private investment. It was also found that the stock of public debt does not appear to depress public investment,debt service does.

2.4 IMPACT OF EXTERNAL DEBT ON ECONOMIC GROWTH

There have been several attempts to empirically assess the external debt-economic growth link - the debt overhang and crowding out effects - mainly by using ordinary least square (OLS). Most of the empirical studies include a fairly standard set of domestic debt policy and other exogenous explanatory variables. The majority find one or more debt variables to be significantly and negatively correlated with investment or growth (depending on the focus of the study).

Hameed et al, (2008) opined that too much of external debt could dampen growth by hampering investment and productivity growth because of the fact that when greater

percentages of reserves (foreign currency) are consumed in meeting debt service, exchange rates fall and creditworthiness erodes; causing reduction in access to external financial resources.

Boyce and Ndikumana (2002) noted that the inability of many SSA countries to meet their social needs and escape from debt is, to a large extent, a result of the fact that the borrowed funds have not been used productively. Instead of financing domestic investment or consumption, a substantial fraction of the borrowed funds was captured by African political elites and channeled abroad in the form of capital flight, they revealed.

They argued that in order to prevent diversion of borrowed fund through capital flight, there is need for greater accountability on the creditor side as well as the establishment of mechanisms of transparency and accountability in the debtor countries' own decision-making processes with regard to foreign borrowing and the management of borrowed funds.

Were (2001) noted that Sub Sahara Africa countries were plagued by their heavy external debt burden. He argued that the debt crisis, compounded by massive poverty and structural weaknesses of most of the economies of these countries made the attainment of rapid and sustainable growth and development difficult. It then became widely accepted that the heavily-indebted countries require debt relief initiatives beyond mere rescheduling to have a turn-around in their economic performance and fight against poverty.

Sun (2004) opined that completion point countries will continue to face a dilemma given their large priority financing needs for development on the one hand, and the need to maintain long-term debt sustainability on the other. To achieve debt

sustainability, he advised that they should maintain macroeconomic stability and deepen reforms to improve policy and institutional frameworks, strengthen debt management, mobilize domestic revenues, and create an environment conducive to attracting foreign direct investment and diversifying exports. He concluded that the mix between debt and grant financing must be closely monitored by both borrowers and creditors to ensure that the potentially large financing needs associated with meeting the Millennium Development Goals do not give rise to a renewed excessive buildup of debt.

Ngassam (2000) argued that debt obligations can be eased temporarily by rescheduling. He however, noted that African countries that are undergoing external debt crisis may improve their situation by: liberalizing their economies in order to bring competitive pressures on domestic private business activities, adjusting the exchange rate so that exports are encouraged and imports are restrained, and reducing inflation through strong policies of fiscal and monetary adjustment. He concluded that because of the structural difficulties facing most African countries, a comprehensive policy package for managing external debt has to aim at addressing not only demand management issues, but also the structural problems.

2.5 LIMITATIONS OF PREVIOUS STUDIES

The limitations of previous studies are evident in lack of clarity of literature and statistical problems such as biasedness, inconsistency, incorrect and unreliable data.

However, the quality of this work will not in any way be distorted as the researcher is systematic in approach to towards this study. This work is therefore suited to be compelling to the reader, user-friendly, direct, comprehensive and simple. Also another limitation of previous studies is the rigidity of focus on external debt without

further disintegration of the concept into external debt stock and external debt service payment. This serves to fill this gap by scrutinizing both concepts mentioned above respectively hence the need for two research models.

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CHAPTER THREE

3.1 RESEARCH METHODOLOGY

The choice of model for this research is the Ordinary Least Squares because it provides satisfactory results for estimates of structural parameters (Koutsoyiannis 1977:43). This method involves decision on whether the parameters are statistically significant and theoretically meaningful. It also verifies the validity of estimates and whether they actually represent economic theory. In order to achieve a comprehensive analysis, the two major components of external debt management: external debt stock and debt service payment were employed. The real Gross Domestic Product was used in the regression analysis because it is to some degree free of the effect of inflation.

3.2 MODELS SPECIFICATION

The models to investigate the impact of external debt on the economic growth of Nigeria are stated below with the dependent variable as real Gross Domestic Productwhile the explanatory variables are External debt stock, Inflation rate, Exchange rate, External debt service payment, Government expenditure and Interest rate.

