

APPRAISAL OF NIGERIA'S EXTERNAL DEBT MANAGEMENT

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**DEPARTMENT OF BANKING & FINANCE, FACULTY OF BUSINESS
ADMINISTRATION, UNIVERSITY OF NIGERIA,
ENUGU - CAMPUS.**

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**BEING A DISSERTATION PRESENTED TO THE DEPARTMENT OF BANKING
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SUPERVISOR: PROF J.U.J ONWUMERE

2015

DECLARATION

I, Ogunsola Olayemi Akintayo, a postgraduate student in the Department of Banking & Finance, with registration number PG/M.Sc/08/47309 do hereby declare that the work embodied in this dissertation is original and has not been submitted in part or in full for any other Diploma or Degree of this or any other University.

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APPROVAL PAGE

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DATE

DEDICATION

This dissertation is dedicated to the Almighty God for His guidance, protection and source of my inspiration throughout the course of my study. Finally to my parents Mr. Olukayode Abayomi Ogunsola and Mrs. Adetunke Caroline Ogunsola for their love and support.

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ABSTRACT

This study reflects an appraisal of Nigeria's External Debt Management necessitated by inadequate internal capital formation arising from vicious cycle of low productivity, low income and savings in the Nigerian economy. Considerable linkage has been established between external debt and economic performance. The study determined the impact of Nigeria's external debt stock on gross domestic product and also examined the impact of external debt penalties on arrears for default of external debt stock covering a period of 25 years, 1989-2014, using secondary data. The study used ordinary least square (OLS) estimation technique for analysis. Findings showed that external debt stock had a negative significant impact on gross domestic product. Threats associated with borrowing externally for capital formation in Nigeria outweigh the benefits therein. There was a positive significant impact of penalties arrears for default on external debt stock. An increase of external debt stock as a result of rising penalties on arrears has deepened the burden of debt and its sustainability in Nigeria. External debt by economic sector to support infrastructure should be taken into consideration, which is in accordance with the provisions of the Fiscal Responsibility Act and the National Debt Management Objectives & Strategy. Also external debt service payment should be paid as at when due to avoid accumulation of compounding late interest on penalty payment which in the past had contributed immensely to the deteriorated debt situation in Nigeria within the period under study.

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ABBREVIATION

DSA	- Debt Sustainability Analysis
NPV	- Net Present Value
GDP	- Gross Domestic Product
HIPC	- Highly Indebted Poor Countries
IDA	- International Development Association
IMF	- International Monetary Fund
DAC	- Development Assistance Committee
NBS	- National Bureau of Statistics
ADB	- African Development Bank
SDR	- Special Drawing Right
GBP	- Great Britain Pound (Sterling)
NGN	- Nigeria Naira
JPY	- Japanese Yen
USD	- United States Dollar
EUR	- Euro
KRW	- Korean Won
DMO	- Debt Management Office
CBN	- Central Bank of Nigeria
CPIA	- Country Policy and Institutional Assessment
NPC	- National Planning Commission
SGED	- State Government External Debt
FMF	- Federal Ministry of Finance
OECD	- Organization for Economic Cooperation and Development
LDC	- Least Developed Countries

CHAPTER ONE

INTRODUCTION

1.1 BACKGROUND OF THE STUDY

Debt is created by the act of borrowing. It is defined according to Oyejide, Soyede, and Kayode (1985), as "the resource or money in use in an organization which is not contributed by its owners and does not in any other way belongs to them". It is a liability represented by a financial instrument or other formal equivalent. Legally debt is a chose in action transferable by the creditor to some other person debtor provided that the transfer is in writing and confirmed seal (Anyafu 1996). When a government borrows, the debt is a public debt. Public debt either, internal or external is debt incurred by the government through borrowing in the domestic and international market respectively, so as to finance domestic investment. Public debts are outstanding payment or contractual obligations of all tiers of government (Federal, State and Local) public corporations and parastatals (Anyafu 1996).

After an attempt definition of public debt and debt, Uche (2005:127) defines external debt of a country as the summation of indebtedness of a country to other countries, institutions and non-residents of that country. The contractual liabilities are denominated in foreign currencies. In essence external debt can therefore be seen as the foreign exchange component of public debt. For the context of this research, Nigeria external debt management will be analyzed in terms of structure, genesis, challenges and contemporary issues. External debt in real sense is not bad, it depends on how the funds were applied, if it is prudently applied it facilitates international trade, improves the International image of a country, buoys the economy of a country and improve infrastructure and general standard of living of a country. However where undue pressures exerted on the external debt to the point where available reserves are unable to support debt repayment such debt now becomes burden to the debtor.

The origin of Nigeria debt problems are related to both the nature of the economy, economic policies put in place by the successive government as well as exogenous factors beyond the control of government. The country is a mono-product economy; depending largely on oil revenue which accounts about 80% of foreign exchange receipts. It is therefore not a surprise that whenever the international oil market fluctuates, Nigeria react more rapidly.

Government's debt portfolio is usually the largest financial portfolio in a country. It often contains complex financial structures and can create substantial balance sheet risk for the government. Large and poorly structured debt portfolio also make governments more vulnerable to economic and financial shocks and have often been a major factors in economic crisis (IMF, 2003:10).

Considering overall macroeconomic policy, debt management policy plays an important role in ensuring and maintaining long-term debt sustainability. Jill and Caroline (2004:6) stress that following world war I, foreign governments began to issue large amounts of bonds in New York city. In the early 1920, the principal issues of sovereign bond were Argentina, Chile, Brazil and Cuba (Erika and Jeffrey 1989:53). Over the course of the decade as the bond market grew banks established extensive network of branches that unsuccessfully marketed the bonds to individual sovereign debtors, eager for the large premia they offered over domestic returns (Albert, 1983:419-20). With the beginning of the great depression, these sovereign debtors experienced difficulty servicing their debts (Vinod 2003:13). In December 1930, Bolivia failed to meet sinking fund requirement on its bonds, and in January 1931 the fiscal agent for the bonds declared Bolivia to be in default making it the first country in history to default on its bonds (Eichengreen and Portes 1993:21). This was followed by default on bonds issued by Peru, and soon Chile followed this suit. By 1933 twelve Latin America sovereign debtors suspended at least part of their debt servicing and by 1934, only Argentina, Haiti and the Dominican republic had not suspended normal debts servicing (Wallich 1943:321). International debt crisis has a history nearly as long as international debt flow (Gray 2002:1). Bordo (1998:3) argues that financial integration has followed a U-shaped pattern: it was at very high levels until the early twentieth century, collapsed between the wars, and then has gradually returned to pre-1914 levels.

Williamson (1999:11) argues that when debt servicing capacity was undermined by decreased oil prices and the world recession of the early 1980s at the same time that global interest rates soared because the West Europe decided to bring inflation down and crisis ensued. The debt managers primary objectives of securing funds to finance the government deficit is complemented by objectives of minimizing the cost and risks of the debt portfolio and promoting financial development and efficient market.

There has been an inspiring development around Nigeria's public debt management issues, in terms of growing interest and participation by stakeholders. This development which has

manifested in various forms including comments, enquires, concerns, critics and suggestions demonstrates that the efforts of the Debt Management Office (DMO) to democratize public debt management knowledge and practice is producing the desired results. It represents a growing effective demand for public debt management services, which is very essential for guaranteeing and sustaining quality supply of the services. In this context, it would be useful to present to stakeholders and the general public the true position of the country external debt, even after the paying off of the Paris club and London club debts. Indeed, some of the loans were contracted in the 1960s, 1970s and 1980s for various infrastructure and social development projects. There is no doubt that some of the infrastructures funded in those periods are still useful assets to the people. The repayment were scheduled to be gradual so as not to put serious burden on fiscal resources that part of them are still outstanding. That the loans have a long repayment period is beneficial, given the nature of the projects and services they financed i.e. basic education, health and rural water supply as well as roads whose revenue generating impact is at the best slow, small and indirect.

1.2 STATEMENT OF THE PROBLEM

In this research effort, there is a problem (fundamental questions) necessitating the investigation and study, reflecting the obvious fact that Nigeria is in debt.

Nigeria's External Debt Stock "was characterized by excessive and poorly controlled borrowing, a situation in which poor debt management practices has become a recurring event in the country" (DMO 2009:44). Nigeria began to experience external debt problems from the early 1980s when foreign exchange earnings plummeted as a result of the collapse of prices in the international oil market, and external loans began to be acquired indiscriminately. Most of the borrowing was not linked to future growth, export or targeted at impacting positively on the GDP. Some financial creditors before the fall in world oil prices classified Nigeria to be under borrowed. The applause given to Nigeria, made the rule of law on external borrowing to be upheld up to 1979. However during the period 1980-1983, there was an unfortunate departure from the guidelines, thus the federal government and the 19 state governments, each on its own account, borrowed from foreign sources.

State Governments were able to negotiate huge external project finance with a retroactive federal Government approval and guarantee. Due to poor control by the Shagari led federal Government, there was difficulty to exactly determine the volume of Nigeria's external debt.

At this period, the government relied heavily on foreign resources, a situation where shortage of foreign exchange become one of the bottlenecks to national economic development.

Accumulation of Penalties for default on Nigeria's External Debt Stock is another salient factor that causes Nigeria's external debt burden. The international creditors through a compounding method sanctioned heavily on default of principal repayment, interest charges and other surcharges which penalty charges has a great significance, because it threatens economic growth. This situation makes the international inflows of financial resources not to accommodate production capacity vis-à-vis total export of goods and services.

High cost of borrowing and debt refinancing is a major factor of Nigeria's debt stock. The over dependence on crude oil as a major revenue is a contributory factor to external burden of debt, because when the oil prices fell, the interest rate went up which did not result to reduced borrowing and spending of the Nigerian government, thus its level of debt started to increase.

The terms on which the country's loan from the international capital markets was contracted were unfavourable primarily because the loans not only carried variable interest rates which increased the vulnerability of the economy but also had shorter maturity. Also, the repayment schedules were bunched too close together and involve several other indirect costs, yet rescheduling does not eliminate the debt but merely pushes the payment to a latter date

Poor debt utilization has become significant as debt management is of great significance because loan will turn out to be good or bad depending on its negotiation and utilization. The negotiation of external debt/ loan by public and private bodies has been indiscriminately contracted not minding the terms associated to it, such as (interest rate, maturity, penalty of defaulters i.e. compounding). Utilization of external debt/borrowing should be prudently based. A short term borrowing to finance a long term project is definitely a mismatch while a loan utilize to finance unviable project will eventually become problematic as the loan will have no chance to liquidate itself. Therefore debt serving problems set in through compounding interest leading to debt overhang in the economy. Nigerian government over the years has finance various white elephant project using fund contracted externally mostly on stringent condition.

Ihimodu (1985;108) observed that ñKwara state contracted from a foreign private company loans worth N200 million specifically to transform its existing college of technology into a university yet it was obvious that such a project was incapable of generating funds at least immediately to service the debt.

In other words, **Mismatch of debt maturities against project yields** is a great impediment to external financing of development in a country.

The country in the 21st century still struggle with financial distress. Rapid accumulation of external debt and payment arrears have constrained the scope of economic management and led to a consequent constraint on economic growth. A mismatch of debt maturity against project yield poses a threat.

A borrower must ensure that the maturity structure of any debt favours the project yield otherwise, cash flow problem would arise as the borrower finds that the project income distribution is sufficient to offset the debt obligations as and when due. In Nigeria's case certain worthwhile industrial project such as steel and paper mills were financed with short and medium term loans with amortization falling due to before project completion and current account deficits were financed with short term credits.

It is quite evident that Nigeria's external debt burden rest upon present and future generation. Recommendation and result oriented strategies for mitigating against possible external debt management problems in Nigeria in the future will be proffered.

1.3 OBJECTIVES OF THE STUDY

This research work has a primary objective which is an appraisal of Nigeria's external debt management, with special focus on structure, source, control and utilization of external debt of the government of Federal Republic of Nigeria. The secondary objectives of this research include:

- i. To determine whether there is a significant impact of Nigeria's External Debt stock on Gross Domestic Product.
- ii. To examine whether the external debt penalties on arrears for default have impact on Nigeria's external debt stock.

1.4 RESEARCH QUESTIONS

These are very fundamental to this study and the researcher.

- i. Does Nigeria's external debt stock have significant impact on the Gross Domestic Product ?
- ii. Does external debt penalties on arrears for default have positive impact on Nigeria's external debt stock ?

1.5 RESEARCH HYPOTHESES

This is a tentative statement about phenomena whose validity is usually unknown. (Onwumere 2009:25). Hypothesis serves as a powerful beacon that light the path for the research work. Uzoh (2000) also describe "hypotheses as necessary whenever cause and effect relationship are to be discovered". Thus formulating hypothesis as framework for this study becomes imperative.

These hypotheses in specific form are:

H₀: External debt do not have a significant negative impact on Gross Domestic Product (GDP).

H₀: External debt penalties on arrears for default do not impact positively on Nigeria's external debt stock.

1.6 SCOPE OF THE STUDY

This study is restricted to external debt as it poses a threat to the National economies of debtor countries including Nigeria. The World Bank Annual Report (1977) identified "external debt problem as a present day major obstacles that must be cleared from the development path to ensure progress in developing countries".

This research is therefore limited to the management of Nigeria's external debt with an appraisal on its control, challenges, utilization profile and impact as stated in the hypothesis. The external debt is thus seen as a financial resource for national economic development.

The time span covered by the main thrust of the study was 1989-2014, focusing on **Appraisal of Nigeria's External Debt Management of the Government of the Federal Republic of Nigeria**. The period 1989-2014 was selected based on the availability of consistent data and at 1989 Nigeria's debt stock started to rise persistently.

1.7 SIGNIFICANCE OF THE RESEARCH

Uloglobui (2007), identified that research work was not initiated and commissioned for the sake of it but for some significant benefits to the managers of Nigeria's External Debt profile, the academic (student and experts) and the society at large. This research work will be of significance to:

1. Government
2. Economic Policy Makers
3. Institutions, Researchers, Professionals, Business Associate/Mogul & Corporate Bodies
4. General Public

This research work will assist Nigeria Government in policy and decisions as regards borrowing outside the shores of the country. The work will also present the Impact of Nigeria External Debt Stock on Gross Domestic Product, vis-à-vis Nigeria Debt Management approach to Debt Sustainability, thereby allowing the managers of the nation's Debt portfolio in ensuring a dynamic and efficient Debt Management Approach in Nigeria.

It will examine the consequences of Penalties on Arrears for Default on Nigeria External Debt Stock. Its findings will aid Economic Policy Makers and Government in proffering policies aimed at timely Servicing of Nigeria External Debt Stock to avoid compounding penalty payment for default vis-à-vis Debt crisis situation in Nigeria.

The study will serve as a body of reserved knowledge to be referenced to by Institutions, Researchers, Professionals, and Business Associate/Mogul & Corporate Bodies in making corporate business and academic decisions. It will contribute significantly to the enrichment of the literature External Debt Management.

The research work will awaken the consciousness of the General Public to the sensitivity of External Debt Stock to the Growth of the Economy and the Penalty on Arrears for Default on External Debt Servicing.

1.8 OPERATIONAL DEFINITION OF TERMS

For this study, terms as used here imply the key words which will be employed in the course of his research. This includes:

External debt to Export Ratio: This signifies the extent to which the debt outstanding and disbursed is accommodated by the annual export earnings.

External debt to GDP Ratio; Indicates the intensity of external debt burden on the economy.

Debt Sustainability; ñis the level of debt which allows a debtors country to meet its current future debt services obligations in full, without recourse to further debt relief or rescheduling avoid accumulation of arrears while allowing acceptable level of economic growthò (UNCTAD/UNDP 1996)

Interest to Export Ratio: This gives consideration to export earnings to adequately accommodate interest payment.

External Debt Service to Government Revenue Ratio: It highlights the financial drain imposed on the economy and the extent to which the government must cut back domestic financial commitments in order to satisfy external debt obligations.

External Debt Service to Export Ratio: This expresses the extent to which the total foreign exchange earnings on current account are sufficient to offset the annual amortization and interests.

Interest to GDP Ratio: The level of burden which interest payment on external debt, as distinct from amortization imposes on the economy.

Debt service/Government Revenue Ratio: This ratio ñshows the fraction of government revenue devoted to servicing of debtò (DMO, 2004:7)

Sovereign Debt: The IMF (1988:1) defines sovereign debt as "a liability represented by a financial instrument or other formal equivalent owed to other parties by an independent state".

External Debt: Uche (2003:72) refers to the "summation of indebtedness of a country to other countries, institutions and non-residents of that country".

Foreign Bonds: This refers to bonds that are designated in foreign currencies and traded in foreign capital markets.

External Debt Management: Emmanuel (2004) refers to it to be "the technical and institutional arrangement as well as policy measures, involved in organizing external liabilities so that the debt service burden is contained within a sustainable level".

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CHAPTER TWO

REVIEW OF RELATED LITERATURE

2.1 CONCEPTUAL FRAMEWORK

Effects of external debt on growth generally reveal the debt overhang hypothesis, even if the link between debt and growth is not perfectly defined, because the relative incidence of the debt variables and the magnitude of the effects differ across different studies. Pattillo, et. al. (2002), ñshows how the stock of debt is the reason for a slow growthò. Chowdhury (2004), ñfind that both the debt burden and debt service obligations squeeze investment and the economic performanceò. Some early studies reject the hypothesis that the debt-to-GDP ratio depresses investment, while they find evidence in support of the relevance of debt service payments. Cline (1995) underlines

that debt relief makes sense only whether a country is on the wrong side of the debt laffer curve, but this is not always the case: he reports the result on some studies done in the 1980s which found the few countries were effectively on the right side of the diagram.

Clements, et. al. (2003) investigate the relationships between external debt, investments and growth in 55 low-income countries, finding some empirical evidence in favour of the debt overhang: estimating a simple growth model and using panel data, they find ñthat over a certain threshold, more debt lead to negative rates of growthò. Those threshold are lower than the ones used in the HIPC program (external debt is roughly 30-37 percent of GDP, OR 115-120 percent of export). Furthermore, they show that public investment are what really matters for economic growth: a one percent increase in public investment results in a 0.2% increase in GDP, but this positive linkage becomes less effective as long as public investments increase, because they lead to higher deficit and to higher levels of debt, which negatively affect economic growth.

