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**| RESEARCH ARTICLE****Impact of Government Debt on Nigeria's Economy Growth****IBUKUNOLUWA ADEBIYI<sup>1</sup> and TOHEEB AKANBI MUSLIUDEEN<sup>2</sup> ✉**<sup>12</sup>*Economic Growth and Development, University of Ibadan***Corresponding Author:** TOHEEB AKANBI MUSLIUDEEN, **E-mail:** [toheebakanbi3@gmail.com](mailto:toheebakanbi3@gmail.com)

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**| ABSTRACT**

Government debt and its importance to revenue generation have generated a lot of debate over the years in Nigeria, particularly with respect to economic growth. This paper examines the effect of government debt on economic growth in Nigeria between 1986 and 2022. The study reveals that the impact of government debt on economic growth over the period under review is significant- with external debt, which has been enormous over the years, contributing minimally to real gross domestic product. The study makes use of a multiple regression model to check the relationship that exists between government debt and Nigeria's economy growth. The findings of the study reveal that if the cause of consistent borrowing is not curbed, the economy will slump further, resorting to surplus budgeting and igniting increases in unemployment, decreases in total investment, falling reserves, increased exchange rate high inflation and consequently increased poverty. Borrowing is thus recommended as a last resort by the government to revitalize the economy, and if necessary, the loans should be sourced within the economy so that when the principal and interest on the loans are paid back, it will serve as a crowd-in-effect, which in turn accelerates economic activities in the country. Also, other alternative sources of government revenue, especially taxation hitherto neglected, should be explored to minimize dependence on borrowed funds to revamp the economy. Finally, power should be made steady so that the costs of sectors that rely on alternative energy sources to thrive can be decreased; thus, such monies can be utilized for remunerative alternative employment.

**| KEYWORDS**

Public Debts, Economic Growth, Internal Debt, Exchange Rate, External Debt

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**1. Introduction****1.1 Background to the Study**

Governments borrow when their spending exceeds their revenue. Thus, internal and external debt are crucial tools for governments to use to finance public spending, especially when it is challenging to increase taxes and cut spending. This method has resulted in the majority of countries having enormous unpaid debts over time. The key to accelerating economic growth is prudent borrowing to fund public and infrastructure projects.

In any economy, one of the ways to finance capital projects is through external debt. It is usually assumed that Nigeria and other emerging nations will borrow money from abroad to complement domestic savings when faced with insufficient capital. The relationship between foreign and domestic saving, investment, and economic growth determines the pace at which countries borrow from other countries. The major lesson learnt from the literature on "growth with debt" is that a nation should borrow money from abroad as long as the capital gained yields a return greater than the cost of foreign borrowing. In that situation, the borrowing nation is using foreign savings to boost capacity and increase output.

Therefore, a country's external debt should lead to economic growth. Countries with strong levels of exports and heavy foreign debt may be able to maintain their level of external debt. The service of external debt, which is also a sign of a bigger current account deficit, can result in debt overhang in a nation, which offers a higher danger to economic success if it is not sustainable (Shabbir, 2009). When a country's debt level reaches a particular point, paying off its debts becomes a big burden, and it is on the wrong side of the debt-laffer curve, where debt crowds out investment and growth. The weight of debt service has hampered Nigeria's rapid economic growth and made social issues worse (Audu, 2004).

Inferentially, a high level of public debt outstanding translates into expensive debt servicing as a result of a rise in the budget deficit, which is supported by raising public borrowing levels and raising the level of the country's public debt. The accumulating of such debt may expose the government to macroeconomic risks like cutting back on social and development plans. It may also lock the country in a debt trap by limiting sovereign fiscal options. As a result, it would undermine the goals of the social and economic development for which the debt was raised (Fan, 2007).

Governments have recently become more interested in domestic borrowing (Beaugrand, Loko, and Mlachila, 2002; Eichengreen, Hausmann, and Panizza, 2007; Hanson and Slaughter, 2005). In addition, a number of non-bank participants entered the market as a result of the financial system reforms, particularly the establishment of the Debt Management Office (DMO) in 2000 and the introduction of a new fully funded pension fund scheme in Nigeria in 2004.