MODEL I

$$loggdp = a_0 + a_1EXD + a_2 INF + a_3EXR + e$$

Where loggdp - Gross Domestic Product

EXD - External debt stock

INF - Inflation

EXR - Exchange rate

a_0, a_1, a_2 and a_3 - Parameters

e - Error term

MODEL II

$$loggdp = b_0 + b_1EDS + b_2GEX + b_3INT + e$$

Where loggdp - Real Gross Domestic Product

EDS - External debt service payment

GEX - Government expenditure

INT - Average interest rate

b_0, b_1, b_2 and b_3 - Parameters

e - Error term

3.3 DATA ANALYSIS TECHNIQUE

The method of data analysis to be used in this study is the Ordinary Least Square method (OLS). This approach, which is quantitative technique, includes table and the test for the hypotheses formulated by using the Augmented Dickey Fuller Test (Unit Root),ErrorCointegration Model(ECM) and Regression analysis at 5% level of significance.

3.3.1 APRIORI EXPECTATION

ECONOMIC CRITERIA

The economic apriori test shall be conducted to enable us examine the magnitude and size of the parameters estimate. This evaluation is guided by economic theory to ascertain if the parameter estimate conforms to expectation.

MODEL I

$$gdp = a_0 + a_1 EXD + a_2 INF + a_3EXR$$

Where a_0, a_1, a_2 and a_3 are parameters

$a_0 > 0$, $a_1 < 0$, $a_2 < 0$ and $a_3 > 0$

MODEL II

$$gdp = b_0 + b_1 EDS + b_2 GEX + b_3 INT + e$$

Where b_0, b_1, b_2 and b_3 are parameters

$b_0 > 0$, $b_1 < 0$, $b_2 > 0$ and $b_3 < 0$

3.3.2 The Unit Root Test (Augmented Dickey Fuller Statistics Test)

The augmented Dickey–Fuller (ADF) statistic, used in the test, is a negative number. We consider the ADF in absolute terms. The essence of Unit Root is to check if the variables are stationary (if they do not change over a period of time) and reliable for forecasting. If all variables are of the same order, we run a cointegration test. The result of the ADF shows if the variable is stationary or not.

Decision Rule

Ho: $\Theta = 0$, ai=1 (presence of unit root, the data is non-stationary)

H_1: $\Theta < 0$, ai≠1 (the data is stationary and does not need to be differenced)

If the ADF test statistics value is greater than the critical value in absolute terms at 5% level of significance, we reject Ho and accept H_1. This means that there is no unit root and the data is stationary.

3.3.3 STATISTICAL TEST (First Order)

Under the statistical test, we will test for the goodness of fit, the individual significance of each regressor using the t-test and finally the significance of the regression models using the f-test.

(i) Goodness of fit test: We shall make use of the coefficient of multiple determination $R^2$to find how the variations in the explanatory variable effect the dependent variable.

(ii) **Student's t-test:** It is used for testing the significance of each variable. We shall make use of 5% level of significance with (n-k) degrees of freedom and where necessary, the probability value will be used as rule of thumb.

(iii) The f-test: It will be used for testing the overall significance of the regression models. In order words, it will be used to test the joint impact of the independent variables on the dependent variable.

3.3.4 ECONOMETRIC (SECOND ORDER) TEST

Econometric test will be used for empirical verification of the model. This will range from testing for autocorrelation, normality and heteroscedasticity.

(i) Autocorrelation: The classical linear regression model assumes that autocorrelation does not exist among the disturbance terms. In order to find out where the errorterms are correlated in the regression, we will use the Durbin Watson Statistics.

Durbin Watson's Statistics

This is used to test for the presence of serial autocorrelation. This means that the serial dependence of successive error terms in the regression.

(ii) Normality Test: This test will be conducted to find out if the error terms are normally distributed with zero mean and constant variance. This is one of the assumptions of the classical linear regression model. The JargueBera test will be used to test for the normality in the time series variables used.

(iii) Heteroscedasticity test: Heteroscedasticity occurs when the variance of the error is not constant.