Elbadawi, et. al. (1997) finds evidence for 99 developing countries of the debt overhang hypothesis: there data are consistent with an inverse-U shaped curve that has its maximum where the ratio of the current stock of debt to GDP is 0.97. Even if the result can change using different specifications, the general conclusion supporting the adverse effects of debt on growth is confirmed: current deficit stimulates growth, but there is a limit above

which past accumulation hinders output growth. Moreover, this analysis provides some support to a broader interpretation of the debt overhang hypothesis: it seems that a large debt affects the real exchange rate, fiscal deficit and inflation, which, in turn impact negatively on private investments; the effects on these policy variables deters reform programs and reduces the government's capability of absorbing and adjusting shocks.

The implication for debt relief of a non-linear relationship depends crucially its estimates. The more threshold used in the HIPC initiative, the higher will be the contribution of the new debt burden on output growth. Debt forgiveness has the aim of moving from the right to the left of the 'wrong' side of this curve and its impact depends on the shape of that curve. Presbitero (2005) shows that 'a huge debt burden as a negative effects on GDP growth, arguing that the basic relationship is negative'. Using a dynamic panel model, the analysis on developing countries finds a negative and linear link between debt and growth (and the lack of an inverse U-shaped curve), which could be explained by the sample of countries. In fact, dealing with developing and indebted countries (in which debt is likely to impair economic growth) means that quite all the sample is on the right side of the inverse U-shaped curve, while the side of the curve should be occupied by industrialized and low indebted countries, in which more debt leads to more growth.

The negative effect of debt service on growth is confirmed also by the analysis done by Chowdhury (2004), who shows that 'there is a negative causal impact that runs from debt to economic growth'. The results address the problems of causality and heterogeneity of the data, but not the effects on investment. As a consequence, there is no evidence of a debt-Laffer curve, even if four different measures of debt stock and debt service payment affect negatively and linearly the GDP growth. 'Debt service payments are shown to have a detrimental impact on per capita income growth and on private investment because they reduce import capacity and available credit, creating a disincentive for investors' (Elbadawi, et. al. 1999).

Pattilo et. al. (2004), find evidence of a narrow interpretation of the debt overhang effect, which works mainly through physical investment. The used a panel data set for 61 developing countries and confirm, using different econometric techniques their previous findings about the debt

Overhang hypothesis. They also show that the non-linear relationship between debt and growth works through physical capital and total factor productivity channels.

Presbitero (2005), shows that a huge debt burden has as a negative effect on GDP growth, arguing that the basic relationship is negative. Using a dynamic panel model, the analysis on developing countries finds a negative and linear link between debt and growth, which could be explained by the sample of countries means that quite all the sample is on the right side of the inverse U-shaped curve, while the left side of the curve should be occupied by industrialized and low indebted countries, in which more debt leads to more growth. Goldstein (2003), stresses the importance of the exchange rate behavior for the emerging economics, since public debt is generally denominated in foreign currency. A sharp depreciation or a showdown in the world trade could reduce the capability of a country to generate enough foreign exchange revenues to service its debt obligations. The new debt sustainability framework for LICs recognizes the importance of exogenous shocks on the capability of repaying external debt. However, shocks are evaluated only in a partial equilibrium, which does not consider secondary effects.

2.2 THEORETICAL REVIEW

Developing countries in Africa e.g. Nigerian was characterized by inadequate internal capital formation arising from the vicious circle of low productivity, low income, and low savings. This act calls for technical managerial and financial support from overseas to bridge the resources gap. The accesses to external finance strongly influence the economic development process of nations. It is an important resources needed to support sustainable economic growth. Various theories that explain the subject of external debt include: Dual-gap theory, Debt overhang theory, Solow-growth model and Dependency theory.

a. Dual-gap Theory

The two-gap model is an extension of the Harrod-Domar growth model. Omoruyi (2005), stated that most economies have experienced a shortfall in trying to bridge the gap between the level of savings and investment and have resorted to external borrowing in order to fill this gap. The dual gap analysis which explained that development is a function of investment and that such investment, which requires domestic savings, is not sufficient to ensure that development take place. There must be the possibility of obtaining from abroad the amount that can be invested in any country is identical with

the amount that is saved. Furthermore, if the domestic resources are to be supplemented from abroad, such as excess of import over export (i.e $M > E$).

$$I \dot{-} S, M \dot{-} E$$

$$\text{Hence, } I \dot{-} S = M \dot{-} E$$

In national income accounting, an excess of investment over domestic savings is equivalent to excess surplus of import over export.

$$\text{Income} = \text{consumption} + \text{import} + \text{savings}$$

$$\text{Output} = \text{consumption} + \text{export} + \text{investment}$$

$$\text{Income} = \text{output}$$

$$\text{Then Investment} \dot{-} \text{savings} = \text{Import} \dot{-} \text{Export}$$

Savings gap: domestic savings are inadequate to support the level of growth which could be permitted given the import purchasing power of the economy and the level of other resources.

Foreign Exchange gap: import purchasing power conferred by the value of exports plus capital transfers may be inadequate to support the level of growth permitted by the level of domestic savings.

The two-gap theory purports that investment and development are restricted by level of either domestic savings or import purchase capacity. This is the basis of dual gap analysis; assume that there is a country that requires savings and investment good import to achieve a particular rate of growth. If the available domestic savings fall short of the level necessary to achieve the target rate of growth, a savings investment gap is said to exist on a similar note, if the maximum import requirement needed to achieve the growth target is greater than the maximum possible level of export then there is an export-import of origin exchange gap. Oloyede (2002), describes dual-gap analysis as a framework that shows that ñthe development of any nation is a function of investment and that such investment requires domestic savings which is not sufficient to ensure that development takes placeò.

Ordinarily, economic growth should depend largely on domestic capital formation and accumulation, but due to severe limitations, it requires imports of capital goods and complementary raw materials that are not domestically available. These foreign imports are

necessary for various reasons. Balanced growth calls for substantial investment in infrastructures i.e. Dams, Roads, Ports etc.

According to Telegram (1992), foreign debt is needed to cover two gaps in the development process. They include:

- a. The foreign exchange gap which is the payments of deficit a country faces when it has reduced its external reserves to a minimum, accompanied with projected imports requirements.
- b. The investment-saving gap which is the foreign capital needed to supplement domestic savings for financing real investment levels.

b. Debt-overhang Theory

The debt overhang theory also explains a situation in which the creditors do not expect to be fully repaid because of the presence of a large stock of debt. The literature about the debt overhang start generally from two papers by Krugman (1988) and Sachs (1989), who analyze what happens to a country which is unable to service its debt payment in full, without new borrowing. Krugman (1988) asserts that ña country has a debt overhang problem when the expected present value of potential future resource transfers is less than its debt.

The presence of this stock of debt changes the incentives of both creditor and debtor and debt relief could benefit both of them. The creditor could have an incentive to keep on lending in order to avoid a loss, with the hope that the recipient will improve its economic conditions and will repay all its claims in the near future. The debtor has a disincentive to invest because he perceives that all the gains will be used to repay the lender and, in some way, they will be taxed away. What is important for debt relief is that a debt reduction could be in the interest of both debtors and creditors, because the lender could increase the likelihood that the remaining obligations will be serviced in full and the debtors could reduce the distortions given by the presence of the debt burden on investment choices.

Clement et, al. (2003), stated that external debt accumulation can promote investment up to a certain point where debt overhang sets in and the willingness of investors to provide capital starts to deteriorate. Audu (2004), relates the concept of debt overhang to Nigeria's debt situation. He stated that the debt service burden has prevented rapid growth and development and has worsened the social issues. Cohen (1993) and Clement, et. al. (2003), observed that

aside from the effect of high debt stock on investment, external debt can also affect growth through accumulated debt service payments which are likely to crowd out investment (private or public) in the economy.

c. Solow Growth Model

Solow (1957), presents an exogenous growth model, an economic model of long run economic growth set within the framework of neoclassical economics. It attempts to explain long-run economic growth by looking at capital formation, labor or population growth and increases in productivity commonly referred to as technological progress. The Solow growth model was built on a closed economy which makes use of labor and capital as its means of production. External debt effect on growth can be seen through the domestic saving which in turn used as investment in a closed model. At its core is a neoclassical aggregate production function, usually of a Cobb-Douglas type, which enables the model to have contact with microeconomics. The Solow-growth model has the following assumptions:

- Countries will produce and consume only a single homogenous good.
- Technology is exogenous in the short run

The model is developed based on a Cobb-Douglas production function given by the form:

$$Y = F(K, L) = K^\alpha L^{1-\alpha}$$

Where:

Y = Output

K = Capital Input

L = Labor Input

α and $1-\alpha$ are output elasticity of capital and labor respectively and α is a number between 0 and 1.

Solow growth model capital accumulation equation is expressed in the form:

$$\dot{K} = sY - dK$$

Where:

$\dot{K}$ = change in capital stock

sY = gross investment

dK = depreciation during the production process

The model derives the capital accumulation equation in terms of per worker i.e $\dot{k} = sy - (n+d)k$. This implies that the change in capital per worker is a function of investment per worker, depreciation per worker and population growth. Out of the three variables only investment per worker is positively related with change in capital per worker.

The general effects of external debt on the Solow growth model can be analyzed using individual effects of the debt overhang and debt crowding theories on the Solow growth model. The debt overhang hypothesis examined the government in an attempt to amortize the accumulated debt, will increase tax rate on the private sector. This will discourage private sector investment and also reduce government expenditure on infrastructure as the resources are used to pay up huge debt service payments instead of been put into good use. This will lead to a reduction of total (private and public) investment in the economy and a shift downward of both the investment and production function curves in Solow growth model.

On the other hand in the case of debt crowding out, in a bid to clear their outstanding debts using their revenue from export earnings and in some cases transfer resources including foreign aid and foreign exchange resources to service their forthcoming debt. Those countries which transfer revenue from export earnings which can be used in investment in the economy to avoid huge debt payments will discourage public investment. This in turn will decrease economic growth and will shift both the investment and production function curves in Solow growth model downward.

d. Dependency Theory

James (1997), is of the notion that "resources flow from a periphery of poor and underdeveloped states to a core of wealthy states, enriching the latter at the expense of the former". It is a central contention of dependency theory that poor state are impoverished and rich ones enriched by the way poor states are integrated in to the world system.

The theory originates from the works of Hans Singer (1949) and Raul Prebisch (1949), in which they observed that the terms of trade for underdeveloped countries relative to the developed countries had deteriorated over time: the underdeveloped countries were able to purchase fewer and fewer manufactured goods from the developed countries in exchange for a given quantity of their raw material exports.

The theory arose as a reaction to modernization theory, an earlier theory of development which held that all societies progress through similar stages of development, that today's underdeveloped areas are thus in a similar situation to that of today's developed areas at some time in the past, and that therefore the task in helping the underdeveloped areas out of poverty is to accelerate them along this supposed common path of development by various means such as: investment, technology transfer, and closer integration into the world market. Dependency theory rejected this view, arguing that underdeveloped countries are not merely primitive versions of developed countries, but have unique features and structures of their own.

The premises of Dependency theory are that:

- Poor nations provide natural resources, cheap labor, a destination of obsolete technology, and markets for developed nations, without which the latter could not have the standards of living they enjoy.
- Wealthy nations actively perpetuate a state of dependence by various means. This influence could be multifaceted, involving economics, media control, politics, banking and finance, education, culture and sport.

Ajayi (2000), "the dependent position of most underdeveloped countries has made them vulnerable to the products of the Western metropolitan countries and Bretton Woods Institutions".

The dependency theory gives a detailed account of the factors responsible for the position of the developing countries and their constant and continuous reliance on external funding for their economic growth and development.

2.3 EMPIRICAL REVIEW

2.3.1 The Structure of Nigeria's External Debt

External debt can therefore be seen as the foreign exchange component of public debt (Uche 2005: 72). In the context above, foreign debt also constitutes loans procured from international institution, foreign creditors i.e. government, corporate bodies and non-corporate bodies. In international economics relation, external debt is the term that describes the financial obligation that ties one party (debtor country) to another (Lender country). It usually refers to incurred debt that is payable in currencies other than that of the debtor country.

External debt may be incurred through a number of transactions such as trade, contractor. Finance, Supplies credit, Private investment and Public borrowing. Sources of loans that make up external debt include banks, international financial market (euro money and capital markets) international organization e.g. IMF and the World Bank International loans and multilateral private loans.

Ojo (1989), was of the belief that it is no exaggeration to claim that Nigeria's huge external debt is one of the hard knots of the Structural Adjustment Programme (SAP) introduced in 1986 to put the economy on a sustainable path of recovery. The corollary of this statement is that of only the high level of debt service payment could not be reduced significantly, Nigeria would be in a position to finance a larger volume of domestic investments, which would enhance growth and development, but more often than not, a debtor has only limited room to manage a debt crisis to advantage. Smyth and Hsing (1995), have tried to test the federal government's debt impact on economic growth and examine if an optimal debt ratio exists that will maximize the economic growth. The author calculated the optimal debt ratio (DEBT/GDP), which represents the maximum real GDP growth rate (38.4%). The DEBT/GDP ratio corresponding to the maximum GDP growth rate is 38.4 percent.

Chowdhury (1994) argued that, "external debt burden leads to bad management in highly indebted countries such as exchange rate mismanagement". The expectation of currency devaluation leads to speculative capital flight. Devaluation also causes the currency cost of debt service obligations, deteriorates budget deficit and affects money supply and inflation.

Amaeteng and Amoako-Adu (2002), the empirical study declared that there is a unidirectional and positive causal relationship between foreign debt service and GDP growth

after excluding exports revenue growth for Africa and South of Saharan countries during 1983-1990. Afrenton and Serletis (2000), argued that whether indebtedness impacts on the economic activity of developing countries. It is also argued that if foreign loan are converted into capital and other necessary inputs, development will occur. On the other hand, if borrowing countries misallocate resources or divert them to consumption, the economic development is negatively affected. This study employs the frame work of granger. In doing so, six measure of indebtedness were used as proxies for the multiple mechanisms.

Arias (2002), showed a striking diversity of experience with growth episode and poverty changes. This became clear in the study carried out by him where it is seem that while some countries over some periods achieve a significant reduction in poverty as the economy grower others obtain much less appreciable progress. He then concluded that how growth reduces poverty depends on the pattern of growth as well as on the initial inequality of income and assets and its evolution over time.

Anyanwu, et. al. (1997) was of the opinion that whole scale of white elephant development project in the country is the root cause of our external debt problems. He said instead of emphasis being placed on small rural development project so as to reverse the chaotic trend of urbanization and lessen the opportunity for corruption. According to Nweke (1990;42)

a correct analysis of external debt in a third world countries such as Nigeria must be replace in the content of the country's forceful integration into the western structural and dominated world capitalist economy as a peripheral appendage that provide natural resources and cheap lab our for the industrialization process in the west include lucrative markets for surplus of the advanced country's manufacturers and the advance countries get a very high cost of the manufactured product of the west

Muhtar (2005:12) also stated that, the service of these debts have direct negative impact on economic development. He says debt services encroach on resources needed for socio economic development and poverty reduction. It also contributed to negative net resources flow. In yet another study showing an in slight from cross-country regression analysis by Hasen (2001) on the impact of aid and external debt in growth and investment the regression result were suggestive of a series of interesting relationships. This then is to say as a result

of the explanatory regression there is quite strong evidence of positive impact of aid both on the growth rate in GDP per capital and the investment rate.

Foreign loans are organized international credit negotiated between two countries, on terms acceptable to them in today's world, the lender countries are usually the advanced industrialized countries of Europe, Asia (Japan) and North America while the borrowing country are the poor under developed countries of the third world in Africa, Asia and Latin America. From the stand point of the latter, foreign loans are ostensibly for development purposes or to facilitate industrial progress or for improving the quality and quantity of food production. "The ultimate objective is to increase the standard of living of the generality of the people" (Nwoke 1990).

Sanusi (1987) "is of the view that the rationale for raising external loan by developing countries has always been to bridge the domestic resources gap in order to accelerate economic development". To that extent, no one will quarrel with any developing country for resorting to external borrowing provided that the proceeds are utilized in a productive way that will facilitate the eventual servicing and liquidation of the debt.

Thus, Nigeria resorted to external borrowing early in her history in order to quicken the pace of economic development. The origin of Nigeria's debts dates back to 1958 when a sum of US\$ 28million was contracted for railway construction. During the periods of 1958 and 1977, more debts were incurred but not to the level that could be regarded as a burden to the country. They are debts from bilateral and multilateral sources with longer repayments periods and lower interest rates constituting about 78.5per cent of the total debt stock.

In 1970 after the civil war, the level of Nigeria's external debt outstanding was relatively low at N488.8 million. At this level, external debt constituted only 9.2% of Gross Domestic Product (GDP). The external loans (Rehabilitation, Reconstruction and Development) Decree of 1970 had sanctioned the raising and use of external loans not exceeding N1billion for reconstruction rehabilitation and development and for on-lending to the states. The period, 1973-1976 coincided with the oil boom, which substantially buoyed the country's external resources position. Nigeria was considered by the developed creditor's nation to be under borrowed and the creditors too were eager to lend very liberally to the country. Infact, "oil Boom" era, the country's. Foreign exchange position was so comfortable that Nigeria was in a position to lend money to the international monetary fund (IMF) under oil facility in 1974.

A turning point was however reached in 1978, as the oil boom collapsed and an oil glut surfaced. Consequent upon this, foreign exchange inflow dwindled and this exerted pressure on government finances. There was therefore, the compelling need to borrow for balance of payment support and project financing. The enthusiasm with which multilateral and bilateral credits were extended to the country without ensuring their corresponding viability contributed to the rapid buildup in total external debt. The pressure on governments led to the first major borrowing of U\$1billion referred to as the “**Jumbo loan**” contracted from the international capital market in 1978; increasing the total external debt stock to U\$2.2billion.