The 2004 Pension Reform Act decentralized and privatized the nation's pension system, resulting in the development of pension fund managers and the creation of a sizable pool of long-term funds that are now available for investments. For instance, in compliance with the provisions of the Pension Reform Act of 2004, Leadway Pensure PFA Limited (Leadway Pensure) was incorporated as a pension fund administrator on the 25th day of August 2004. With an authorized share capital of N2.0 billion and a shareholders fund in excess of N7.6 billion, unaffected by losses, Leadway Pensure, formed by a group of three (3) significant financial service organizations, is one of Nigeria's best-capitalized PFAs. The nation's internal debt market activity may have also increased as a result of this. The worries regarding the debt's sustainability and stability, as well as its potential implications on the economy, are the topics that are frequently brought up.

The role of public debts in fostering economic growth has been studied over time by a number of scholars, but recently, it has seen a very notable resurgence that is probably due to the significant deterioration of public finances in various economies brought on by the 2008 financial crisis (Alejandro & Ileana, 2017).

### **1.2 Statement of the Problem**

Because of their massive public debt loads and debt servicing obligations, African nations in general and Nigeria in particular were unable to increase domestic investment levels, which would have boosted growth and development (Clements et al., 2003).

Nigeria's external debt accumulation increased from N2.3 billion to N328.5 billion in 1990, respectively, prior to the debt reduction in 2005. The country's external debt stock ranged between N3176.3 billion and N896.8 billion between 2000 and 2010. It increased further by 2014, reaching N1,631 billion, or over 42% of the nation's entire real gross domestic product (RGDP) ratio. The tragedy of subjecting the economy to outside shocks as a result of the external debt overhang thesis, however, is further exacerbated by recent debt levels (Peter & Ferdinand, 2016). The ongoing increase in the country's overall price level, fiscal imbalances, excessive government spending, and insufficient growth in the gross domestic product were all cited as contributing factors to the increase in the country's external debt accumulation since the commencement of the oil crisis of the early 1980s.

Despite declining tax revenues, the government had consistently grown its debt load. Due to uncertainty and poor project prioritization, large infrastructure projects that have already been completed or are now being completed lack the ability to repay debts. There are security issues with certain projects, like the train network, which prevent them from making enough money. Because they are not tolled, other improvements like highways are not

financially feasible. Aviation-related investments haven't generated enough money to repay the loans utilized to fund their implementation.

It is essential to thoroughly investigate the long- and short-term impact of government debt on economic growth using long period Nigeria-specific debt and growth related data and an advanced econometric method for improved policy formulation as the pursuit towards debt reduction that will enhance economic growth with a resultant improvement in poverty level intensifies. This is essential to improve domestic resource mobilization, reduce fiscal deficit, lower the amount of public debt, and uphold fiscal restraint that can help the economy get back on a higher growth path.

### **1. 3 Research Questions**

The following are the research questions for this study:

- 1). What are the effects of public debt on the economic growth of Nigeria?
- 2). Does a long run relationship exist between public debt and economic growth in Nigeria?

### **1. 4 Objective of the Study**

The main focus of this study is to:

- 1). To examine the effect of public debt accumulation on the economic growth of Nigeria.
- 2). To examine the link between public debt (internal and external ) and economic growth.
- 3). To determine the long-run relationship between public debt (internal and external) and economic growth in Nigeria.

### **1. 5 Statement of Hypothesis**

The following hypotheses are to be tested:

- 1). H<sub>0</sub>: That internal debt does not have an impact on the economic growth of Nigeria.  
H<sub>1</sub>: That internal debt has an impact on the economic growth of Nigeria.
- 2). H<sub>0</sub>: That external debt does not have an impact on the economic growth of Nigeria.  
H<sub>1</sub>: That external debt has an impact on the economic growth of Nigeria.