3.4 DATA REQUIRED AND SOURCES

Secondary data shall be the basis of data to be used in this study. It shall be sourced mainly from the publications of the Central Bank of Nigeria (CBN) such as CBN Statistical Bulletin and CBN Annual Reports and Statement of Accounts; as well as the publications of Debt Management Office (DMO), and National Bureau of Statistics (NBS) etc. The variables for which data were sourced include: External debt stock, Inflation rate, Exchange rate, Gross Domestic Product, External Debt Servicing, Government Expenditure, and Interest rate for the period 1981 to 2010.

CHAPTER FOUR

DATA PRESENTATION AND ANALYSIS

4.1 UNIT ROOT TEST RESULTS

MODEL I

VARIABLE	ADF STATISTIC LEVEL FORM	CRITICAL VALUE @ 5%	LAG LENGTH	ADF STATISTIC 1ST DIFFERENCE	CRITICAL VALUE @ 5%	LAG LENGTH	ORDER OF INTEGRATION
RGDP	1.708094	2.9750	2	5.505377	2.9665	2	1(1)
EXD	2.217963	2.9705	1	3.622060	2.9750	2	1(1)
INF	2.163648	2.9750	2	4.430918	2.9798	2	1(1)
EXR	0.239497	2.9705	1	3.590337	2.9750	2	1(1)

MODEL II

VARIABLE	ADF STATISTIC LEVEL FORM	CRITICAL VALUE @ 5%	LAG LENGTH	ADF STATISTIC 1ST DIFFERENCE	CRITICAL VALUE @ 5%	LAG LENGHT	ORDER OF INTEGRATION
RGDP	1.708094	2.9750	2	5.505377	2.9665	2	1(1)
EDS	2.105628	2.9750	2	3.931870	2.9798	2	1(1)
GEX	3.500388	3.5867	2	3.429161	2.9750	1	1(1)
INT	2.413059	2.9705	1	5.826977	2.9750	1	1(1)

The result of all the ADF test statistics show that these variables are not stationary intheir level form but were stationary after the first difference. The necessary but insufficient

condition for cointegration is that the variables be integrated of the same order. Since all the variables are integrated of order 1, this implies evidence ofcointegration between them.

4.1.1 RESIDUAL TEST FOR COINTEGRATION

We use Engle &Grenger cointegration procedure by generating the residuals and test the order of integration of the residual. Mathematically the residual is derived thus:

$Y= a_0 + a_1X_1 + a_2X_2+ a_3X_3 +Ui$

$Ui= Y- a_0 - a_1X_1 - a_2X_2- a_3X_3$

Where Ui= residual

Decision Rule (Ui)

If the ADFstatistics of the residual>critical value at level form, we conclude that there is a cointegration between the dependent variable and the independent variables in the models.

RESIDUAL TEST RESULT

VARIABLE	ADF TEST STATISTIC	CRITICAL VALUE @ 5%
RESID01	3.209717	2.9705
RESID02	3.767747	2.9705

Since the ADF test statistic>critical value @ 5% in both models 1 & 2, this implies that there exists a long run relationship between the variables. We therefore estimate the ECM(Error Correction Model):

4.1.2 ECM TEST RESULT

VARIABLE	COEFFICIENT
RESID01(-1)	-0.206170
RESID02(-1)	-0.929799

The coefficient of ECM in model 1 is -0.206, implying that 20.6% of the disequilibrium in the model is corrected every year.

In model 2, the coefficient of ECM is -0.9298, implying that 92.98% of the disequilibrium in the model is corrected every year. These results suggest that the speed of adjustment is higher in model two than in model one.

4.1.3 REGRESSION RESULTS

MODEL 1

VARIABLE	COEFFICIENT	STANDARD ERROR	t-Statistic	PROBABILITY
C	12.27120	0.053292	230.2626	0.0000
EXD	-9.41E-08	2.29E-08	-4.101033	0.0004
INF	0.001453	0.001399	1.039014	0.3084
EXR	0.008634	0.000594	14.54193	0.0000

R^2 = 0.916292

$\bar{R}^2$=0.906633

F =94.86724

DW = 1.832744

MODEL II

VARIABLE	COEFFICIENT	STANDARD ERROR	t-Statistic	PROBABILITY
C	177097.2	19262.94	9.193679	0.0000
EDS	0.092692	0.024757	3.744154	0.0009
GEX	0.140861	0.005448	25.85625	0.0000
INT	2729.815	965.9784	2.825959	0.0089