The recovery of oil market between 1979-1981, with oil price rising to an all time high of U\$40 per barrel led to illusion that the economy was buoyant. Consequently, some deflationary measures put in place in 1978 were either relaxed or completely jettisoned. Subsequently, it was a period of free -for - all borrowing by the Federal Government of Nigeria and its various organs. Also our penchant for imported goods also increased the volume of bilateral and private sector creditor. Over the years till date, Nigeria’s debt has continually fluctuating.

The Nigeria debt grew rapidly through the 1980’s due to accumulation of debt services arrears and escalation of market interest rate. London Inter-Bank Offered Rate (LIBOR) peaked at 13% in mid 1989 from 3% and 4% in 1980’s. For Nigeria debt servicing problems constitute a serious obstacle to the inflow of external resources into the economy. Although concerted effort is being made by the government to service the debts, the accumulation of debt services arrears which is being compounded with penalty charges has not permitted reduction of the debt stock.

(DMO 2009) “The establishment of debt management office on 4th October 2000 in Nigeria, help to coordinate the management of Nigeria’s debt stock”. During rescheduling of our debt with Paris club, we found out that out of the US \$21 billion that was being rescheduled about 24% was penalty and 22% was interest. In spite of that, another 48% constituted arrears, which are payments that should have made. Only 7% was really the outstanding amount. A giant stride made by the Nigeria is its exit from the Paris club of creditors. The exit was made possible after the country paid the last tranche of \$4.5billion to the Paris club. “Nigeria had therefore become the first Africa country to pay off its debts to the club” (NDIC 2006). The development had made Nigeria to move from a highly indebted country to a country with a manageable debt.

It is worthy of note that the exit of the country from the Paris club came after a favourable appraisal of the nation's economic reform programme by the Executive Board of the International Monetary Fund (IMF) in a debt- buy- back scheme negotiated under the Naples Term. Nigeria reached a debt deal in October 2005 with the Paris club and that allowed her to pay about \$12billion for about \$30billion in accumulated debt, an overall discount of about 60 percent. Also the International Monetary Fund (IMF) during the period approved a two-year Policy Support Instrument (PSI) for Nigeria, as a pre-condition to exit the Paris club debt quagmire because of the strength of the country's economic programme.

Up to 2008, Nigeria enters fresh N359b external debt. Under the new debt portfolio Nigeria owes multilateral agencies, mainly the International Development Association about \$2.4billion, while bilateral non-Paris club accounts for \$718billion, documents from the DMO reports so. Rising oil prices had helped Nigeria to get off the hook of Paris club in 2006, after the country negotiated and paid \$12.2billion out of the about \$30billion debt. While acknowledging the need to build infrastructural and power base of the economy, the DMO warned states and the Federal Government not to initiate new debt in such a manner as to threaten debt sustainability. Several developing countries have accumulated large external debt which hamper economic growth and are a constraint to poverty alleviation. A high debt burden negatively affects economic growth through the effects of the debt overhang hypothesis and liquidity constraints. These factors theoretically explain how a large external debt and debt service could squeeze investment and dent economic growth. The existing evidence seems to support this view: the disincentive effects, due to debt overhang, and the crowding out public investment negatively affects the rate of growth of output.

The High Indebted Poor Countries (HIPC) Initiative is launched by the IMF and the World Bank- deals with long term external debt sustainability and poverty reduction, so as to prevent debtor countries to re-accumulate high level of external debt, insure a permanent exit from debt dependence and provide budgetary support to implement the poverty reduction strategies designed by the HIPCs themselves.

2.3.2 Sources of Nigeria External Debt

This significantly represent various body corporate and institutions to which Nigeria has contracted a number of debt obligation from external source i.e. outside the shores of the country, making her indebted in foreign currencies.

Nigeria's external debt outstanding stood at US\$9,711.45 million as at end of December, 2014.(see appendix). The composition revealed that a significant amount of external debt was from the official creditors at concessional rates and this was essentially used to finance the development of projects and programmes in various sectors of the economy. The non-concessional loans were from bilateral and commercial creditors. The stock of the external debt by remaining maturity was in the long-term category. The increase in the net inflow of resources was largely on account of additional disbursement from multilateral and bilateral creditors.

This is classified, according to Adepoju, et. al. (2007) as:

1. *Official debt*: - This consists of Paris club debt, multilateral debts and bilateral debts.
2. *Private debt*:- This is made up of uninsured short-term trade arrears contracted through the medium of bills for collecting, open account etc. commercial banks debts acquire through loans/ letters of credit. Credits are in this case referred to London club debts.

1. OFFICIAL DEBT

As at end of December, 2014, Nigeria's external debt portfolio was dominated by debts owed to the Official Creditors, which accounted for US\$8,211.43 million or 84.55 percent. The official creditors comprised Multilateral and Bilateral Creditors which constituted 70.01 percent of total debt stock. Sources of official debt include:

i. Paris club of creditors

Uche (2005) is of the view that the club represents official government creditors originating from government to government credits and exports guaranteed by various Export Credit Agencies of Creditor Countries. The first Paris club meeting was held in 1956. When export credit agencies guaranteed the export activities of their nationals and the recipients' nation government is unable to pay the foreign exchange equivalent of the domestic currency cover paid by the importer, it becomes government debt owed to creditor nations. The Paris club members to which Nigeria was indebted to as at Dec 31st 2004 before the cancellation include: Spain, Israel, Germany, Denmark, Italy, Russia, Finland, Belgium, UK, USA, Japan, Netherlands, Australia, Switzerland, and France.

ii. Multilateral creditors

These are projects loans owned to multilateral financial initiatives and institutions such as European investment Bank, World Bank group, International fund for Agricultural Development (IFAD), African Development Bank (ADB), and IMF, By Federal and State Government. Multilateral loans accounted for US\$6,799.36 million or 70.01 percent of the external debt portfolio. The trend analysis of the external debt stock between 2010 and 2014 revealed that the share of multilateral debt decreased marginally from 71.13 percent in 2013 to 70.01 percent in 2014, due to the redemption of maturing loans and increased borrowing from the bilateral source.

iii. Bilateral creditors

This is an inter-governmental credit called non-Paris club. These are debt owed to countries which are not members of the Paris club but whose debts are not insured by the Export credit agencies. The Non-Paris Club bilateral Debts in 2009 comprised the Exim Bank of Korea and the Chinese Exim Bank (Nigerian Communication Satellite-NIGCOMSAT) loans. These loans are concessional bilateral debts. Debts owed to the bilateral creditors comprised loans contracted from China and France on semi-concessional terms. As at 2014 decenmebr, debt owed to the bilateral creditors amounted to US\$1,412.08 million, compared to US\$1,025.70 million at the end of the corresponding period in 2013. This showed an increase of US\$386.37 million or 37.67 percent over the level in 2013. This development was attributed to loans contracted from Exim Bank of china during the review period.

2. Private debt

The private creditors comprised non-concessional loans that are obtained from the commercial window. As at end-December, 2009, the sum of US\$261.19 million was owned to the commercial creditors. These private sector loans were guaranteed by the China Exim Bank. The loans were; ZTE- Nigeria Local Government. The stock of commercial debt amounted to US\$1,500.00 million as at end of december, 2014 compared to US\$1,521.00 million in 2013. The marginal decrease of US\$21.00 million or 1.4 percent was attributable to the redemption of the China loan, amounting to US\$21.00 million obtained from ZTE and CMEC.

i. Promissory Note Creditors

These were trade arrears contracted by ordinary Nigerians. This group of creditors are holders of central Bank of Nigeria promissory note issued in respect of verified and reconciled private sector uninsured trade debt arrears financed under bills for collection and open accounts.

ii. London club of creditors

This is a group of commercial banks that join together to negotiate the restricting of their claims against debtor countries. The origin of the debt is traced to transaction involving letters of credit and inter-bank loans as well as other external loans by banks. The first London club meeting was held in 1976 and they are mainly uninsured and not guaranteed by government agencies.

2.3.3 RATIONAL FOR EXTERNAL DEBT

These are different reasons where external debt could be justified. Thus include;

1. To combat natural disasters like Ogunpa River Flood at Ibadan in 1980, serious drought and epidemic breakout, accidental oil spillages etc.
2. Where a country has adverse balance of payments position, it may be justifiable to borrow to correct the disequilibrium.
3. Government could borrow for the purpose of industrial development with the ultimate aim of boosting employment.
4. Government could borrow for technological development and innovative changes.
5. In an effort to stabilize the exchange rate, government could resort to external borrowing for the purpose of intervention in the foreign exchange market.

2.3.4 RISK ANALYSIS OF NIGERIA'S TOTAL PUBLIC DEBT

This evaluates the risk exposure of the country's debt. The major objective of the Nigeria's debt management strategy is to meet the financing needs of the government at a minimum cost and within prudent level of risk. The analysis of the cost/risk matrix of the debt profile of the country is therefore a strong component of the debt management practices of any country.

Cost minimization and risk mitigation are very essential in public debt management. Three types of risk associated with the country's public debt portfolio examined includes: 1. Currency risk 2. Interest rate risk 3. Re-Financing risk.

CURRENCY RISK: This is only associated with the external debt components of the country's debt. In particular, exchange rate and foreign reserves have implications for the currency risk of the external debt profile of the country. The profile of Nigeria's external debt in 2009 places the country at a low currency risk. The external debt stock by currency composition as at end of December, 2014, showed that the portfolio was mainly made up of seven major currencies, namely: Swiss Franc (CHF), Euro, Great Britain Pounds (GBP), United State Dollar, Japanese Yen, Special Drawing Rights and IDR Units of Account (Islamic Dinar). Table 2.1 and 2.2 shows that Special Drawing Rights (SDR) was the dominant currency accounting for 60.96 percent of the external debt stock. The currency structure has remained unchanged with SDR dominating the currency composition, thus, reducing the exchange rate vulnerability of the debt portfolio, as only 39.04 percent of the portfolio was held in other currencies.

Table 2.1 EXTERNAL DEBT STOCK BY CURRENCY COMPOSITION 2014

S/N	Currency	Debt stock in Original currency	Debt Stock in Naira	Debt Stock in USD	Percentage of Total (%)
1	CHF(Swiss France)	6,435,439.61	1,092,405,607.00	6,502,414.33	0.07
2	EUR	177,745,974.48	38,704,085,095.00	230,381,458.90	2.37
3	GBP	23,078,922.50	5,558,812,352.00	33,088,168.76	0.34
4	IDB UNIT OF ACCOUNT	15,806,873.38	3,866,708,980.00	23,016,124.88	0.24
5	YEN (000)	13,020,837.96	3,136,212,923.00	18,667,934.07	0.19
6	US DOLLARS	3,480,090,607.56	584,655,222,070.08	3,480,090,607.56	35.83
7	SDR(Special drawing rights)	4,087,083,391.99	994,510,001,772.93	5,919,702,391.51	60.96
	Total		1,631,523,448,800.01	9,711,449,100.00	100.00

Source: Debt Management Office (2014), Annual Report and Statement of Accounts

TABLE 2.2 EXTERNAL DEBT STOCK BY CURRENCY COMPOSITION PERCENTAGE, 2009-2005

CURRENCY/ YEAR	2009 %	2008 %	2007 %	2006 %	2005 %
EUR	9.21	10.36	28.30	9.21	35.80
USD	16.94	24.55	16.93	42.34	22.80
JPY	2.59	3.41	-	3.90	9.87
CHF	0.21	0.25	-	-	-
SDR	70.96	61.35	54.45	44.04	4.88
NGN	0.00	0.003	-	-	-
KRK	0.04	0.068	-	-	-
GBP	-	-	-	-	14.76
OTHERS	0.05	-	0.32	-	-

Source: Debt Management Office (2009), Annual Report and Statement of Accounts

The fact that external debt portfolio is comprised several convertible currencies has helped to hedge against foreign exchange risk associated with unfavourable trends in currency movement. The funding of external debt service through the External Creditors Funding Account (ECFA) denominated in Us Dollars further provided strong cushion against exchange rate risk.

Table 2.2 shows the breakdown of the foreign currency debt portfolio with SDR having the highest percentage (70.96 percent), US Dollars (16.94 percent), Euro (9.21 percent) and other currencies (2.89 percent). The dominance of SDR in the currency composition of the debt profile reduces the exchange rate risk of the debt portfolio. This is because the SDR is a basket of currencies which in themselves hedge against one another, thereby mitigating currency risk.

Similarly, the low level of the currency risk could further be explained by the composition of the external reserves of the country which is dominated by US Dollar and the Euro. This forms a back- to- back hedge with the components of similar currencies in the external debt portfolio.

The low level currency risk of the external debt portfolio is in consonance with Nigeria's debt management objective of attaining prudent level of risk in government borrowing decisions. Nigeria's external reserves stood at US\$42.382 Billion as at the end of December 2009, and this contrast with the total external debt of the country which stood at US\$3.947 billion in the same period. The country's ability to meet its external debt service payment obligations is an indication of its currency exposure. Accordingly, table 2.3 & 2.4 shows the currency composition of the reserves and external debt portfolio indicates a very low level of currency risk. The composition of the country's external reserves position by currency as at end of December, 2014 stood at US\$34.24 billion. The proportion of US Dollar of the foreign reserve still stands at the high rate like that of the year 2009 which constituted the bulk of the reserve (80.06 percent), the Euro (11.01 percent), the GBP (3.25 percent) and other currencies (5.63 percent).

TABLE 2.3 NIGERIA'S EXTERNAL RESERVES CURRENCY COMPOSITION AS AT 31ST DECEMBER, 2014

Currency	USD Equivalent	% of Total
US Dollars	26,599,868,451.25	77.6721
GB Pounds	799,184,110.17	2.3336
Euro	2,210,622,168.09	6.4551
Swiss Franc (CHF)	1,437,245.58	0.0042
Japanese Yen	8,105,169.18	0.0237
Chinese Yuan (Renminbi)	2,200,611,042.96	6.4258
Special Drawing Right (SDR) Allocation	2,426,282,781.55	7.0848
Other Currencies	247,809.73	0.0007
Total	34,241,668,648.20	100

Source: Debt Management Office (2014), Annual Report and Statement of Accounts

TABLE 2.4 NIGERIA'S EXTERNAL RESERVES CURRENCY COMPOSITION AS AT 31ST DECEMBER, 2009 (US\$ EQUIVALENT)

S/No	CURRENCY	AMOUNT	%
1.	US DOLLARS	33,931,984,502.45	80.06%
2.	GB POUNDS	1,378,329,453.05	3.25
3.	EUR	4,664,941,237.70	11.01
4.	SWISS FRANC	3,273,277.29	0.01
5.	JAPANESE YEN	16,527,263.61	0.04
6.	OTHERS	2,387,437,585.59	5.63
	TOTAL	42,382,493,319.69	100.00

Source: Debt Management Office (2009), Annual Report and Statement of Accounts

INTEREST RATE RISK: One of the major threats to public debt service payments is adverse changes in (especially a rising) interest rate. However, about 98 percent of the total public debt stock is in fixed interest rates (Table 2.5). The floating rate instruments in respect of the domestic debt were part of the Ist FGN bonds issued in 2003, whilst those relating to the external debt stock were African Development Bank (ADB) loans. To this extent, there is virtually no risk of future interest rate volatility in the total debt stock. The low level of floating rate instruments in Nigeria's debt portfolio indicates a very low interest rate risk.

Table 2.5 NIGERIA'S TOTAL PUBLIC DEBT BY INTEREST RATE CLASSIFICATION IN 2009

DEBT STOCK	FIXED RATE (%)	FLOATING RATE (%)	TOTAL
DOMESTIC DEBT	84.59	0.12	84.71
EXTERNAL DEBT	14.69	0.60	15.29
TOTAL	99.28	0.72	100.00

Source: Debt Management Office (2009), Annual Report and Statement of Accounts

The average interest rate in the total debt portfolio went up from 7.7 percent in 2010 to 10.14 percent in 2012, thereafter; it dropped to 9.69 percent in 2014. The low average interest rate on external debt was due to the high proportion of concessional debts that was about 83 percent of external debt portfolio, and which helped to moderate the average interest rate of external debt portfolio in particular and overall cost of debt in general. However, the high average interest rate of domestic debt portfolio was attributed to CBN's monetary and liquidity management policies, in which the MPR was increased to 13 percent in November, 2014, after it had remained stable at 12 percent from January to October 2014.

Table 2.6 TREND IN AVERAGE INTEREST RATE 2010-2014

Year	Detail	2010	2011	2012	2013	2014
Average Interest Rate (%)	External	7.74	6.21	4.49	3.37	3.57
	Domestic	7.8	9.56	11.02	11.15	10.95
	Total	7.7	9.10	10.14	9.90	9.69

Source: Debt Management Office (2014), Annual Report and Statement of Accounts

The proportion of variable or floating interest rate debt is an indication of the level of interest rate risk inherent in any debt portfolio. Thus, the high proportion of fixed interest rate debt in the country's public debt portfolio of 99.53 percent in 2014, which indicated that the portfolio was not exposed to interest rate risk volatility. The Average Time-to-Refixing (ATR) of the total public debt portfolio was 6.4years Ā ATR for domestic debt was 5.4 years, while external debt was 13.9 years. This implied that the total debt portfolio had low exposure to interest rate risk.

Table 2.7 TREND IN INTEREST RATE RISK INDICATORS 2010-2014

Year	2010	2011	2012	2013	2014
Fixed Interest Rate Debt (%)	99.99	99.86	71.83	99.41	99.53
Variable Interest Rate Debt(%)	0.01	0.14	28.17	0.59	0.47
External Debt-Average Time-to-Re-Fixing (Years)	-	15.9	16.2	14.4	13.9
Domestic Debt-Average Time-to-Re-Fixing (Years)	-	4.1	4.2	4.6	5.4
Total Debt-Average Time-to-Re-Fixing (Years)	-	5.8	5.9	5.8	6.4

Source: Debt Management Office (2014), Annual Report and Statement of Accounts

REFINANCING RISK: The maturity structure of the total debt portfolio is used to measure the refinancing risk of the debt portfolio. The longer the maturity structure of the debt instrument the lower the refinancing risk. The percentage distribution of the total debt outstanding indicates that 79.07 percent of the debt portfolio is in long term instrument. This confirms, in general terms, a low level of refinancing risk in the overall debt portfolio, although more rigorous analysis would be required to identify problems of bunching and concentration ratio in the portfolio.