### **1.6 Significance of the Study**

Even though its revenue has decreased, Nigeria's debt load has steadily risen. Due to uncertainty and improper project prioritization, major infrastructure projects that have been completed or are now being completed lack the ability to repay loans. Nigeria's economy is in a crisis and would collapse if nothing is done because of the country's rising debt profile.

The goal of this study was to offer alternative measures of solutions to public debt management. It will also be used as a tool to restructure Nigerian government policy around the acquisition of loans and debt payments. This study could be used as a benchmark for future investigation and documentation on Nigeria's public debt crisis. The study's findings will help to establish a foundation on which policymakers can base their suggestions for handling Nigeria's debt crisis.

## **2. Literature Review**

### **2.1 Theoretical Literature Review**

According to economic theory, a developing nation's ability to borrow at reasonable rates will certainly help it thrive economically. Early-stage economies have a limited pool of capital and are, therefore, more likely to offer investment opportunities with a greater rate of return than those in advanced countries. As noted by Pattillo et al. (2004), growth should increase and enable timely debt repayment as long as these countries use the borrowed

money for productive investment and do not experience macroeconomic instability, policies that distort economic incentives, or significant adverse shocks.

### **2.1.1 Dependency Theory**

The dependency theory seeks to outline the factors that have contributed to the development of the underdeveloped countries. This theory is based on the assumption that resources flow from a "periphery" of poor and underdeveloped states to a "core" of wealthy states, thereby enriching the latter at the expense of the former. The phenomenon associated with the dependency theory is that poor states are impoverished while rich ones are enriched by the way poor states are integrated into the world system (Todaro, 2003; Amin, 1976).

Dependency theory contends that, contrary to what free market economists frequently claim, the poorer states in the world's periphery are not poor because they are not fully or sufficiently integrated into the global economy but rather because of the manner in which they are integrated. This view claims that the bourgeoisie scholars represent a common school of thought. They believe that domestic accidents are to blame for the underdevelopment and ongoing reliance of less developed nations on developed nations. They contend that this problem can be attributed to factors such as their lack of close integration, diffusion of capital, low level of technology, weak institutional framework, poor leadership, corruption, and mismanagement, among others (Momoh and Hundeyin, 1999).

### **2.1.2 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 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 by 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).

### **2.1.3 Debt Crowding-out Hypothesis**

The debt crowding out hypothesis states that rising debt servicing costs may increase a nation's budget deficit and lower public savings if private savings do not rise to make up the difference. This might, therefore, either crowd out financing available for private investment or increase interest rates, slowing economic development. Higher interest rates discourage private sector investment when the government borrows more money to pay for increased spending or tax cuts. The interest rate-sensitive private sector is likely to curtail investment due to a lower rate of returns if increasing borrowing results in higher interest rates through raising demand for money and loanable funds and so raising prices. 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).

## **3. Empirical Review**

Egbetunde (2012) examined the relationship between public debt and economic growth in Nigeria using the vector autoregressive approach and annual data from 1970 to 2010. According to the results of the VAR model, Nigeria's economic growth and its broken-down components of public debt are causally related in both directions. The study lacked any control variables and was based on data whose findings might have been affected by recent changes in the government debt position.

In a study using the Solow-Swan growth model with debt added as a factor, Babu et al. (2015) examined the impact of domestic debt on economic growth in East African countries between 1990 and 2010. A panel fixed-effect model that has heteroscedasticity corrected was chosen using the Hausman specification test. The findings revealed that the economies of East African nations grew significantly faster when domestic debt was taken into account. The study's conclusions, however, are based on international data, and Nigeria cannot use them to directly compare the two countries.

Using time series data from 1970 to 2007, Ogunmuyiwa (2011) investigated whether external debt encourages economic growth in Nigeria. Using econometric methods such as the Augmented Dickey-Fuller test, Granger

causality test, Johansen cointegration test, and vector error correction method (VECM), the regression model was calculated. The findings showed that there is no correlation between Nigeria's external debt and economic growth.