R^2 = 0.970023

$\bar{R}^2$=0.966564

F =280.4398

DW = 1.587174

4.1.4 INTERPRETATION OF REGRESSION RESULT

MODEL I

If P<0.05, the variable is significant or otherwise.The above result in terms of coefficients and probabilities of the regression can be interpreted as follows;

The intercept is 12.27120. This shows that if all explanatory variables were held constant, GDP will be 12.27120 all things being equal.

The coefficient of external debt sock is -9.41E-08 and P=0.0004. This indicates thatdebt stock is negatively related to GDP (a unit increase in external debt stock will reduce GDP by 9.41E-08) and its impact on growth is significant.

The coefficient of inflation is 0.001453 and P=0.3084. This indicates that inflation rate is positively related to GDP (a unit increase in GDP is followed by an increase in inflation by 0.001453) though it has no significant impact on growth.

The coefficient of exchange rate is 0.008634 and P=0.0000. This indicates that, exchange rate is positively related to GDP (a unit change in exchange rate will change GDP by 0.008634) and that it exerts a significant impact on growth.

MODEL II

The intercept is 177097.2. This shows that if all explanatory variables were held constant, GDP will be 177097.2 all things being equal.

The coefficient of external debt service is 0.092692 and P=0.0009. This indicates that external debt service is positively related to GDP (a unit increase in debt service will improve GDP by 0.092692) and it has significant impact on growth.

The coefficient of government expenditure is 0.140861 and P=0.0000. This indicates that government expenditure is positively related to GDP (a unit increase in government expenditure will increase GDP by 0.140861) and it has significant impact on growth.

The coefficient of interest rate is 2729.815 and P=0.0089. This indicates that interest rate is positively related to GDP (a unit change in interest rate will change GDP by 2729.815) and it hassignificant impact on growth.

Referring to Chapter 2 of this work, Clement et al(2003), found that external debt stock of public debt does not depress public investment but debt service does. This result contradicts their finding.

4.2 EVALUATION OF RESULT

4.2.1 Evaluation Based On Economic "a priori" Criteria

This test is carried to ascertain if the parameter estimates conform with what economic theory statesin terms of sign and magnitude. The test is summarized in the table below;

VARIABLE	EXPECTED SIGN	OBSERVED SIGN	CONCLUSION
EXD	NEGATIVE	NEGATIVE	CONFORMS
INF	NEGATIVE	POSITIVE	DOES NOT
EXR	POSITIVE	POSITIVE	CONFORMS
EDS	NEGATIVE	POSITIVE	DOES NOT
GEX	POSITIVE	POSITIVE	CONFORMS
INT	NEGATIVE	POSITIVE	DOES NOT

Muoghalu et al (2007) found that a positive association exists between external debt stock and investment burdens. This also conforms to the result of the "a priori" test.

4.2.2 Evaluation Based On Statistical Criteria

4.2.2.1 R-squared:

R^2 (Decision Rule)

The higher the value of R^2, the higher the percentage of variation of the dependent variable, the better the R^2 of the regression plane to the sample observation while if closer to zero, the goodness of fit becomes worse. The value of R^2 lies between 0 and 1, therefore the closer the value to 0 or 1, it becomes worse or better respectively.

In model 1 and 2, the $R^2$is 0.916292 and 0.970023 respectively. This indicates that the independent variables explain the variation in GDP in the tune of 91.63% and 97% respectively. That is 91.63% and 97% of the variations in GDP is explained by the exogenous variables in model 1 and 2.

4.2.2.2 Student t-test

To test the individual significance of the explanatory variables, we make use of t-test. It follows t-distribution with n-k degrees of freedom.