The total public debt portfolio of the country is generally at a low risk level in the period under review. The situation is likely to be sustained in the medium to long term provided the national debt management strategy will continue to guide the debt management objective of funding government financial requirements at minimum possible cost and prudent level of risk.

2.3.5 EXTERNAL DEBT MANAGEMENT

Jhingan (2004), is of the view that debt management is often referred to the amount, composition and refunding of National debt. Krugman and Paul (1988), showed that there is limit at which debt accumulation stimulate investment and growth. They argued that at high levels of indebtedness, growth and investment would only improve if part of the current debt service obligations of a debtor country were forgiven.

Emmanuel (2003), refers to external debt management to be the technical and institutional arrangements as well as policy measures involved in organizing external liabilities so that the debt service burden is contained within a sustainable level. In his view the technical aspect focus on determining the level of debt required to ensure that the terms and conditions of those borrowings are commensurate with the future debt service capacity of the country. The institutional aspects include the administrative, organizational, legislative, accounting and monitoring aspects of managing both new borrowings and the total stock of debt.

Thus, external debt management involves a conscious and carefully planned schedule of acquisition, deployment and retirement of external loans either for development purposes or to support the balance of payment. Until the year 2000, the institutional arrangements for external debt management in Nigeria reflected conspicuous shortcomings and inadequacies for proper management to occur, it led to an autonomous agency been created and report direct to the presidency as to matters involving Nigeria Debt issues. The body is referred to Debt Management Office which perform specific task.

Objective that necessitate the management of debt include the following:

- To benefit from foreign borrowing while avoiding problems of macroeconomic and balance of payments instability.
- Maintaining a comprehensive inventory of loans
- Providing policy guidelines to maintain optimum structure of debt in terms of maturity, currency composition and interest rate costs.
- Improving the debt profile in the short term and reduce the burden of debt servicing in the medium term to a level that will cause less strain on the available foreign exchange resources.

Debt management can be seen as the summation of policy measures of government aimed at careful planning of the composition, acquisition, utilization and repayment of public debt. The most important determinant of debt sustainability, as well as for poverty reduction is

economic growth. An increase in the rate of growth of GDP makes affordable a higher level of debt. On the contrary, whether the economy is sluggish, it is difficult to find resources to pay the current debt service obligations and the debtor country need to borrow money to cover its current expenditures. Traditional neoclassical models and some endogenous growth models imply positive relationship between debt and growth. However, the assumption of perfect capital mobility is unrealistic and, when dropped, lower debts are associated with higher growth. The debt overhang hypothesis considers the investment channel and the disincentive effects on government policies that lead to poor macro policies. Also inflation tax, reduced public investment and uncertainty (option of waiting and misallocation of investments) are likely to occur with a large debt stock. Additionally, large debt stock leads to capital flight, high tax rate and continuous over-borrowing, with a negative effects on growth.

Claessens, et. al. (1996), provides an accurate definition of the linkages between debt and economic performance:

Disincentive effects

- Debt overhang theory: when the debt burden is too high (the debt exceeds the future repayment ability), the expected debt service is a positive function of the aggregate output. This squeezes investment, because the returns are "taxed away" by the foreign creditors.
- The stock of debt has another negative effect on economic performance, due to the level of uncertainty of the fraction of debt service that will be repaid with the country's own resources as outcome of debt rescheduling negotiations.

Cash flow effects

- Moreover, debt reduction could facilitate the access to the international financial markets and the repatriation of flight capital (increasing private investment and the efficiency of the investment selection).
- The liquidity constraints: a reduction in current debt service increases the current level of investments, for any given level of future indebtedness. It is different from debt overhang, which is focused on the stock of the debt. If there is no debt overhang, the same increase in investment can be reached with a new loan or with a reduction in current debt service

Moral hazard effect

- With debt relief, debtors might believe that creditors have erased their position and that they will be more willing to forgive any future debt, when the likelihood to obtain a repayment will become low. Conditionality could reduce moral hazard (debt reduction to countries with a good record of sound macro policies). In the sense, refinancing and rescheduling (‘short-leash’ approach, which however, is criticized because it does not allow for a complete ownership of the reform by the indebted country) has an advantage on granting debt reduction

2.3.6 ESSENTIAL FEATURES OF EFFICIENT DEBT MANAGEMENT

Mike Obadan (2003), expresses ‘how Nigeria’s debt problem can be tackled in the context of a new policy that emphasizes efficient management and the use of loans for export-increasing and import-decreasing activities’. He further stressed about three essential aspects of the effective management of debt, which are: knowing the debt, deciding how much to borrow, and selecting the appropriate financing strategy.

With the Nigeria’s exit from the Paris Club and London Club in 2006, the external debt management strategy was aimed at borrowing from concessional sources to finance development. The strategy was later expanded to include borrowing from the International Capital Market (ICM), so as to diversify the government’s funding sources, reduce debt service cost and create opportunities for other economic agents to access external financing from the ICM. In view of the reclassification of Nigeria from IDA-only to a lower-Middle-Income country in 2013, coupled with the recommendation in the MTDS, 2012-2015, for the strategy of substituting domestic debt with less expensive long-term external funding, so as to achieve a composition of 40-60 external to domestic ratio by 2015, borrowing from the commercial sources is expected to increase in the medium term.

Effective debt management will enable the country to know how much foreign debt it has and how much additional debt it should contract and on what terms. But, then, how much foreign capital can the economy absorb efficiently and how much debt can it service without risking external payments difficulties? It is therefore necessary to have an active debt management unit that must continually assess the amounts of each type of credit available and likely to be available and the impact of new borrowing on the overall structure of debt, so that maturities may be spread as evenly as possible. It will also collect, collate, analyze, and program on a

continuous basis comprehensive and up-to-date statistics on external debt as an important input into macroeconomic planning and management strategy.

Effective debt management requires that the authorities must project accurately the time profile of their debt service obligations, and forecast export earnings, domestic revenues, and future access and various sources of finance. Debts must be properly monitored to take advantage of new borrowing on better terms, to adapt loan maturities to the revenues generated by the projects financed, or to cope with shortfalls in earnings from exports or unanticipated expenditure oil imports.

2.3.7 NIGERIA DEBT MANAGEMENT OFFICE

The Debt management office was established on 4th October, 2000 to centrally coordinate the management of Nigeria's debt which was hitherto being done by a myriad of establishments in an uncoordinated fashion (DMO 2014). This diffused debt management strategy led to inefficiencies. For instance in the FMF alone, four different departments have functions for the management of external debt in the following format:

- External finance department responsible for all Paris Club debts and for the management of public debt statistics;
- Multilateral institutions department responsible for relationships with all multilateral institutions (excluding the African development bank and its subsidiaries such as ADF and the NTF, which is handled by the ABER department. It is also responsible for managing and servicing multilateral debt;
- Africa and bilateral economic relations (ABER) department: responsible for liaising with the ADB and its subsidiaries ECOWAS, and all non- Paris club bilateral creditors.
- Treasury department (OAGF) responsible for issuing mandate to the CBN for payment of all external debts;
- Foreign exchange and trade relations department: responsible for issuing reconfirmation for payment externalization to the CBN and for documenting repayment and servicing of external debts.

In the CBN the following department had some involvement with external debts management.

- Debt Management Department: Responsible for the London Clubs debts consisting of trade debts, par bonds, and promissory notes;

- Debt conversion committee: responsible for managing various conversion options such as debt-for-debt, debt-for-equity, debt-for-export, debt-for-nature, and debt-for-development; and
- Various departments responsible for processing and effecting loan repayments on behalf of all the other agencies or department of government listed above.

This diffusion in the management of public debt created fundamental problems, including the following;

Operational inefficiency and poor coordination;

- Inadequate debt data recording system and poor information flow across agencies with consequent inaccurate and incomplete debt records.
- Extreme difficulty in the verification of creditor's claims due to conflicting figure from the various bodies handling the debt management functions.
- Complicated and inefficient debt service arrangement, which created protracted payment procedure and often led to penalties that added to the nation's debt stock.
- Inadequate manpower and poor incentive systems for the affected personnel, which affected outputs and performance;
- Lack of consistent well-defined borrowing policies and debt management strategies;

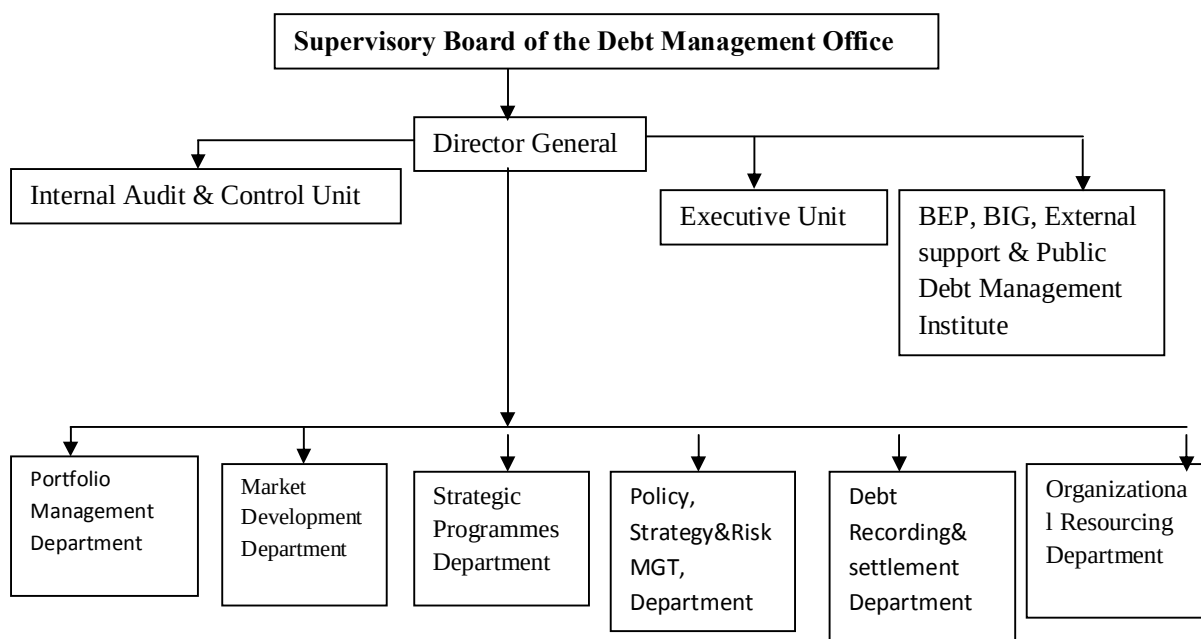
The consideration of these myriad problems led government to support the establishment of a relatively autonomous debt management office, which resulted in the formation of the DMO in October 2000. The need for the creation of a separate public debt management office was therefore aimed at achieving the following advantages:

- Good debt management practices that make positive impact on economic growth and national development, particularly in reducing debt stock and cost of public debt servicing in a manner that saves resources for investment in poverty reduction programs;
- Prudently raising financing to fund government deficits at affordable costs and manageable risks in the medium and long term;
- Achieving positive impact on overall macroeconomic management, including monetary and fiscal policies;
- Consciously avoiding debt crisis and achieving an orderly and development of the national economy;

- Improving the nation's borrowing capacity and its ability to manage debt efficiently in promoting economic growth and national development;
- Projecting and promoting a good image of Nigeria as a disciplined and organized nation, capable of managing its assets and liabilities;
- Providing opportunity for professionalism and good practice in nation building.

ORGANIZATIONAL STRUCTURE OF THE DEBT MANAGEMENT OFFICE

Figure 1



Source: DEBT MANAGEMENT OFFICE (2012)

The strategic thrust behind the structure at the DMO is to redistribute the operational responsibility for debt management into separate front, middle and back offices, each with its distinctive functions, accountabilities, and separate reporting lines. The DMO structure is designed to impose controls and to reduce exposure to risk, specifically in order to:

- Get a separation between those executing transactions and those settling and recording transactions.
- Get a separation between those managing a portfolio and those monitoring the performance of the portfolio managers
- Get a separation between those checking compliance with policies and procedures and those undertaking the activities of the business

The function of each elements of the new structure is clearly specified with effective coordination and information sharing. The VISION of the institution is 'to manage Nigeria's debt as an asset for growth, development and poverty reduction' while the Broad Objectives is 'to ensure that National and Sub-national Governments subscribe to the principles of prudent and sustainable borrowing, and effective utilization of resources, and to create a robust domestic debt market supportive of private sector development'.

The DMO is quite instrumental to the exit of Nigeria from all its Paris club debt obligations between October 2004 and April 2005. This was also followed by the exit from its London club debt obligations in 2006 (DMO 2008).

2.3.8 EXTERNAL BORROWING GUIDELINES (2008-2015)

In order to avoid a relapse into debt unsustainability, the following head guidelines have developed for the use of the Federal and State governments, as well as their agencies. The following guidelines complement the existing provisions as contained in *The constitution of the Federal Republic of Nigeria*. The Debt Management Office (Establishment) Act, 2003, Act No 18 and the fiscal Responsibility Act 2007.

International best practice for overall debt sustainability in Low Income Countries (LIC) recommends external debt stock to GDP ratio of not more than 30 percent. Given Nigeria's economic condition, the need to avoid a relapse into debt unsustainability, as well as the country's increasing emphasis on domestic borrowing and the development of the domestic debt market, an external debt stock GDP ratio of 20 percent is recommended, (it should be noted that according to DRI recommendation, the domestic debt stock-GDP ratio for Nigeria would range between 20-25 percent and the upper limit of 25 percent is considered appropriate for Nigeria, given the emphasis on domestic borrowing. Therefore, the recommended total public debt/GDP ratio for the medium term, i.e. 3-5 years is 45 percent). Accordingly, the following general guidelines will apply with regards to external borrowing by the Federal and State Governments or their agencies, for the fiscal years 2008 up to 2015, subject to modifications from time to time.

These guidelines are headed as follows;

1. Purpose of External Borrowing.
2. Approval/Approval-in-Principle.
3. Terms of New External Borrowing.

4. Non-Concessional Borrowing.

2.3.9 CAUSES OF NIGERIA EXTERNAL DEBT BURDEN

According to Sanusi (1987), "the external indebtedness of a country becomes a problem when the burden of servicing the debt becomes so heavy and unbearable that it imposes intolerable constraints on the economy and on the development efforts of the authorities". The burden of servicing the debt is highly influenced by accumulation of arrears and penalties. In such circumstance, the bulk of the foreign exchange earnings are earmarked for servicing of the debt and, at times, and worse still, drawings on new loans may be needed to service existing debt. In such a situation, only a small proportion of total foreign exchange earnings are available for financing of economic and social projects.

Ahmed (1984) asserted that "the causes of debt problem relate to both the nature of the economy and the economic policies put in place by the government". He articulated that the developing economies are characterized by heavy dependence on one or few agricultural and mineral commodities and export trade is highly concentrated on the other. The manufacturing sector is mostly at the infant stage and relies heavily on imported inputs. He stated that they are dependent on the developed countries for supply of other input and finance needed for economic development which makes them vulnerable to external shocks.

Debt accumulation has been brought about in many cases by the over ambitious attempts of many governments to speed up growth, prompted by international creditors who were also overly generous. The ability of debtor countries to meaningfully absorb and pay for the debts was overstated. "The causes of debt accumulation in Nigeria have been attributed mainly to external and internal factors" according to Ngozi Okonjo-Iweala, et. al. (2003).

1. External Factors thus include the impact of world oil price shocks, rising real interest rates brought about by the restrictive monetary policy of developed countries, declining terms of trade, and liberal lending policies of the international commercial banks. The problems arising from the external sector were exacerbated in most cases by internal factors.
2. "Internal Factors are mostly attributed to successive administrations' macroeconomic policy errors, in addition to their penchant for investing in white elephant project. Two

of such domestic macroeconomic policy errors are those attributed to fiscal irresponsibility and exchange rate misalignment (Ajayi 1991)

Nigeria's case has discussed, found itself in this unfortunate situation. It will therefore be instructive to look more closely to some of the factors that contributed to this problem. Although, Nigeria's debt problem became pronounced in 1981, its causes may be traced largely to the activities and decisions of the past years. Some of these major factors include:-

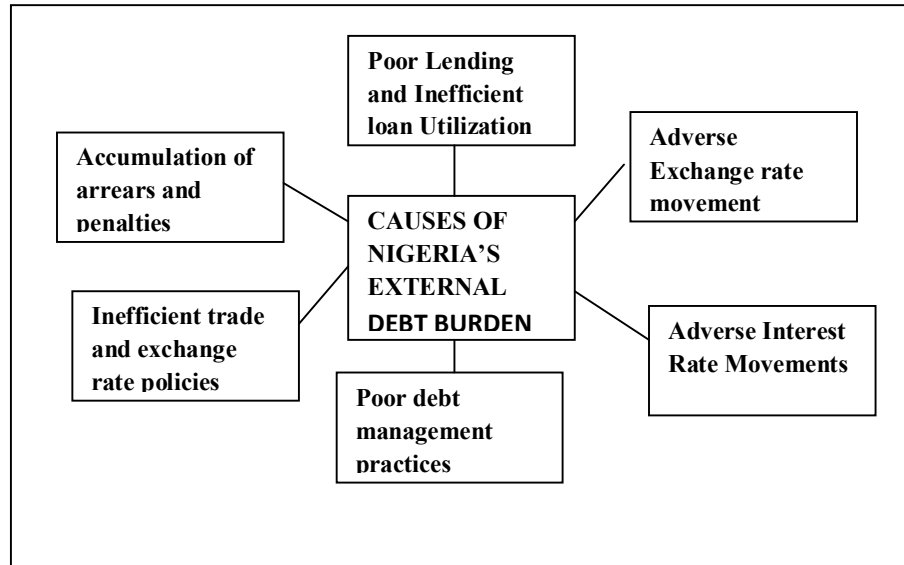
1. Low Savings Propensity
2. Unrealistic Exchange Rate
3. Poor External Debt Management Policies
4. Financing of Long-Term Project with Short/Medium: Term Loans
5. Declining Foreign Exchange Earnings and High Import Bills.
6. Diversion of the Proceeds of Loan into other uses.