In their study on the impact of external debt on Nigeria's economic growth, Suleiman et al. (2012) used time series data spanning the years 1970–2010. Ordinary least squares (OLS), the Augmented Dickey-Fuller unit root test, the Johansen Co-integration test, and the error correlation approach were all used in the empirical analysis. The integration test demonstrates the long-term relationships between the variables, and results from the error correlation model showed that external debt has helped the Nigerian economy expand. According to the study's findings, Nigeria should maintain political and economic stability to achieve efficient debt management.

Obademi (2012) utilized the ordinary least squares (OLS) method in an augmented Cobb Douglas model to examine how Nigeria's public debt affected economic development. The budget deficit, total debt, domestic debt, and external debt were the variables used. Although it had a positive short-term effect, he discovered that debt had a long-term, major negative effect on economic growth. As a result of ineffective debt management, he came to the conclusion that while borrowing money had a favorable short-term effect on the Nigerian economy, it had a negative long-term effect.

#### 4. Theoretical Framework of Analysis

##### 4.1 Data Sources

This analysis uses secondary data from the National Bureau of Statistics, World Bank Estimates, CBN statistical bulletin, and Debt Management Office that spans a 36-year period from 1986 to 2022.

The dual-gap theory postulates that for development to occur, it requires investment, and this investment is a function of savings and investment, which requires domestic savings, is not sufficient enough to ensure that development takes place. The dual-gap framework is coined from a national income accounting identity, which states that excess investment expenditure over domestic savings is equivalent to the surplus of imports over exports. Thus at equilibrium, the following identities hold;

$$I - S = m - X \dots\dots\dots (1),$$

$$S - I = x - m \dots\dots\dots (2)$$

Where; I = Investment

S = Savings

M = Import

X = Export

The above equations show that the domestic resource gap ( $S - I$ ) is equal to the foreign exchange gap ( $x - m$ ). An excess of import over export implies an excess of resources used by an economy over resources generated by it. This further implies that foreign borrowing is determined overtime by the rate of investment in relation to domestic savings.

##### 4.2 Model Specification

The main aim of this study is to examine the Impact of External Debt on Economic Growth in Nigeria.

The model is adopted from a simple open macroeconomic debt growth model employed by Schalarek (2004) and Izedonmi and Ilaboya (2012). The model is specified in the functional form:

$$RGDP = f(GOVD, INF, EXR, CPI) \dots\dots\dots (1)$$

Thus, the stochastic equation becomes:

$$RGDP = \alpha_0 + \alpha_1 ID + \alpha_2 ED + \alpha_3 INF + \alpha_4 EXR + \alpha_5 CPI + \mu \dots\dots\dots (ii)$$

Where:

RGDP = Real Gross Domestic Product,

ID=Internal debt,

ED= External Debt,

INF Infrastructure proxied as index of Energy Consumption,

EXR = Exchange Rate;

CPI = Corruption Perception Index,

$\alpha_0$ - $\alpha_4$  - Parameters to be estimated,

$\mu$ = Error term

## 5. Data Analysis and Presentation

### 5.1 Model Summary

| <b>Table 5.1. Model Summary<sup>b</sup></b>                          |        |          |                   |                            |                   |          |             |               |
|----------------------------------------------------------------------|--------|----------|-------------------|----------------------------|-------------------|----------|-------------|---------------|
| Model                                                                | R      | R Square | Adjusted R Square | Std. Error of the Estimate | Change Statistics |          |             | Durbin-Watson |
|                                                                      |        |          |                   |                            | R Square Change   | F Change | Sig. Change |               |
| 1                                                                    | 0.995a | 0.990    | 0.988             | 2240.07275                 | 0.990             | 595.902  | .000        | 1.076         |
| a. Predictors: (Constant), EXR, ED (Million), CPI, ID (Billion), INF |        |          |                   |                            |                   |          |             |               |
| b. Dependent Variable: RGDP (Billion)                                |        |          |                   |                            |                   |          |             |               |

The significant value obtained from the model is less than 0.05 at a 95% confidence level. This shows that the variation observed in the regression model is statistically significant.