Test for Hypothesis

Ho:βi=0 (The parameter is statistically insignificant)

Hi: βi≠0 (The parameter is statistically significant)

@ 5% level of significance

Decision Rule

Reject Ho if t-cal>t-tab otherwise accept Ho. t-tab= 1.706

VARIABLE	t-statistic	t-tab	CONCLUSION
EXD	4.101033	1.706	SIGNIFICANT
EDS	3.744154	1.706	SIGNIFICANT

4.2.2.3 F-test: The F-test is used to test the overall significance of the models.It is carried out under the following hypothesis;

Ho: $\beta_0 = \beta_1 = \beta_2 = \beta_3 = \beta_4 = 0$ (The model is insignificant)

H1: $\beta_0 \neq \beta_1 \neq \beta_2 \neq \beta_3 \neq \beta_4 \neq 0$ (The model is significant)

The theoretical F-value (F-tab) under 5% level of significance with V1= 3 and V2= 26 is 2.99

Decision Rule

Reject Ho if F-cal> F-tab otherwise accept Ho. In model 1:

F-cal=94.86724 therefore Model 1 is significant

Whereas in model 2:

F-cal=280.4398(Model 2 is significant)

We therefore reject Ho since F-cal>F-tab in both models and conclude that the models are significant.

4.2.3 Evaluation Based On Econometric Criteria

4.2.3.1 Test for Auto Correlation(Durbin Watson)

Decision Rule

If D=2, we accept that there's no autocorrelation among the variables.

If however, 0<D<2, there's positive autocorrelation among the variables.

If 2<D<4, there's negative autocorrelation among the variables.

The computed D (Durbin Watson) is 1.832744 and 1.587174 in Model I and II respectively, which reveals to us that there is positive autocorrelation between the Gross Domestic Product, external debt stock, inflation, exchange rate, external debt service, government expenditure and interest rate in Nigeria.

4.2.3.2 Normality Test

Test Hypothesis:

Ho: Ui= normally distributed

H_1: Ui≠ normally distributed

Decision Rule

Reject Ho if probability of JarqueBera, P<0.05

From the result, the JarqueBera coefficient is 0.599383 and its probability is 0.741047>0.05. We cannot reject the null hypothesis because P>0.05, therefore we conclude that the error term follows normal distribution.

4.2.3.3 Heteroscedasticity Test

Heteroscedasticity occurs when the variance of the error term is not constant. The test contains the following hypothesis:

Ho: $a_0=a_1=a_2=a_3=0$ (Homoscedasticity), the variance is constant.

H1: $a_0\neq a_1\neq a_2\neq a_3\neq 0$ (Heteroscedasticity), the variance is not constant.

Reject Ho if $P<0.05$

From the test result, $P=0.012366<0.05$, we reject Ho and conclude that the variance is not constant.

4.3 EVALUATION OF RESEARCH HYPOTHESIS

From the results and analysis so far, we see that external debt stock and external debt service have significant impact on GDP as is shownby t-test and their probabilities. The F-test also showed that the models are significant in explaining the variations in GDP. We therefore reject Ho (refer to Chapter 1) and conclude that external debt stock and external debt service both have significant impact on Nigeria's economic growth.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 SUMMARY OF FINDINGS

Since 1985, Nigeria has been engaged in debt servicing, rescheduling and buy back with its creditors. Yet its debt stock as at the end of 2004 was $36 billion dollars after having paid about $35 billion to its creditors on $15 billion which it actually borrowed. The situation could be blamed on two factors: (1) compound interest accrued to the actual loan within these years; and (2) the disposition of the Paris Club of Creditors towards the restructure of Nigerian debt for political reasons.

The major findings of this study are highlighted below:

i. It was found that there is a general increase in the external debt stock of the country over the years mostly due to accrued volatile compound interest and the ever increasing appetite of various governments to secure loan for dubious projects.

ii. It was also found that the external debt of Nigeria has been unproductive in terms of its contribution to the growth process of the country due to corruption and challenges of debt sustainability. The effect of the debt service payments was not found to impair economic growth thereby not eroding the gains of the external debt.

5.2 CONCLUSION

Nigeria's debt crisis can be attributed to both exogenous and endogenous factors such as the nature of the economy, economic policies, dependency on oil, dwindling foreign exchange receipts etc. The origin of Nigeria's external debt dates back to 1958. Debt service payments were within manageable limits until 1982, but became unmanageable in 1983 because of the preference for private lending.