Uche (2005), identifies causes of Nigeria external debt burden to include:

- i. Problems of mis-match in the use of short and medium-term loans to finance long terms projects with the result that a good number of the projects were hardly completed before amortization was due, thus aggravating the debt service problem.
- ii. The over-dependence on oil revenue as the major foreign exchange inflow has resulted to high-degree vulnerability to external shocks.
- iii. Devaluation of the naira in 1986 subsequently fuelled inflation and increased repayment burden of external debt.
- iv. Another cause of external debt problems was that some project-tied loans were contracted without consideration for economic viability because foreign lenders were too eager to lend, as the country was considered under-borrowed in the late 1970s and early 1980s. Many of the projects were white-elephant projects.
- v. Political instability in the country, which resulted to frequent changes in government and policies, discouraged foreign private investment, which could have gone a long way to boost economic growth.

DMO CHART SHOWING PERSPECTIVE OF CAUSES OF NIGERIA'S EXTERNAL DEBT BURDEN

Figure 2



Source: www.dmo.gov.ng

DMO also highlights the following:

- Massive external borrowing took place in the 1980s, largely to offset the collapse in oil prices, crucially:
- Borrowing was not linked to future growth or exports.
- Insufficient regards given to economic viability of projects.
- Poor implementation due to weak absorptive capacity and governance problems.
- Mismatch between loan terms and project profiles.
- Interest rate risk as LIBOR rates escalated.
- Leakages associated with governance problems.

2.3.10 STRATEGIES OF MANAGING EXTERNAL DEBT: NIGERIA CASE

In order to prevent a breakdown of world economic and financial system in an increasingly globalized world of economic relation, creditor groups and international financial institutions took initiative to evolve measures to address the debt problems of nations (Uloghobui, 2007).

Anyao (1994), "Nigeria's external debt crisis management was fundamentally anchored on a posture of avoidance of debt repudiation. External debt repudiation can attract retaliation from aggrieved creditor countries. Uche (2003), "The best method of solving the overhang of external debt is to pay back if the country can afford it".

Some of the popular strategies which the country could deploy in managing its external debt include:

i. Debt Conversion

It is a programme that affords creditors whose debts had been confirmed and re-scheduled the chance to discount their debts by getting the proceeds of settlement in a wide range of securities mostly denominated in the debtor's currency.

Uche (2004) "This is a mechanism for reducing a country's debt burden by changing the character of the debt. It involves the exchange of monetary instruments (e.g. promissory notes) for the exchange of tangible assets or other financial instruments".

According to CBN (2004), the objectives of debt conversion programme is as follows:

- To reduce the stock of outstanding foreign currency denominated debts in order to alleviate the debt service burden.
- To serve as an additional incentive for the repatriation of capital.
- To achieve industrial development in the economic growth through significant dependence on local inputs.
- To increase access to appropriate technology, external market and other benefits associated with foreign investment.

Debt Conversion Programme is an ingenious way of attracting for local use; the country's foreign debts duly discounted and paid in local investment denominated in naira. Debt conversion is categorized as follows:

- a. *Debt for cash* → Sanusi (1987), "This is similar to debt conversion to equity except that the proceeds from the conversion are not capitalized, but rather used for working capital, for local loan repayments and for local tax payments". The debt is converted to naira and issued to a local company for working capital purposes. The arrangement is made easy where the local company is the subsidiary or overseas outfit of the creditors.

- b. *Debt for export swap* → The creditor agrees to accept the exportation to his country of choice specified local goods in settlement for the debts. Essentially, it involves exchange of export for debt obligations.
- c. *Debt for Re-lending* → CBN (2003), ñThe creditor permits CBN to convert the foreign debt to naira for local lending for the benefit of the creditor.
- d. *Debt for equity* → Sanusi (1987), ñThis is conversion of debt at face value and at the prevailing exchange rate for the currency of the debtor country. Proceeds are designated as registered capital investment of the creditors in the debtor country. This scheme seeks to reduce the size of the external debt and link the servicing of the external obligations more closely to the country's capacity to pay in that the outflows of returns to investor would depend upon the earnings generated by the activity being financed.
- e. *Debt-Debt swap* → This is a change of one creditor for another in respect of loans.

ii. Debt Rescheduling

According to Adepoju, et. al. (2007), ñdebt rescheduling involves the postponement, extension and re-orderings of the repayment of the existing debt. This involves the elongation of the maturity profile of a debt so as to reduce the burden of immediate repayment on the debtor. Debt rescheduling could take form of refinancing, buy-back, issuance of collateralized bond and the provision of new money. 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 rescheduling Nigeria's debt under *Houston Terms*. Rescheduling of Nigeria's Paris club debt totaling US\$20.5 Billion in year 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 marked 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.

iii. Debt Cancellation/Forgiveness

A country could attempt to reduce its external debt by mounting vigorous international campaign for debt cancellation or forgiveness. Many creditor nations have treated such cases based on merit and have relieved many debtor nations and their debt burden in this way. (NDIC 2006) ñNigeria made an exit from Paris club debt, through cancellation. Nigeria obtained about USD 18billion debt relief from the Paris club of creditors in 2005.

iv. Partial Embargo on External Borrowing

In the view of Anyafo (1994) , in 1985 ña policy of not entering into new external loan commitments came into force with certain exceptions to allow for projects considered absolutely necessary in public interest and for projects designed to diversify the economic base and increase local production. Statement of Federal Budget (1990) ñThe external borrowing programme of the government was restricted to profitable and growth-generating projects which could pay their way and service the related loans.

v. Debt Repudiation

ñThis borders on gangsterism especially if the debts had been confirmed (Uche 2003). A country could seek to reduce its external debt burden by refusing to pay any portion of its external debt that cannot be reconciled or is of dubious origin.

vi. Regular Payment

ñSubject to availability of foreign exchange, it is strongly being advocated that debtor nations should strive to make regular payment of interest and principal when due so as to avoid the buildup of external debt (Uche 2004).

2.3.11 DEBT RELIEF OVERVIEW

Economic growth in developing countries should be fostered primarily on sound macroeconomic policies and good governance. Debt relief recently constitutes critical issues of political economy, because it affects the life of many people across the world. Giant strides were taken by several NGOs and by Jubilee 2000 campaign by raising a lot of attention on debt relief and have brought pressure on the rich countries government. This large mobilization resulted in a deeper commitment in debt reduction and has pushed forward the debt issue in the political agenda. Despite past experiences, many countries keep on having large external debt and debt service obligations which hamper economic growth and are a constraint to poverty alleviation.

The High Indebted Poor Countries Initiative (HIPC) deals with the solvency issue of LICs and includes for the first time also the multilateral institutions. The two main objectives of the Initiative, as stated by the World Bank and the IMF, are the long-term debt sustainability and poverty reduction. Notwithstanding an increased commitment of donors that originated the Enhanced HIPC (E-HIPC), the initiative has received many criticisms both from NGOs activists and from academic literature. Birdsall, et. al. (2002) provides a very exhaustive review of the HIPC Initiative and of its criticisms. The most important distinction is between who argues for a much broader and deeper debt reduction, as the only solution to reduce poverty and who claims that more conditionality and selectivity is needed in order to avoid wastes and loans to corrupted governments. Both the line of criticisms are well-founded and have in common the underlying idea that debt relief until now was not able to foster a strong path of economic growth, which is the core elements for poverty alleviation and debt sustainability. The *poverty trap approach* argues for a much broader and deeper debt reduction that should be linked to an assessment of the specific requirements needed by debtors to meet their essential needs. The other view *selective approach* claims that more selectivity should be instrumental to stimulate governments to improve their economic policies, while conditionality is a necessary condition to urge recipients to adopt structural reforms.

A complete debt cancellation without increased foreign aid is calculated (Sachs, 2002) to be not enough to meet only the basic health expenditures, while other resources are required for other basic needs and social infrastructures. Many activist and NGOs call for a complete debt write-off: Pettifor, et. al. (2001) are very critics about HIPC Initiative, which, in their opinion, has not reached the long-term debt sustainability and has failed the poorest countries.

Oxfam (2005), reports calls for a 100% cancellation of bilateral and multilateral debt, for an increase in aid volume (at least until the 0.7% of GNP target pledged by OECD countries) by donor countries and for a limited use of conditionality. Sachs (2002), was among the ones who calls for a deeper commitment and, even admitting that poor targeting is a source of the scarce results reached by foreign aid, he claims also that the current level of aid is not enough to start a growth process. He advocates for a real change in the creditors-donor point of view: debt reduction should be directly linked to an assessment of debtor specific requirements for meeting their essential needs.

A debt reduction limited to a general threshold is doomed to obtain poor results in terms of poverty reduction and economic growth. Birdsall and Deese (2004), propose to deepen debt relief, which should be based on the burden of debt payments on social needs expenditures, and to enlarge the group of eligible countries, other than to insure the HIPC countries against external shocks. Debt relief given to irresponsible government is not only ineffective, but it is also a lost opportunity to help better governed countries eradicate poverty. William Easterly (2001), links the previous arguments with the potential exclusion of other equally poor countries, which were able to manage well their external balance (i.e India, Bangladesh). Easterly clearly rejects the statement that debt relief allows for more spending on health and education and endorses conditionality claiming that debt relief will only help reduce debt burden if government policies make a true shift away from redistributive politics and towards a focus on economic development (Easterly 2001).

2.3.12 External Debts, Capital Flight and Growth

Both external debt and capital flight can affect the economic performance of a country. The theoretical framework through which the impact of external debt burden is felt on economic performance is through investment and/ or growth. One of the important arguments in this area is based on the debt overlapping theory. The theory is based on the premises that, if debt will exceed the country's repayment ability with some probability in the future, then expected service is likely to be an increasing function on the country output level.

The debt overhang act has an anticipated foreign tax on both current and future income. Thus, since part of the future return on any investment will accrue to the creditor as bigger debt service payments, it discourages capital accumulations and promotes capital flight.

Secondly there is credit-rationing effect. An indebted country is likely to face credit constraint in the international market. This is equivalent to facing higher real interest rates,

which discourage investment. As a result of reduced access to international financing, this will shift the burden of financing the budget to the domestic sector. Depending on how the financing is done, it can lead to increasing inflation [if the printing of money; for example is involved] and higher interest rates. Higher interest rates and rising inflation have deleterious effects on investment.

Thirdly as a result of the complementarities between public and private investment, the amount of money that is used to service debt crowds out public investment and discourages private investments.

Fourthly, there is a high degree of uncertainty in the debt rescheduling exercises. Not only are some countries not too sure of what they face but a lot of time is spent negotiating. This degree of uncertainty creates instability in the pursuit of macroeconomics objectives and thereby discourages domestic investments.

Turning to the effects of large external debt on growth, there are both direct and indirect channels [Elbadawi, et. al. 1997]. In the direct channel, debt accumulation expressed as a ratio of debt to GDP stimulates growth initially, while past debt accumulation [debt overhang] impacts negatively on growth. These two channels produce a debt-laffer debt, which shows that there is a limit at which debt accumulation stimulates growth. When this limit is reached, further debt accumulation impacts negatively on growth. The third channel works on liquidity constraint where debt service payment obligation reduces export earnings available for expenditures and thus impacts negatively on growth. The indirect channel is one in which as a result of reduction in available resources, government's ability to expand the economy is constrained, and growth is thereby compromised.

2.3.13 External Debt Burden Indicators

The external debt situation of a country is often measured by a number of macroeconomic aggregates and debt data (Ajayi, 2003). Different analysts give different weights to these indicators, but no single indicator or set of indicators can substitute for a thorough analysis of the overall situation of an economy. The advantage of the indicators in Global Development finance is that they are calculated from standardized data series that are compiled on a consistent basis by the World Bank and IMF. The ratios offer various measures of the cost, or capacity for, servicing debt in terms of the foreign exchange or output forgone.

Different debt burden indicators should be interpreted with caution as they suffer the limitations endemic to ordinal measurement e.g. a country may have a low ratio of debt to GDP, but may still have an unsustainable external debt if exportable comprise a very small proportion of GDP. The debt/GDP ratio is also influenced by the exchange rate depreciation of domestic currency. Even Debt/GDP and Debt/Exports do not convey the terms and conditions and mix of concessional and non-concessional loans in the debt factors which have a crucial impact on the magnitudes of debt service payment during the year. Many debt ratios are strongly affected by inflation. Majorly, debt indicators are relied upon for measuring the sustainability of debt. The limitations of the indicators are not such as to attenuate the severity of the debt situation in Nigeria. **The following ratios are often used:**

- (1) Interest payment to export of goods and services
- (2) Total external Debt to export of goods and services is a useful indicator of trend in debt that is closely related to the repayment capacity of the country.
- (3) Total debt services to exports of goods and services.
- (4) Interest payment to the GDP
- (5) Total debt service to GNP
- (6) Total external debt to GNP
- (7) Concessional debt to total external debt
- (8) Multilateral debt to total external debt

Table 2.8 Showing Nigeria Public Debt percentage of GDP

Country	Borrowing as % of GDP	Rating
Romania	21.4	BBB
India	52.8	BB+
South Korea	32.9	BB+
Lebanon	209.0	BB-
Jordan	72.2	BB-
Brazil	50.0	BB-
Nigeria	10.4	BB-
Russia	8.0	BB-
Morocco	70.9	BB
Turkey	64.7	BA3
Vietnam	47.5	BA3
Argentina	61.0	B+
Germany	66.8	AAA
France	64.7	AAA
USA	64.7	AAA
United Kingdom	42.2	AAA
Japan	176.2	AA
Korea	31.9	A2
China	22.1	A-
Average	61.5	

Source: World Fact Book 2007

Table 2.8 shows that Nigeria's Total Debt / GDP ratio is desirably much lower, whether compared with other countries at a similar stage of economies or with countries having more advanced economies compared with other countries, Nigeria's overall debt sustainability condition as measured by the debt ÷ GDP ratio remains sustainable

2.3.14 Debt Sustainability Analysis (DSA)

Nigeria's Debt Sustainability Analysis exercise always led by the DMO with the participation of the CBN, FMF, BOF, NPC, NBS and WAIFEM which provide the consultancy and technical support. The 2014, DSA result showed that Nigeria has remained at a low risk of debt distress, which is consistent with the result of the 2013, DSA. Various debt indicators showed that the public debt portfolio was within the sustainable limits. The debt-to-GDP ratio were at sustainable levels over the period under review, even when various shocks were applied to the baseline scenario. However, all the solvency and liquidity indicators under the fiscal sustainability analysis showed that the debt portfolio was vulnerable to revenue shocks, especially when crude oil price was set below US\$50.00pb.

The exercise was based on the World Bank Debt Sustainability Framework For Low Income Countries (World Bank DSF - LIC).

The purpose of the exercise was to assess Nigeria's Debt Sustainability and financing gaps in the medium to long term, as well as, proffer how best these gaps could be filled with additional borrowing and/or other financial inflows. The exercise in 2009 was undertaken within the context of the unfolding global financial crisis which adversely affected crude oil price, which is a major foreign exchange earner for the country. The result of the exercise which were based on the analysis of the country's debt profile and other macroeconomic data were benchmarked against the World Bank's Country policy and institutional Assessment (CPIA) Index which classifies Nigeria into one of the three policy performance categories [strong, medium, and poor], and Nigeria is currently classified as a medium performer with a rating of 3.4.

The Government is committed to ensuring debt sustainability and avoiding a relapse into Pre-Paris club debt exit situation. DMO is working closely with the ministry of Finance, the CBN, the National Planning Commission and other agencies in conducting DSA to keep track of the statics and dynamics of the public debt sustainability under changing local and external scenarios. Although the country desires massive resource inflows in order to fund the closing of its huge infrastructure deficit, it will continue to limit the extent of its dependence on external debt financing, while encouraging the inflow of non-debt resources, such as Foreign Direct Investments. A comprehensive framework on debt sustainability requires fully-fledged government budget constraint, which includes not only the external position, but also domestic debt and exchange rates. The theory of debt is generally concerned with the government budget constraint and the evolution of debt (internal and external) indicators along with the other relevant macroeconomic variables. A more appropriate approach should be based on the government budget constraint that links fiscal deficit, public debt, output growth, inflation and the balance of payments. Goldstein (2003) points out that even private sector liabilities should be considered, because they could become government debt (in case of a banking crisis, as happened in the Asian financial crisis).

A complete DSA should consider not only the financial sustainability, but also the economic one: a country should dispose of enough resources to serve its debt obligations and also to improve its economic performance. The great emphasis given to economic growth as a necessary condition to achieve sustainability is embedded in the IMF and WB works (IMF

2002), which clearly state that while the existing stock of debt (and associated debt service) sets the point of departure for determining long-term debt sustainability, the growth of income exports, and fiscal revenue, which to a large extent reflect a country's economic policies- are the underlying determinants of the evolution of a country's capacity to service external debt over longer term.

The new IMF-WB debt sustainability framework is based on three main pillars: (1) a country specific analysis, (2) a borrowing policy based on the risk of debt distress, and (3) a more careful projection method, which should give relevance to external shocks. The IMF and WB staff has elaborated a proposal for evaluating long term sustainability (IMF 2005) which moves from the previous context, but includes some of the received suggestions. Sun (2004), stresses the relevance of four elements which affect fundamentally the HIPC's capability of achieving long term sustainability: (1) the quality of policies and institutions, (2) an adequate debt management, (3) diversified export base, and (4) fiscal revenues mobilization. The relevance of institutions is generally confirmed by the literature, which stresses the importance that institutional quality has for a country's capability of managing debt and fostering growth.