#### 5.1.1 The Durbin-Watson Statistic

As an economic criterion, an auto correlation test is carried out on time series data. The conventional Durbin Watson test was carried out to determine the auto correlation between the dependent variable, GDP, and the explanatory variables. The Durbin Watson auto correlation test is guided by three rules:

- A Durbin Watson value less than 2 indicates a positive auto correlation;
- A value of 2 indicates that there is no auto correlation, and
- A value greater than 2 indicates a negative auto correlation.

As reported in table 4.1, the Durbin Watson value obtained from the regression model is 1.076, which is less than 2. This shows that there is a positive auto correlation between the dependent and independent variables. A positive auto correlation would indicate that the value of the GDP last year (since the variables are measured in a year) has a positive correlation with the GDP this year.

#### 5.1.2 R<sup>2</sup> (Coefficient of determination)

As shown in the model summary presented in table 4.1, the R squared of the regression model is 0.990, which implies that approximately 99% of the variation in the dependent variable (RGDP) is caused by the explanatory variables included in this model.

### 5.1.3 Adjusted R2

From the model summary presented in table 4.1, the adjusted R2 of 0.988 gives a better measure of the goodness of fit, having been adjusted for the loss of a degree of freedom as more explanatory values, which are internal and external debts, are added.

### 5.2 Analysis of the Influence of Public debt on RGDP

In the regression analysis carried out on the data, the individual impacts of the predictors (independent variables; internal and external debts) are measured by the unstandardized coefficients and are presented in table 4.2 below:

| Table 5.2. Coefficients <sup>a</sup>  |              |                             |            |                           |        |      |
|---------------------------------------|--------------|-----------------------------|------------|---------------------------|--------|------|
| Model                                 |              | Unstandardized Coefficients |            | Standardized Coefficients | T      | Sig. |
|                                       |              | B                           | Std. Error | Beta                      |        |      |
| 1                                     | (Constant)   | -12741.291                  | 5710.546   |                           | -2.231 | .033 |
|                                       | ID (Billion) | .978                        | .246       | .288                      | 3.982  | .000 |
|                                       | ED (Million) | -.184                       | .074       | -.101                     | -2.487 | .019 |
|                                       | CPI          | 4274.711                    | 2042.809   | .137                      | 2.093  | .045 |
|                                       | INF          | 462.722                     | 60.170     | .734                      | 7.690  | .000 |
|                                       | EXR          | -28.843                     | 13.554     | -.170                     | -2.128 | .042 |
| a. Dependent Variable: RGDP (Billion) |              |                             |            |                           |        |      |

However, unstandardized coefficients are not useful for comparing the effect of an independent variable with another one in the model. Therefore, the standardized coefficients would be used to rank predictors (independent or explanatory variables) as they eliminate the units of measurement of independent and dependent variables. The most important variable will have the maximum absolute value of the standardized coefficient. As can be seen from table 4.2, infrastructure has the highest standardized coefficient of 0.734, which means that it has the highest impact (73.4%) among the explanatory variables in influencing the RGDP. This is followed by the internal debt and corruption perception index, with standardized coefficients of 0.288 and 0.137, respectively. External debt and exchange rate have coefficient values of -0.101 and -0.170, respectively, which reflected that these variables have a negative impact on the RGDP.

### 5.3 T-test

This is used to test the statistical significance of individual estimated parameters. The result of the test is shown in table 4.2. It can be deduced that the higher the standard coefficients of the predictors, the higher their t value. From the result obtained, internal debts and INF explanatory variables are statistically significant based on the t-test statistic. Internal Debt (ID) has a t-test value of 3.982 and a p-value less than 0.05; External Debts (ED) has a t-test value of -2.487 and a p-value greater than 0.05. CPI has a t-test value of 2.093 and a p-value greater than 0.05; INF has a t-test value of 7.690 and a p-value less than 0.05; and EXR has a t-test value of -2.128 and a p-value greater than 0.05. Therefore, it can be concluded that only internal debts and INF have a significant impact on the RGDP.