However, Nigerian political leaders need to develop homegrown policies to enhance the country's competitive advantage in the international market in this era of globalization. Besides, conscious efforts must be made to secure total exit from all forms of commercial debts that exposes the country to another regime of debt overkill. Nigeria must also explore and develop more export products outside crude oil.

5.3 RECOMMENDATIONS

Based on the findings of this study, Nigeria can only avoid future debt management problems if only they take the following recommendations.

1. Nigeria should ensure that debt service obligations do not rise rapidly than foreign exchange earnings.

2. Loans contracted should be invested in profitable ventures, which will generate a reasonable amount of money for debt repayment. External finance should be used only for projects of highest priority such as mineral resources, education and agricultural projects.

3. Foreign borrowing by private and public organizations should be adequately monitored by the government debt agency – Debt Management Office (DMO) and all the external loans contracted should be reported to the agency so that an up to date record of the

volume of debt can be kept. Transparency and accountability are high on the agenda of modern debt management practices.

4. The composition of the external debt should be regularly checked in order to forestall problems associated with the bunching of debt service obligations.

5. Adequate safeguards should be put in place to cope with the sudden or unexpected shortfalls in earnings from exports or anticipated expenditures on imports.

6. The principal vulnerability of Nigeria is to an open ended burden of higher interest payment. The use of superior method to negotiate for fixed interest payment and varying amortization schemes is necessary. Nigeria should seek multi-year reschudling rather than year by year basis.

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APPENDIX I

Regression Data for The Effect of External Debt on Economic Growth of Nigeria (1981-2010)

Year	RGDP (N'M)	EXD (N'M)	INF	EXR	EDS (N'M)	GEX (N'M)	INT
1981	205222.1	2331.2	21.42	0.61	600	11413.7	7.75
1982	199685.3	8819.4	7.16	0.67	700	11923.2	10.25
1983	185598.1	10577.7	23.22	0.72	1300	9636.5	10
1984	183563	14808.7	40.71	0.76	0	9927.6	12.5
1985	201036.3	17300.6	4.67	0.89	1335.623	13041.1	9.25
1986	205971.4	41452.4	5.39	2.02	2582.772	16223.7	10.5
1987	204806.5	100789.1	10.18	4.02	2974.8	22018.7	17.5
1988	219875.6	133956.3	56.04	4.54	7181.826	27749.5	16.5
1989	236729.6	240393.7	50.47	7.39	16023.74	41028.3	26.8
1990	267550	298614.4	7.5	8.04	28722.1	60268.2	25.5
1991	265379.1	328453.8	12.7	9.91	34040.85	66584.4	20.01
1992	271365.5	544264.1	44.81	17.3	41391.98	93835.5	29.8
1993	274833.3	633144.4	57.17	22.05	39083.63	136645.4	36.09
1994	275450.6	648813	57.03	21.89	40343.27	156837.2	21
1995	281407.4	716865.6	72.81	21.89	35474.93	254038	20.18
1996	293745.4	617320	29.29	21.89	41078.77	282969.6	19.74
1997	302022.5	595931.9	10.67	21.89	32760.57	428215.2	13.54
1998	310890.1	633017	7.86	21.89	27855.9	487113.4	18.29
1999	312183.5	2577374	6.62	92.52	159587.7	947690	21.32
2000	329178.7	3097384	6.94	109.55	187988.9	701059.4	17.98
2001	356994.3	3176291	18.87	112.48	239376.6	1018026	18.29
2002	433203.5	3932885	12.89	126.4	147685.8	1018156	24.85
2003	477533	4478329	14.03	135.4	244976.5	1225966	20.71
2004	527576	4890270	15.01	132.67	232802.7	1426200	19.18
2005	561931.4	2695072	17.85	130.29	1164912	1822100	17.95
2006	595821.6	451461.7	8.24	128.27	863154.5	1938003	17.26
2007	634251.1	431079.8	5.38	117.97	120570.1	2450897	16.94
2008	672202.6	493180.2	11.6	132.56	61591.35	3240820	15.13
2009	716949.6	590441.1	12.5	149.58	64026.22	3452990.8	18.36
2010	775525.7	689845.3	13.7	150.66	53300	4194217.9	17.59

Source: Debt Management Office (DMO), Central Bank of Nigeria's Statistical Bulletin and Annual Reports for various years.