DEBT SUSTAINABILITY ANALYSIS SCENARIOS

The DSA examined three scenarios: Baseline Scenario, Optimistic Scenario (Accelerated GDP Growth) and Pessimistic Scenario (Reduction in the oil Production and Global Financial Meltdown). The following were the main assumptions of the *Baseline Scenario*: average real GDP growth rate of 6.65 percent, double digit inflation rate averaging 11.5 percent yearly over the period 2009-2015, average oil price of US\$48 per barrel for the period 2009-13 and thereafter, US\$55 per barrel for the rest of the period under review, oil production level of 2.4 million per day by 2029, budget deficit of an average of 3 percent of the GDP, projected growth in exports and imports throughout the projection period,

Exchange rate of US\$1/N150 for 2009-2005 and US\$1/N160 for 2020-2029, external borrowing at a minimum concessional grant element of 35 percent, projected deficit to be financed 40:60 ratio from external/domestic sources, and restructuring of the domestic debt in the ratio of 75/25 for long term/short term instruments. The *Optimistic Scenario* has the following assumptions: achievement of the 7th Point Agenda and Vision 20:2020, average real GDP growth rate of 11 percent, single digit inflation from 2010, improvements in

government revenue due to favorable outlook in oil revenue, average oil price of US\$71 per barrel throughout the projection period, daily oil production of above 3 million barrels per day, current account surplus due to exports growing faster than import, Exchange rate of US\$1/N120, and fiscal deficit to be financed largely from less concessional sources.

The *Pessimistic Scenario* has the following assumptions: prolonged impact of the global financial meltdown in the medium term and possible reduction in oil production, average real growth rate of 2.9 percent in 2009 and not more than 3 percent over the projection period, single digit inflation from 2010, shortfall in oil production due to the Niger Delta issue and possible reduction in Nigeria's OPEC production quota, average oil production of 1.75 million barrels per day, average oil price of US\$33 PER barrel, Exchange rate ranging from US\$1/N145 to US\$1/N230 during the projection period, current account deficit due to imports growing faster than exports throughout the projection period.

EXTERNAL DEBT SUSTAINABILITY

Under the *baseline scenario*, the results of the DSA showed that both the solvency and liquidity indicators of the country's external debt will remain sustainable throughout the projection period. All the external debt ratios are within the indicative threshold. The output Baseline data in Table 2.9 indicates that all the debt indicators would remain below the external debt thresholds for Nigeria's peer group both in the medium to long-term. While the PV of ratio of External Debt/GDP remained constant between 2014 and 2017 before declining, other solvency indicators show a rising trend up to 2019. This means that the increase in the country's GDP is not accompanied by a proportionate increase in export and revenue, thereby making the debt portfolio susceptible to both indicators. Though the liquidity indicators remained relatively low over the projection period compared to the thresholds, it could be observed that the ratio of Debt Service/ Revenue not only rose at a faster rate than other indicators with noticeable spikes in 2018. It also kept rising even when the ratio of Debt/GDP was falling, further highlighting the weak link between rising GDP and growth in revenue.

TABLE 2.9 NIGERIA’S EXTERNAL DEBT INDICATORS UNDER THE BASELINE SCENARIO

Descriptions		Threshold	2014	2015	2016	2017	2018	2019	2024	2034
Solvency Indicators	PV of Debt/GDP	40	2.4	2.4	2.4	2.4	2.3	2.2	1.6	1.5
	PV of Debt/Export	150	12.9	13.8	14.6	15.1	15.4	15.6	15.6	14.4
	PV of Debt/Revenue	250	51.7	58.6	65.1	69.6	71.6	75.8	79.8	78.9
Liquidity Indicators	Debt Service/Exports	20	0.4	0.5	0.6	0.7	1.3	0.9	1.2	1.2
	Debt Service/Revenue	20	1.7	2.2	2.6	3.1	6.1	4.5	6.4	6.5

Source: 2014 Debt Sustainability Analysis Report.

The *optimistic scenario* showed that the country’s external debt ratios would remain sustainable in the medium term. All the solvency indicators showed sustainability due to macroeconomic assumption of massive increase in investments mainly from less concessional sources which would increase the debt burden of the country and lead to unsustainability in the long term. The liquidity indicator under this scenario also displays a similar trend of debt sustainability only in the medium term. This is due to assumption of relying on external funding sources to fund development which would have the effect of putting pressure on government’s ability to service its mounting debt in the medium term and thereby leading to unsustainability in the long term.

The results of the analysis on debt indicators under the Optimistic Scenario are generally below those under the Baseline based on the assumptions of robust economic growth and lower fiscal deficit relative to the Baseline. The ratio of PV of external Debt/GDP is projected at 2.3 percent for 2014 and this continued to trend downward over the projection period. The other non-GDP solvency indicators- ratios of PV of External Debt/Export and PV of External Debt/Revenue – however, rose in the medium term before declining towards the of the projection period. The liquidity indicators also showed a gradual rising trend in the medium

term, meaning that exports and revenue did not grow at the same pace with total output, further highlighting the weak link between the GDP and revenue, amongst others.

TABLE 2.10 NIGERIA’S EXTERNAL DEBT INDICATORS UNDER THE OPTIMISTIC SCENARIO

Descriptions		Threshold	2014	2015	2016	2017	2018	2019	2024	2034
Solvency Indicators	PV of Debt/GDP	40	2.3	2.3	2.3	2.2	1.8	1.6	1.4	0.8
	PV of Debt/Export	150	10.1	12.6	13.1	13.9	14.6	11.0	9.5	7.7
	PV of Debt/Revenue	250	42.3	50.4	52.8	56.9	58.1	61.9	57.5	42.0
Liquidity Indicators	Debt Service/Exports	20	0.3	0.4	0.5	0.6	0.9	1.0	1.2	1.0
	Debt Service/Revenue	20	1.5	2.0	2.4	2.7	4.1	3.5	5.4	3.8

Source: 2014 Debt Sustainability Analysis Report

Debt sustainability analysis under the pessimistic scenario showed that the country’s debt ratios would be sustainable in the medium term; it would be unsustainable in the long term as long as the global financial meltdown persists and any factor continues to undermine oil production.

The *Pessimistic Scenario* assumes reduction in the growth of the GDP, increase in the rate of inflation decline in revenue accruing to the FGN as a result of a steady fall in crude oil prices, deterioration in fiscal deficit and current account balance, amongst others. Unlike the previous year which made Pessimistic Scenario revenue-specific, this year’s DSA considered deterioration in a broad range of macroeconomic indicators and variables that could impact negatively on the debt portfolio. Although the result indicate that the country would still remain at a low risk of debt distress under this scenario. All the indicators reached their peak at the end of the projection period at which point the ratio of PV of External Debt/Export, in particular breached the threshold, thus, highlighting the need to strengthen the revenue base of the country for long-term sustainability.

TABLE 2.11 NIGERIA'S EXTERNAL DEBT INDICATORS UNDER THE PESSIMISTIC SCENARIO

Descriptions		Threshold	2014	2015	2016	2017	2018	2019	2024	2034
Solvency Indicators	PV of Debt/GDP	40	2.6	2.8	3.0	3.2	3.2	3.2	3.3	5.4
	PV of Debt/Export	150	39.7	45.4	50.2	53.9	56.0	59.0	82.6	164.9
	PV of Debt/Revenue	250	60.7	68.8	77.3	84.6	89.7	94.5	110.0	210.7
Liquidity Indicators	Debt Service/Exports	20	1.3	1.7	2.0	2.4	4.8	3.5	6.6	13.6
	Debt Service/Revenue	20	2.0	2.5	3.1	3.8	7.6	5.6	8.8	17.4

Source: 2014 Debt Sustainability Analysis Report

2.3.15 The Evian Approach

The ‘Evian Term’ adopted in October 2003 in Evian, France. It enable debtor countries to get their debts restructured by the Paris club with facilities that reflect their specific financial needs, not predefined facilities (DMO 2009). The Evian Term are a more orderly way of attaining long_ term debt sustainability prior to the adoption of the Evian Terms, the Paris Club used two board criteria to treat debtor countries: income and degree of indebtedness. The poorest countries with access only to IDA loans were entitled to a 67% debt stock reduction under the Naples Terms. HIPC were entitled to around 90% debt reduction under the Cologne Terms. all other indebted states including Nigeria were entitled to rescheduling for 20 years under the Houston Term: aid loans rescheduled on a Concessional basis: but no debt write-offs.

The Evian Term is an improvement to this rigid method of classifying countries, and provides a more flexible way of dealing with debtor nations. Countries entitled to Evian Term are not treated via pre-defined rules: they are treated on a case-by-case basis, with their individual circumstances coming into play.

- The Evian Term work begins with the IMF conducting a debt sustainability analysis (DSA) for a country. The DSA assesses the long term cash needs of the country, not just its short-term cash position. If the DSA reveals that the country debt position is unsustainable, the Paris Club will then consider long-term solution like reducing the country's debt stock.
- Debtor countries that are entitled to the Evian Terms are all "blend countries" that can borrow from both the IDA and the IBRD, and all low and middle-income countries that are not entitled to the HIPC Cologne Terms. In addition, a formal agreement with the IMF is necessary.
- Benefit that Evian Approach has made Country like Nigeria now entitled to some form of debt relief, not just mere debt rescheduling. The Evian Term also improved the Paris Club's relationship with private sectors of debtor countries, improving the transparency record of the Club.

Impoverished states with little or no access financial markets are labelled by the World Bank as 'IDA only,' making them eligible for long term concessional loans. Nigeria has failed to get 'IDA only' status despite asking for it for over a decade.

There are three main criteria for 'IDA only' status. First, a country must have a per-capita GNI of less than \$895. Nigeria's GNI in 2003 was \$320, yet it is still being exempted from the list. IDA eligible countries must lack the creditworthiness needed for borrowing from both private creditor and the IBRD. Nigeria did not receive any money from private creditor from 1992-2002. The World Bank itself publicly stated that Nigeria is not currently creditworthy for IBRD assistance. Yet Nigeria has failed to become an 'IDA only' Country.

The final criterion for 'IDA only' eligibility is growth friendly economic policies. Nigeria's macroeconomic performance has not been significantly worse than that of the 39 African countries classified 'IDA only'. In fact on fiscal discipline Nigeria outshines 26 of these countries. In 2004, Nigeria kept the single digit inflation rate, something few 'IDA only' states have been able to achieve. Apart from Nigeria, there are three 'IDA only' oil producers: Cameroon, Congo and Angola. Nigeria may produce a third of the continent's oil, but Angola and Congo produce five times more oil per capita than Nigeria. The World Bank insists that Nigeria's oil money can be used to curb poverty, but Nigerians earn less than fifty cents a day per capita from oil, Nigeria's inflation is today below 10 percent. Angola's is in triple digits. Angola's GNI is twice Nigeria's. Its fiscal discipline is worse. Yet Angola is an 'IDA only' country and Nigeria is not. (DMO 2004). The World Bank has continued to

call Nigeria a ðblendô country, even though it has the characteristics of an ðIDA-onlyô country. This double standard continues to limit Nigeriaô access to concessional credit and substantial debt relief.

2.3.16 Nigeria and Unpayable Debts

Speaking at a joint press conference with president Olusegun Obasanjo during his visit to the country in October, 1999, President Clinton said, ðIt is neither morally right, nor economically sound, to say that young democracies like Nigeria, as they overcome the painful legacy of dictatorship or misrule, must choose between making interest payments on their debt and investing in the health and education of their children.ð (Pettifor Ann,1999).

At another meeting with Kwesi Owusu, head of Jubilee 2000 Africa Initiative in March 2000, president Obasanjo averred that, ðthe time for an international commitment of deep debt reduction and forgiveness is now. Our foreign debt stands at U\$31 billion, and continues to rise, not because of any significant additional borrowing, but mainly as a result of the cost of servicing what was actually borrowed in the past. In these circumstances, it is simply not possible to speak of any significant measure of development, for as long as we are obliged to allocate so much of our lean resources to debt servicing. It is morally unjustifiable for the poor people of Nigeria to suffer any longer.ð (Pettifor Ann, 2000).

Nigeria owes \$30.3 billion, according to the World Bankô data for 1998. However, accounting of the debt was very poor during the Abacha years and the debt may well be nearer to US\$35 billion. About two thirds of the debt is to the Paris Club, with Britain, Germany, Japan, and France the largest creditors. More than US\$15 billion of the debt of the Paris Club is in the arrears. Nigeria, in recent years has made serious efforts to pay its commercial creditors and received rescheduling in 1992, but it effectively broke off working relationships with Parish Club Creditors, and hence the large rise in arrears. The total figure (in 2000) owed to bilateral creditors is estimated at nearer US\$22.5 billion.

Nigeria paid creditors at a total of US\$1.5 billion on average each year in the financial years 1998 to 1999 and 1999 to 2000. Of this about US\$250 million to was to the multilaterals, and US\$250 million to private creditors. Payments to the Paris Club made up the remainder. The small arrears that existed with the multilaterals have been cleared, but arrears continue to mount with other creditors. By 2000 the IMF and the Paris Club were insisting that Nigeria devote US\$3.6 billion ï nearly 9 percent of the gross domestic product

(GDP) to debt service to Paris Club and the IMF, the World Bank, and regional bank creditors. The government made public its intention to use the gains from oil revenues for poverty alleviation, and allocated US\$1.5 billion in the 2000 budget for external debt repayment.

The sums to be diverted by Nigeria to western creditors contrasts with resources available for poverty reduction. The new poverty Alleviation Program passed by the National Assembly amounts to US\$150 million, 0.4 percent of spending has been fixed at US\$400 million, 1 percent of GDP. Despite the fact that Nigeria will not pay US\$3.6 billion in debt service, creditors are still demanding 15 times in debt service what the Nigerian government is able to pay in poverty reduction. Having lent money to military dictators, and having failed to collect debts from those dictatorships, they are now coercing the new democratic regime into repayment of those odious debts.

Oil prices have risen from an average of US\$18 in 1999 to a forecast US\$29 in 2000. Oil and gas (the price of which is linked to oil) account for more than 90 percent of Nigeria's exports, and so the increase will mean significantly increased export earnings for this year. Exports in 1999 were US\$13 billion and for 2000 will be about US\$22 billion. This will result in a windfall of between US\$5 and US\$7 billion in government revenue. In June 2000, the managing director of the Nigerian National Petroleum Corporation (NNPC) announced that US\$2 billion of arrears to the oil multinationals have been repaid, but this still leaves a further US\$1 billion still to be settled.

Paris Club creditors are almost all enjoying unprecedented economic prosperity as a result of the long boom in industrialized countries. The poverty indicators in Nigeria are shockingly low, and on current trends Nigeria will not meet the 2015 development targets agreed to by members of the Development Assistance Committee of the OECD.

2.3.17 Nigeria and the HIPC Sustainability Criteria

Debt is about 75 percent of Nigeria's GDP, very high in absolute terms. However, the IMF and the World Bank do not base eligibility on debt to GDP ratios. For the IMF, the key ratio is the debt to export ratio. Nigeria's ratios are dependent on volatile and fluctuating oil prices. Oil prices have been at less than US\$20 a barrel over the last decade, but have moved up to

US\$25 per barrel, Nigeria's oil export revenues (95 percent of all revenues) are of the order of US\$18.3 billions.

Allowing for production costs and the share that goes to foreign firms, oil revenues would provide export earnings of no more than US\$14.5 billion to Nigeria. This means that the effective debt to export ratio is more than 200 percent. The debt service due (US\$3.6 billion) ratio to export revenues is 25 percent. Both these ratio exceed by far the ratios for eligibility for HIPC set by the IMF and the World Bank have never defended their decision to remove Nigeria from the HIPC list, despite repeated challenges for justification by Jubilee 2000 and other advocates.

The external debt sustainability issue is widely debated in the theoretical and empirical literature and there are different perspectives to debt sustainability, depending on the economic targets and on the consideration of lender and borrower behavior. The HIPC Initiative is based mainly on the Debt Sustainability Analysis (DSA), which concerns the behavior of the borrower country and its willingness and ability to meet its debt obligations. However, the notion of debt sustainability is quite complex and it should generally consider both the behavior of the borrower and of the lender. Debt sustainability is achieved by the interaction of the debtor country economy and of the investment choices made by creditors in the financial markets. Approaches presented to sustainability includes (a) a distinction is made between the lender-based and borrower-based approach (b) a broader classification that distinguishes between a simple debt capacity analysis (financial sustainability) and a more complex view that involves the assessment of some basic development targets (economic sustainability). The approach used by the HIPC Initiative is a possible ways to address the issues:

1. Optimising models: where the marginal benefits equals the marginal cost of borrowing.
2. Non-optimising models: *growth-cum-debt model and "debt dynamics" approach*. In the growth-cum-debt model, the external borrowing is used in order to fill the gap between domestic savings and investment, as in the two-gap model. The condition to be solvent requires that the rate of growth of the economy must be greater than the rate of interest (cost of borrowing). The debt dynamics approach looks at the external solvency and at the export rate of growth, which is now the parameter that must exceed the rate of interest.

3. Fiscal space models: due to reduced public expenditures because of debt service. Moreover, the lack of infrastructure and public spending has an adverse effect on private investment, which are dismissed and the result is slow growth. Another way in which the cash flow effect damages the economy is through import compression, which reduces government investment and, in turn, the rate of growth of the economy.
4. Disincentive effects: a large stock of debt undermines economic performance through the *debt overhang* effect, which is related to the tax disincentive and to macroeconomic stability. In the first case, which reflects the basic idea of the debt overhang theory, a large stock of debt discourages the investment because taxes on future income are expected to be used to serve the debt payments. In the second case, the disincentives are related to the possible creation of macroeconomic instability, due to: (1) exchange rate depreciation, (2) increases in fiscal deficit, (3) monetary expansion and inflation and (4) uncertainty due to exceptional financing.

2.3.18 Nigeria and the DAC targets for 2015

Nigeria could only hope to reach the Development Assistance Committee (DAC) targets with complete debt cancellation and increases in aid flows. Nigerian GDP per capita is US\$300 per person. Health spending per capita is a shocking US\$1.5 per person. Life expectancy is 53 and falling because of HIV/AIDS; only 38 percent of children were immunized against measles from 1995 to 1997; 36 percent of under 5 years children are underweight, and 51 percent of the population does not have access to safe water.

Per Capita income showed no significant increase between the years 1965 and 1998. The country is ethnically divided and collapsed social services combined with wide spread disease, a spiralling HIV/AIDS epidemics, low life expectancy, high malnutrition, and low school attendance. Without substantial debt cancellation or not rescheduling, Nigeria will not meet the 2015 Millennium Development Goals. Jubilee 2000 calculate that the difference between Nigeria's taxing capacity and its required social spending to meet the DAC target is more than US\$5 billion a year. This is more than its debt service due. Therefore, even if Nigeria's debt is entirely written off, it will still need additional aid of more than US\$1 billion a year if it is to meet the internationally agreed poverty reduction target for 2015. This means Nigeria needs a total debt cancellation plus additional aid.