### 5.4 F-test

The F-test, which follows an F-distribution, measures the overall significance of the model. The results obtained indicated that the model has an F-distribution value of 340.779 and a p-value of 0.000, which is less than 0.05 at a 95% confidence level. It can, therefore, be concluded that the model is statistically significant. The result of the ANOVA is presented in table 5.3.

| Table 4.3: ANOVA <sup>a</sup>                                        |            |                 |    |                |         |                   |
|----------------------------------------------------------------------|------------|-----------------|----|----------------|---------|-------------------|
| Model                                                                |            | Sum of Squares  | df | Mean Square    | F       | Sig.              |
| 1                                                                    | Regression | 14950970946.903 | 5  | 2990194189.381 | 595.902 | .000 <sup>b</sup> |
|                                                                      | Residual   | 150537777.657   | 30 | 5017925.922    |         |                   |
|                                                                      | Total      | 15101508724.560 | 35 |                |         |                   |
| a. Dependent Variable: RGDP (Billion)                                |            |                 |    |                |         |                   |
| b. Predictors: (Constant), EXR, ED (Million), CPI, ID (Billion), INF |            |                 |    |                |         |                   |

### 5.5 Standard Error

The standard error of estimates (SEE) was used to measure the standard error of the stochastic term. The SEE value, as seen in table 4.1, is 2240.072. The standard error of the estimates is small relative to the mean value of the dependent variable (which is 41453.50); therefore, the model equation is preferred.

## 6. Summary, Conclusion and Recommendation Summary of Findings

### 6.1 Summary

The empirical result also revealed that internal debt have contributed minimally to economic growth. ID has a positive contribution, while ED has a negative contribution. Although borrowing may be viable for government revenue, its impact is negligible- arising from the funds borrowed. The coefficient of ID is positive, suggesting that even if the government resorts to borrowing, it should be domestic as it shoulders no pressure, unlike the requirements of world financial institutions for external debts. The CPI, however, shows that there is hope for growth if corruption can be curbed to a minimum; INF in the study reveals that a unit change in energy consumption will cause output in the economy to increase by 73.4 of that unit change. The adjusted R' shows a strong relationship between the dependent and independent variables, with only 1% of the variations unaccounted for. This implies that ID, ED, INF, CPI and EXR can explain 99% of the changes in RGDP in Nigeria.

### 6.2 Conclusion

The findings reveal that mounting external debt has adverse implications for the Nigerian economy. The study concludes that the impact of government debt on economic growth is significant. This implies that the dual gap theory is relevant to the Nigerian economy due to its positive impact. Thus, government external borrowing has not been able to influence growth significantly in Nigeria. Corruption serves as one of the major factors for this insignificance as such monies are misappropriated, mismanaged or embezzled. The consistent borrowing has led to an increase in unemployment, decrease in total investment, falling reserves, increased exchange rate, high inflation and increased poverty.

### 6.3 Recommendations

The following suggestions for government organizations are offered in light of the findings. The debt ratio is a tool used by non-governmental organizations and policymakers when making financial decisions.

1. The government should only borrow as a last resort to stimulate the economy, and if it must, it should source the loans locally to create a crowd-in effect that will speed up economic activity in the nation once the principal and interest on the loans have been repaid.
2. To reduce reliance on borrowed cash and bolster the economy, it is important to explore additional sources of government funding, particularly taxes.
3. Power needs to be stabilized in order to enhance production. This will lower the cost for sectors of the economy that depend on alternative energy.
4. Since the exchange rate is determined by the relative prices of commodities in other nations, the monetary authority (CBN) should adopt a contractionary posture of money supply in order to raise the value of the naira.



5. To avoid mismanagement of borrowed money, the government should maintain effective monitoring

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