2.3.19 Debt Servicing Difficulties and the Accumulation of Penalties

Debt servicing difficulties, which began in 1983, have continued until now. The actual debt service ratio and not scheduled debt service ratio has been below 30 percent for about a decade. But this has been because of the official policy of holding down disbursement of debt service to 30 percent or less of earnings from export of goods and services. However, the ratio of scheduled debt service payments to exports of goods and services persistently exceeded 30 percent in the 1990s, and was indeed as high as 71.3 percent in 1992 to 1997.

The ratio of total debt to exports has also been rather high, averaging 250.9 percent, although it is less than the critical value of 275 percent. Thus, the servicing of the huge debt stock has continued to be very burdensome on the economy. Given the difficulties in servicing existing loans and meeting current obligations the external debt burden certainly looms large.

Obviously, the burden of amortization and interest payments has tended to drain the nation's resources and reduce the possible expenditure of resources on productive ventures. The setting aside of a disproportionately high percentage of export earnings to meet debt service obligations means increasing inability of the country to pay for imports of goods and services vital for economic growth. Central Bank of Nigeria on the issue of Nigeria's debt management in October 1997 emphasized the point when he warned that the heavy external debt burden that the country is experiencing has reduced investible funds that would have aided the development process. The increasing net transfer of resources from Nigeria is compromising the growth objective of economic restructuring. This has actually been the case to the extent that the external debt service increases the government budget deficit financed mainly by the Central Bank of Nigeria, it frustrate the achievement of other macroeconomic objectives including price, exchange rate, and interest rate stability as well as balance of payment viability. The implication of this, therefore, is the need to reduce the debt service burden substantially to release foreign exchange resources for funding economic recovery programs as well as make the continued contracting of burdensome new loan unnecessary. Efficient management of the debt and a good external borrowing strategy can help in this regard.

Compounding the debt position is the poor and inefficient use of the loans, thus raising issues of poor governance and corruption. Most of the loan, which were produce from private source with unfavorable terms, were either diverted or utilized for project that were

unable to generate fund for servicing the underlying debt. Indeed, the 1996 Federal Government Budget statement confirmed the very unsatisfactory nature of past debt management strategy to the effect that many of the project financed by external loans are either uncompleted ,or partially completed and where they have been completed, they are not functioning.

More insights, with staggering revelation, were provided into the above problem in the 1997 budget. An appraisal by federal ministry of finance of 145 project in 30 state and Abuja, financed with international market loans all amounting to the equivalent of \$13.72 billion, with vary in amounts sourced from ,export credit agencies (Paris Club),London Club, and non Paris Club bilateral creditors disturbing finding and found that 18 project, described as failed project financed with credits and loans amounting to \$836.17 million ,were never executed yet the loans have been drawn down and are being serviced by government .

The implication of these finding are clear. More than 40 percent of the sampled project were not yielding any economic and social benefits .Even those surviving project were barely able to yield meaningful economic and social benefits, All expectations from the projects , in terms of their potential contribution to government revenue, labor employment and overall growth and development of the economy, have yet to materialize. Essentially, the projects have not contributed in any way to the servicing of the loans.

The external debt service amounted to US\$346.72 million as at end of December, 2014, compared with US\$297.32 million at year 2013, representing an increase of US\$49.40 million/16.62%. Nigeria Government obtained in 2014 the sum of US\$216.33 million as waivers, due to timely remittance of debt service in 2014. They were in respect of the payment made to IDA, BADEA and IDB, amounting to US\$132.52 million, US\$0.04 million, US\$83.78 million respectively. Appendix xiv-xviii shows debt service payment with emphasizes on penalty interest. Table 2.12 shows the various distribution of debt service.

Table 2.12 EXTERNAL DEBT SERVICE, 2010-2014(US\$' Million)

SOURCE	2010	2011	2012	2013	2014
A. Official:					
1. Bilateral:					
Non-Paris Club	24.18	51.52	45.28	41.08	48.93
2. Multilateral	212.61	172.27	126.92	142.89	152.74
B. Commercial:					
1. Oil Warrants	41.72	41.72	41.27	41.72	41.72
2. Others(including commercial from China)	75.9	69.23	45.32	37.88	0.01
3. Eurobonds	0	16.87	33.75	33.75	91.26
4. ZTE	0	0	0	0	12.06
Grand Total	354.41	351.61	293	297.32	346.72

SOURCE: DEBT MANAGEMANT OFFICE REPORT (2014)

2.3.20 STATE GOVERNMENT EXTERNAL DEBT STOCK

Total external debt stock of the states stood at US\$3,265.82 million as at end of December 2014, representing 33.63 percent of the total public debt external debt stock of the country, compared with US\$2,816.02 million recorded as at end of December 2013. The increase of the debt stock by US\$449.80 million or 13.77 percent over the figure in 2013. State's external debt comprised FGN's on-lent loans obtained from multilateral sources on concessional terms, which were used to fund projects and programmes in various sectors of the economy. The total external debt service of the states and the FCT was US\$89.47 million. The DMO made commendable progress on its initiative aimed at institutionalizing sound debt management practices at the sub-national level.

Three different categories of trainings were undertaken for a total number of eighteen (18) states as at end of December 2014. This represents US \$ 1,835.64 million or 46.50% of the total external debt stock and 0.98% of the GDP of the country in 2009. Debts are mainly

Federal Government on-lent loans from multilateral sources {IDA, IBRD, ADF, and IFAD}. The loans were used to finance projects in the areas of education, health, water supply, housing and sanitation.

Table 2.13 TOTAL STATE GOVERNMENTS EXTERNAL DEBT STOCK 2005-2014

Year	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
State	5,061.15	1,400.34	1,539.93	1,660.49	1,835.64	2,000.70	2,165.30	2,384.18	2,816.02	3,265.82
External										
Debt										

Source: Debt Management Office (2014)

The external debt stock decreased significantly by 72.33% from US \$ 5,061.15 million in 2005 to US\$ 1,400.34 million in 2006 mainly due to the Paris club and London club debt exit. An increase trend was observed in 2007 due to increase in new disbursements over the years.

Table 2.14 STATE GOVERNMENTS EXTERNAL DEBT

S/N	STATE	MULTILATERAL	BILATERAL	% of TOTAL
1	Abia	33,791,420.92		1.03
2	Adamawa	40,275,205.57	6,500,000.00	1.43
3	Akwa Ibom	58,886,640.86		1.80
4	Anambra	45,154,626.04		1.38
5	Bauchi	87,572,428.68		2.68
6	Bayelsa	34,832,195.13		1.07
7	Benue	33,074,189.47		1.01
8	Borno	23,067,549.16		0.71
9	Cross River	131,468,661.94	10,000,000.00	4.33
10	Delta	24,233,639.67		0.74
11	Ebonyi	45,410,518.38		1.39
12	Edo	123,128,295.53		3.77
13	Ekiti	46,452,932.15		1.42
14	Enugu	62,428,599.36	6,500,000.00	2.11
15	Gombe	39,545,598.76		1.21
16	Imo	52,949,585.74		1.62
17	Jigawa	35,717,805.70		1.09
18	Kaduna	234,416,052.15		7.18
19	Kano	59,796,931.03		1.83
20	Katsina	78,925,362.41		2.42
21	Kebbi	43,786,053.64		1.34

22	Kogi	35,787,836.35		1.10
23	Kwara	52,722,198.82		1.61
24	Lagos	1,087,209,248.65	82,503,600.00	35.82
25	Nassarawa	49,942,696.58		1.53
26	Niger	38,250,438.25	6,500,000.00	1.37
27	Ogun	109,154,553.08		3.34
28	Ondo	52,688,524.40		1.61
29	Osun	67,103,294.39	6,950,000.00	2.27
30	Oyo	72,350,590.32		2.22
31	Plateau	30,947,579.75		0.95
32	Rivers	44,725,095.71		1.37
33	Sokoto	44,864,819.46		1.37
34	Taraba	22,780,063.89		0.70
35	Yobe	31,237,619.25		0.96
36	Zamfara	35,547,562.30		1.09
37	FCT	36,636,548.58		1.12
	SUB TOTAL	3,146,863,962.07	118,953,600.00	100.00
	TOTAL	3,265,817,562.07		

Sources: Debt Management Office (2014)

The detailed breakdown in Table 9 shows the external debt stock of each State, it indicates that Lagos, Kaduna and Cross River States have the highest debt stock 35.82%, 7.18% and 4.33% respectively. The States with the lowest debt stock were Taraba, Borno, and Delta State having 0.70%, 0.71% and 0.74% respectively.

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CHAPTER THREE

RESEARCH METHODOLOGY

3.1 INTRODUCTION

This section deals with the methodology adopted in the research work. The chapter will be divided into subsections as presented below;

3.2 RESEARCH DESIGN

Nachmias and Nachmias (1985; 76) view a research design as part of research methodology to be a blueprint that addresses the problems of scientific inquiry.

The use of analytical method of research is regarded by the researcher as logically sound and adequate for getting solution to the problems posed by the study. A non-experimental data source will be used in this research, which is called Time Series. Time series data implies those data that are carefully gathered over a period of time.

Kerlinger (1983), sees a research design from the perspective of aiming to provide answers to research questions and controlling variances. In the course of this research study *Ex Post Facto* research design was employed. Data that are already in existence were gathered and no attempt was made to manipulate relevant independent variables.

3.3 DESCRIPTION OF OTHER MODEL FINDINGS

This research work uses a model closely related to what is in the literature and in particular Blerjer and Khan (1984), Fisher (1993), Fry (1993), Greene and Villanueva (1991), Servén and Solimano (1993), Fosu (1999) and Ajayi (2003). They include variables such as exchange rate, debt burden indicators and rate of change on prices.

$$GDP = f(BPREM, DEBTGDP, TDSGDP, KFI, GDP)$$

Investment the dependent variable is expressed as a function of the black market premium (BPREM) defined as a ratio of the exchange rate the debt-gross domestic product ratio (Debt/GDP) capturing the debt overhang. The other debt overhang variable is the debt/export ratio (DEBEX). A crowding out effect is measured by the debt-service GDP ratio (TDSGDP). The Growth rate of the GDP (GDP) is included to capture the investment accelerator effect. The extent of capital flight is measured by Kfi. In the model above, it captures the relationship between external debt, capital flight and growth in Nigeria.

This research work also base theories on debt overhang theory which agrees with the study of Ajayi (2003):

- It is based on premises that, if debt will exceed the country ability with some probability in the future, then expected debt service is likely to be an increasing function of the country's output level.
- Debt overhang acts as an anticipated foreign tax on both current and future income. Part of the future income/return on any investment will accrue to the creditor as bigger debt service payment; it discourages capital accumulation and promotes capital flight.
- There is high degree of uncertainty in the debt rescheduling exercise and creates instability in the pursuit of microeconomic objectives and thereby discourage domestic investment.
- Debt accumulation impact negatively on growth. It describes that there is a limit at which debt accumulation stimulates growth. When this limit is reached, further debt accumulation impacts negatively on growth.
- With liquidity constraint, debt service payment obligations reduce export earnings available for expenditure and thus impact negatively on growth.

This research hereby modifies the model above by using GDP, External Debt Stock, Exchange Rate and Penalties on Arrears for Default establishing linkages between external debt and economic performance. The theoretical framework shows the impact of external debt burden is felt on economic performance through investment and/or growth. As a result of external debt that goes beyond the borders of national country, it is hereby necessary to include exchange rate as a variable that is been adopted. Nigeria major export commodity (crude oil) is tagged to the Dollar currency. The exchange value of Dollar vis-à-vis Naira is also used.

3.4 SPECIFICATION OF MODELS

Hypotheses I

H₀ ; External debt do not have a significant negative impact on Gross Domestic Product.

Modeling of the hypothesis, using a linear function. The models for this study were carefully chosen to capture the objective of the study. The major characteristics of an econometric analysis were incorporated in the model specifications in a systematic manner.

$$Y = F(X)$$

$$GDP = F(EDSV, EXCH)$$

$$GDP = a_0 + a_1 EDSV + a_2 EXCH + U$$

GDP = Gross Domestic product {**Dependent variable**}

EDSV = External Debt Stock Values {**Independent variable**}

EXCH = Exchange rate of the Nigeria naira vis-à-vis the US dollar (Control Variable)

U = Stochastic or the error term

a_0 = Constant factor

a_1 = Slope {Value of external debt}

a_2 = Slope {Value of Exchange rate}

$$a_1 > 0, a_2 > 0$$

Exchange rate (EXCH) inclusion was deemed necessary by the researcher to serve as control independent variable. (See appendix xiii)

Hypotheses II

H₀ ; External debt penalties on arrears for default do not impact positively on Nigeria's external debt stock.

Therefore:

Modeling of the hypothesis using a linear function,

$$Y = F(X)$$

$$EDSV = F(APAD, EXCH)$$

$$EDSV = b_0 + b_1 PAD + b_2 EXCH + U$$

EDV = External debt values which is the dependent variable.

PAD = Values of penalty on arrears for default.

EXCH = Exchange Rate

b_0 = Constant

b_i = Slope

$$b_i > 0$$

U = Stochastic or the error term

Exchange rate (EXCH) inclusion is deemed necessary by the researcher to serve as control independent variable

3.5 NATURE AND SOURCES OF DATA

The nature of the data to be employed in this research work is purely secondary data.

3.5.1 SECONDARY SOURCES

Secondary data being already processed and collated data are easily found in publications of private individuals, institutions / organizations and governments (Onwumere 2009 : 138). The sources of secondary data used were the publications of the Central Bank of Nigeria, World Bank, Debt Management Office, National Bureau of statistics, e.t.c. Specifically, data were obtained from journals, magazines, articles of scholars, statistical bulletins, annual reports, economic/Financial bulletin, and unpublished works with a view to elucidate data.

3.6 TECHNIQUES OF ANALYSIS

Multiple regression analysis was used to analyze hypothesis 1 and 2 respectively. A sound comparative analysis will be derived by tables expressing various ratios in percentages or decimals. Multiple linear regression according to Onwumere (2009) "examines the relationship between a dependent variable and two or more regressors (independent variable)". Regression tool is used in measuring the impact of variable(s) on another. The techniques developed are designed not only to measure relationship (covariance) between two variables, but also to measure the degree of relationship (correlation) between these variables.

$Y = a + bx$ (variations in Y is due to changes in X)

a= constant indicating the point of interception with the Y-axis

b= parameter (slope of gradient) that defines the specific relationship between Y and X

Two variables are positively correlated if larger values of one are associated with larger values of the other, or if lower values are associated with lower values of the other and vice-versa if negatively correlated. This range between -1 Or $+1$

Ordinary Least Square (OLS): This is the method of estimation been used. The technique possesses the unique property of Best Linear Unbiased Estimator (BLUE) when compared to other estimating techniques. The OLS estimator also possesses the desirable qualities of unbiasedness, consistency, and efficiency.

The t-test: This is used to determine the statistical significance of the parameters in the model. It was tested at 1%, 5%, and 10% levels of significance.

F-statistics: This determines the overall significance of the entire model as regards the dependent variable and checks the joint variance of the explanatory variables. Hence, if the probability is < 0.05 , the explanatory variable parameters will be significant and vice-versa.

Coefficient of Determination (R^2): The test performed in regression analysis is measured by R^2 . It is a measure of the **GOODNESS OF FIT** of a regression line and measures the percentage of the total variations of our dependent variable as explained by our explanatory variable. If R^2 is found insignificant, this implies that there is no linear relationship between the dependent and independent variable, that is, the true b's are zero;

Level of Significance: It indicates the probability of rejecting the null hypothesis when it is true. 5% **L.O.S** was applied at which the researcher make a right or wrong judgment.

Durbin-Watson: d test was employed to detect auto-correlation in this study among the variables, d statistic is defined as residual to the sum of squared residuals. It shows the presence of positive or negative autocorrelation in a model. Econometric software (3.0 version) was used for the analysis of the parameters.

DECISIONS RULE

If the probability value is less than 0.05, we reject the null hypothesis and accept the alternative hypothesis. But if probability value is greater than 0.05% then accept the null hypothesis and reject the alternative hypothesis

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CHAPTER FOUR

DATA PRESENTATION, ANALYSIS AND INTERPRETATION

4.1 INTRODUCTION

This chapter presents the data, its analysis and interpretation of the methodology adopted in this research work.

4.2 Data presentation for hypothesis One

4.2.1 Computed data for External Debt Stock, Gross Domestic Product and Exchange rate within the period 1989-2014. (see appendix i-iv)

Table 4.1

YEAR	EXTERNAL DEBT STOCK N Billion	GROSS DOMESTIC PRODUCT N Million	EXCHANGE RATE
1989	240.39	236,729	8
1990	298.61	267,550	7
1991	328.45	265,379	8
1992	544.26	271,365	9
1993	633.14	274,833	17
1994	648.81	275,450	21
1995	716.87	281,407	21
1996	617.32	293,745	21
1997	595.93	302,022	21
1998	633.02	310,890	21
1999	2,577.37	312,183	92
2000	3,097.38	329,178	102
2001	3,176.29	356,994	111
2002	3,932.88	433,203	120
2003	4,478.33	477,533	129
2004	4,890.27	527,576	133
2005	2,695.07	561,931	129
2006	451.46	595,821	127
2007	438.89	634,251	116

2008	523.25	674,889	131
2009	590.44	716,949	147
2010	689.84	776,332	150
2011	896.85	834,000	154
2012	1,026.90	888,893	158
2013	1,373.58	950,110	157
2014	1,631.52	624,000	170

Sources: Central Bank of Nigeria, Statistical Bulletin (1989-2014), National Bureau of Statistics (2014), Debt Management Office (2014)

4.2.2 Analysis of Data

Hypothesis One

Ho External debt stock do not have a significant negative impact on Gross Domestic Product (GDP).

Hi External debt stocks have a significant negative impact on Gross Domestic Product (GDP).

4.2.3 Model Specification

The relationship between the dependent variable and the independent variable is given by the linear function represented by the equation below and interpreted as follows:

$$GDP = f(EDSV, EXCH)$$

$$GDP = a_0 + a_1 EDSV + a_2 EXCH + U$$

GDP = Gross Domestic Product (GDP) as Dependent Variable.

EDSV = External Debt Stock / values (Independent variable)

EXCH = Exchange Rate (Control Independent variable)

a_0 = Constant

a_1 - a_2 = Slope

U = Stochastic / Error Term

4.2.4 Test Statistics

Method: Multiple Regression Analysis using Ordinary Least Square (OLS)

Package: E. View (ECONOMETRIC Software package 3.0 version)

Level of Significance = 5%

Other variable of interest adopted in this regression technique are:

T = t statistics

R = Coefficients of determination

R² = Adjusted R

4.2.5 INTERPRETATION OF THE RESULT OF COMPUTER BASED E.VIEW ANALYSIS

Table 4.2 E-View Analysis of Hypothesis One

Dependent Variable: GDP					
Method: Least Squares					
Date: 11/04/15 Time: 05:07					
Sample: 1989 2014					
Included observations: 26					
Variable	Coefficient	Std. Error	t-Statistic	Prob.	
C	243164.2	28436.15	8.551236	0.0000	
EDSV	-6.662805	12.35918	-5.390978	0.0000	
EXCH	3800.275	285.1278	13.32832	0.0000	
R-squared	0.885398	Mean dependent var		479739.0	
Adjusted R-squared	0.875432	S.D. dependent var		222966.5	
S.E. of regression	78694.17	Akaike info criterion		25.49269	
Sum squared resid	1.42E+11	Schwarz criterion		25.63786	
Log likelihood	-328.4050	F-statistic		88.84697	
Durbin-Watson stat	1.957940	Prob(F-statistic)		0.000000	

Source: E-view Result (See Appendix v)

Estimated Equation:

$$\text{GDP} = 243164.2 + (-6.662805 \text{ (EDSV)}) + 3800.275 \text{ (EXCH)}$$

Students- Test:

$$\text{EDSV} = -5.39$$

$$\text{EXCH} = 13.32$$

Standard Error:

$$\text{EDSV} = 12.35$$

$$\cdot \text{EXCH} = 285.12$$

$$R\text{-Squared} = 0.88$$

$$\text{Adjusted R-squared} = 0.87$$

$$\text{Durbin Watson} = 1.95$$

The equation above shows the estimated regression line. There was a negative significant impact of external debt values / stock on gross domestic product. The coefficients of -6.662805 suggest that a one unit increase in external debt will lead to a decrease in GDP of 6.662805 (6 units). There was also a positive significant impact of exchange rate which is the control independent variable on gross domestic product.

The t - statistics (-5.39) and (13.32) is highly significant at 5% level of significance for the two independent variables of the overall regression (F-statistic).

The coefficient of determination and adjusted coefficient of determination shows a goodness fit in the model. This means that about 88% of the variation in GDP is caused by variation in the independent variables (External debt stock / values and Exchange rate).

DECISION RULE

If the probability value is less than 0.05, we reject the null hypothesis and accept the alternative hypothesis. But if probability value is greater than 0.05% then accept the null hypothesis and reject the alternative hypothesis.

DECISION

$$P_v < 0.05 \quad (0.00 < 0.05)$$

Thus, we reject H_0 and conclude that External debt stock / values have a negative significant impact on GDP within the period 1989 ÷ 2014.

4.3 Data presentation for hypothesis two

4.3.1 Computed data for External Debt Stock, Penalties on arrears for default and Exchange rate within the period 1989-2014. (see appendix i-iv)

Table 4.3

YEAR	EXTERNAL DEBT STOCK N Billion	PENALTIES ON ARREARS FOR DEFAULT	EXCHANGE RATE
1989	240.39	0.00	8
1990	298.61	0.00	7
1991	328.45	0.00	8
1992	544.26	20.74	9
1993	633.14	25.01	17
1994	648.81	27.41	21
1995	716.87	19.00	21
1996	617.32	14.78	21
1997	595.93	4.35	21
1998	633.02	3.32	21
1999	2,577.37	11.05	92
2000	3,097.38	1.78	102
2001	3,176.29	2.23	111
2002	3,932.88	0.625	120
2003	4,478.33	6.27	129
2004	4,890.27	3.03	133

2005	2,695.07	0.88	129
2006	451.46	0.29	127
2007	438.89	0.08	116
2008	523.25	0.14	131
2009	590.44	0.01	147
2010	689.84	50.94	150
2011	896.85	540.55	154
2012	1,026.90	0.01	158
2013	1,373.58	-	157
2014	1,631.52	-	170

Sources: Central Bank of Nigeria, Statistical Bulletin (1989-2014), National Bureau of Statistics (2014), Debt Management Office (2014)

4.3.2 Analysis of Data

Hypothesis Two

Ho External debt penalties on arrears for default do not impact positively on Nigeria's external debt stock.

Hi External debt penalties on arrears for default have a positive impact on Nigeria's external debt stock.

4.3.2 Model Specification

The relationship between the dependent variable and the independent variable is given by the linear function and its also logged to avoid spurious result because of the proxy of Penalties on Arrears for Default which is a component of Total Actual External debt service payment is represented by the equation below and interpreted as follows:

$$EDSV = f(PAD, EXCH)$$

$$EDSV = b_0 + b_1 PAD + b_2 EXCH + U$$

$$\text{Log EDV} = b_0 + b_1 \log PAD + b_2 \log EXCH + U$$

EDCH = External debt values / stock (Dependent variable).

PAD = Penalties on arrears for default (Independent variable)

EXR = Exchange Rate (Control independent variable)

b_0 = Constant

b_1 & b_2 = Slope

U = Stochastic / Error term

4.3.3 Test Statistics

Method – Multiple Regression Analysis using Ordinary Least Square (OLS)

Package – E. View (ECONOMETRIC Software package 3.0 version)

Level of Significance = 5%

Other variable of interest adopted in this regression technique are:

T = t statistics

R = Coefficients of determination

R² = Adjusted R

4.3.4 RESULT OF COMPUTER BASED E. VIEW ANALYSIS AND INTERPRETATION OF THE RESULT

Table 4.4 E-View Analysis of Hypothesis Two

Dependent Variable: LOG(EDSV)

Method: Least Squares

Date: 11/04/15 Time: 22:24

Sample(adjusted): 1992 2012

Included observations: 21 after adjusting endpoints

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	4.869761	0.889896	5.472283	0.0000
LOG(PAD)	0.086799	0.070237	1.235799	0.0324
LOG(EXCH)	0.491251	0.201044	2.443494	0.0251
R-squared	0.250148	Mean dependent var		7.009909
Adjusted R-squared	0.166831	S.D. dependent var		0.856185
S.E. of regression	0.781509	Akaike info criterion		2.476383
Sum squared resid	10.99361	Schwarz criterion		2.625601
Log likelihood	-23.00202	F-statistic		3.002371
Durbin-Watson stat	1.879630	Prob(F-statistic)		0.074951

Source: E-view Result (See Appendix vi)

Estimated Equation

$$\text{LOG(EDSV)} = 4.869761 + 0.086799 \text{ LOG(PAD)} + 0.491251 \text{ LOG(EXCH)}$$

Student's Test

$$\text{PAD} = 1.23$$

$$\text{EXCH} = 2.44$$

$$\text{R-Squared} = 0.25$$

$$\text{Adjusted R-Squared} = 0.166$$

$$\text{Durbin Watson} = 1.87$$

The equation above shows the estimated regression line. There was a positive significant impact of penalties on arrears for default on external debt values / stock. There was also a positive significant impact of exchange rate on external debt values / stock.

Penalties on arrears for default are statistically significant at 5 % level of significance. The coefficient of determination and adjusted coefficient of determination shows a goodness of fit in the model. The coefficient implies that about 25% of the variation in external debt values / stock is caused by penalties on arrears for default and exchange rate.

DECISION RULE

On the other hand, if the probability value is less than 0.05, we reject the null hypothesis and accept the alternative hypothesis. But if probability value is greater than 0.05% then accept the null hypothesis and reject the alternative hypothesis.

DECISION

$$P_v < 0.05 \text{ (} 0.032 < 0.05 \text{)}$$

We therefore reject H_0 and conclude that an external debt penalty on arrears for default has significant positive impacts on Nigeria's external debt values / stock within the period 1989 – 2014.

TABLE TREND

Nigeria external debt stock stood at US\$31586M in 1989 do not remain constant till 1990. At this period the country has 0.00 for penalties on arrears for default. The country does not default in repaying its debt obligations. Also the exchange rate of naira to dollar is precisely a single digit number of N8.00.

In 1991 the volume of ED's rose to US\$33099M and the subsequent fluctuation occurred. The year 1992 marks a large significant record of penalty payment of N20.74M and the exchange rate also increases from N9.00 to N24 all through 1998. The payment of penalties on arrears for default falls to one digit (US\$1.78M) in year 2000 during the takeover of democratic government.

A major achievement occurred in the history of Nigeria external debt structure in year 2005, a situation where government repayment schedule and relief was sealed. The relief makes the external debt stock to fall from N4, 890.27 billion in year 2004 to N451.46 billion in year 2006. The trend continues until year 2012, when it takes an upward movement again of N1, 026.90 billion and it's on the increasing till date. The penalty payment also drops to US\$0.29 at exchange rate of N127.00, while it goes up again in year 2010 through year 2011 from US\$ 50.94M to US\$ 540.55M. There has been a persistent fluctuation in the exchange rate in the years under review. Penalty payment between years 2005-2009 has been manageable due to prompt payment of principal and other service charges. But the penalty drastically goes up in year 2010-2011, while there was no record shown for year 2014. As at year 2014 the external debt stood at N1, 631.52 billion, while exchange rate is at N170.

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CHAPTER FIVE

SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATION

5.0 INTRODUCTION

This chapter carefully examined the summary of findings, conclusion report of this research, recommendations proffered and suggestions for further research.

5.1 SUMMARY OF FINDINGS

This study is all about An Appraisal of Nigeria's External Debt Management, with a detailed investigation from 1989-2014. In other words, the study reflects the strength, weakness, opportunity & threat as relates to Nigeria's External Debt Management.

Making inference from the statistical test been carried out on this study, with the use of regression analysis and computer aided program software (E.view), the following result were obtained;

(i) Nigeria's External debt did not contribute to Nigeria's Gross Domestic Product growth, within the period 1989-2014. This implies that threat associated with borrowing externally for capital formation in Nigeria, outweigh the benefit in there. Rising Exchange rate of naira-vis-à-vis dollar also have a positive relationship on Nigeria's GDP.

(ii) External debt penalties on arrears for default contributed to the growth of Nigeria's external debt within the period 1989-2014. Penalty interest payment contributed to the burden of Nigeria's external debt stock. An increase of external debt stock as a result of rising penalties on arrears will deepen the burden of debt and its sustainability in Nigeria. Rising Exchange rate of naira-vis-à-vis dollar also have a positive relationship on Nigeria's external debt stocks.

5.2 CONCLUSION

The conclusion of this study is of great importance and therefore goes thus; Institutional arrangement and governance structure deficiency resulting from non-centralization of the debt management functions, before the establishment of the debt management office constituted part of fundamental challenges that affect the size, structure, repayment profile and efficient external debt management in Nigeria.

That the Nigerian economy is heavily burdened by external debt is no longer news. What would perhaps, become good news in the future is that, as a result of positive changes in Institutional arrangements and the entrenchment of good governance, Nigeria's external debt is adjudged efficiently managed, sustainable and supports development. What has come out clearly from Nigeria's external debt crisis is that the management of the debt has been very weak and inefficient. Inefficient debt management coupled with the nature of the relief packages offered by the Paris club of creditors, have largely caused the debt problem to assume some dimensions till today.

External debt stock has a negative significant impact on GDP in Nigeria within the period 1989-2014. There was a positive significant impact of exchange rate on GDP.

There was a positive significant impact of penalties arrears for default on Nigeria external debt stock. There was a positive insignificant impact of exchange rate on external debt stock within the period 1989-2014.

The servicing of the huge debt stock has continued to be very burdensome on the economy. Given the difficulties in servicing existing loans and meeting current obligations, the external debt burden certainly looms large. Obviously, the burden of amortization and late penalty interest payment has tended to drain the nation's resources, increase external debt stock and reduce the possible expenditure of resources on productive ventures.

Currency composition of Nigeria's external debt stock, which indicates the breakdown of the foreign currency debt portfolio from which loans were procured, could be described as having low currency risk. The portfolio has SDR with highest percentage 2005-2009 and still consistent in year 2014.

External debt from the concessional windows, efficiency in managing debt portfolio, consideration for currency risk and exchange rate, upholding the Debt Sustainability Analysis Report, increased capital formation within the economy and prompt payment of debt servicing to avoid penalty charges and considering other factors that constitute debt service payment (i.e principal payment, interest fee, commitment charges, deferred principal/interest) will at long run produce positive result that will increase the growth of our economy.

5.3 RECOMMENDATIONS

This research work embodies comprehensive and desirable recommendations for enthrone efficient external debt management, prevention of penalties on arrears for default. It also presents a broad spectrum of opinions on possible solutions to debt crisis in Nigeria. The researcher also considers the fact of various policy measures and strategies adopted over the years at achieving a sustainable external debt portfolio. Thus based on the summary and conclusions above, the following recommendations are made;

- (i) External loan should be sourced concessionally. The concessional implies a lesser stringent form of obtaining a loan, in terms of repayment pattern, interest charges e.t.c. Adopting a concessional terms will be integrated with the objectives of the national debt management strategy
- (ii) In maintaining efficient debt sustainability, the researcher suggest appropriate funding mix in the ratio of 30/70 for external/domestic sources, pursuit of alternative funding sources such as joint ventures and Public-Private-Partnership, massive investments in agriculture and critical infrastructure (power and energy) and improving the efficiency of revenue generation agencies and a borrowing cap for all the three tiers of government for the years ahead.
- (iii) Accumulation of debt service payment and penalty for late payment arrears has been identified as compounding factors for the rising debt stock in the past as it contributed immensely to the deteriorated debt situation in Nigeria. To forestall a repetition of such development, regular and accurate payment is hereby suggested
- (iv) External debt service payment should be paid as at when due to avoid compounding late interest payment which is detrimental to economic growth.
- (v) Indiscriminate increase in the country's debt stock could be attributed to adverse exchange rates movement. The DMO should go for *hedging* as a check against future inflationary trend. Furthermore the dominance of SDR in the currency composition of the debt profile reduces the exchange rate risk of the portfolio. SDR is a basket of currencies which in themselves hedge against one another, thereby mitigating currency risk.
- (vi) External debt by economic sector should be taken into consideration. Bulk of Nigeria's external debt must be utilized to support infrastructure (telecoms, water, energy (electricity and gas), transportation (rail, road and air), housing, human capital development (education), health, social welfare and agriculture. This is in

accordance with the provisions of the Fiscal Responsibility Act and the National Debt Management objectives and strategy.

- (vii) With the legal and constitutional provisions in the country, strict adherence should be adopted in following the External Borrowing Guidelines i.e External Borrowing Guidelines (2008/2015).
- (viii) Budgetary controls, implementation and monitoring with financial accountability must be re-established in the public sector. This would help to restore financial discipline, thereby minimize misappropriation and embezzlement of public funds.
- (ix) Good governance on the part of the authorities to ensure that new external resources are productively employed is imperative. As Nigeria has taken step of establishing a well-focused and dynamic debt management office, the DMO should face Nigeria's debt overhang with strategies to facilitate a turnaround of Nigeria's debt portfolio. The DMO requires a very strong and sophisticated institutional structures and highly specialized skills across diverse professions. It also requires a well- articulated and coordinated communication and consultation system to enable it to cope effectively with the management of the various power groups who must buy into the perspective of a new type of macroeconomic set-up capable of supporting a management strategy at turning the debt burden into an asset for the promotion of growth and development within the shortest time possible.
- (x) Measures at the international level, is that the creditors countries, the multinational financial institutions as well as the commercial banks have a pivotal role to play in the resolution of the debt crisis. There is therefore the need for substantial cancellation, for the debt burden to be reduced to tolerable levels. Importantly many countries in West Africa sub-region owe their debts to official creditors who are in a position to absorb the cost.
- (xi) Some constraint faced by DMO, which is expected to be alleviated include; inadequate number and mix of manpower, limited professional training opportunities due to inadequate funding, Insufficient data processing (Data Base) and specialized financial market monitoring facilities, inadequate infrastructural facilities i.e office building and IT-networked environment.
- (xii) Concerted efforts should be made at efficient use of the established Debt Management units at the states level, working effectively in collaboration with

Debt management office of the Federal Government towards achieving overall objective of the DMO.

It is the hope of this researcher that if all that has been recommended are implemented, debt management in Nigeria will be effective and result oriented. This will reflect on the robustness of the Nigeria economy and will always enthrone a more efficient external debt management practices in Nigeria in the unfolding century.

5.3.1 SUGGESTION FOR FURTHER STUDY

The researcher calls for future research in this study area, specifically as follows:

- An opinion has been suggested that, while Nigeria seeks foreign banks and creditors nations to cancel our debt, why can't we (Nigerians) ask our CBN to cancel our own domestic debt. In the light of this, there should be a study on "An Appraisal of Nigeria's Domestic Debt Management". It will reveal the contribution of domestic debt to National economic growth in Nigeria.
- Scholars are encouraged to further research into other components of Actual external debt service payment i.e Principal payment, commitment charges, interest fee e.t.c as it affect External Debt Stock.

5.3.2 CONTRIBUTION TO KNOWLEDGE

1. This work examined the Impact of Penalties on Arrears for Default as a component of Actual External Debt Service Payment on Nigeria's External Debt Stock. It proffered policies at timely servicing to avoid compounding penalty payment for default vis-à-vis debt crisis situation in Nigeria.

2 It opened the frontier of knowledge by presenting an Appraisal of Nigeria's External Debt Management, reflecting the Impact of Nigeria's External Debt Stock on Gross Domestic Product and ensuring an efficient Debt Management approach that will assist policy/decision making of Government as regards borrowing outside the shores of the country.

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