

Public debt, debt servicing and economic growth in Nigeria**Kayode David Kolawole***

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Abstract. Public debt is a vital tool that governments use to finance public spending, especially in situations where it is challenging to raise taxes and cut spending. Nigeria is currently bedevilled with high debt servicing amounting to \$1.12 billion by the end of quarter one of 2024. This study investigated the effect of government debt on economic growth in Nigeria. The study employed auto regressive distributed lag model to analyse the secondary data that was obtained from statistical bulletin of Central Bank of Nigeria from 1992 to 2023 and World Development Indicator. The study revealed that there is an existence of significant but negative relationship between domestic debt and economic growth on the long run with a coefficient value of -0.008394 and at 5% level of significance. There also exist a significant and positive impact of foreign debt on economic growth in long run with value of coefficient of 0.360653 and at 5% level of significance. Debt servicing was reported to have negative relationship with economic growth in Nigeria with value of coefficient of -0.120965 and at 1% level of significance. The study also reported a bi-directional effect of domestic debt on growth of economy in Nigeria while a unidirectional causality was reported between economic growth and debt

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servicing. The study concluded that public debt has significant impact on the growth of economy in Nigeria. Government of Nigeria should make effort in reducing the debt-revenue ratio by paying some affordable debt as soon as possible and seeks for ways of enjoying debt forgiveness by multinational banks. The study recommends that Nigerian government should make more use of external debt than domestic debt because of the low interest of external debt to domestic debt which will help in reducing the debt burden

Keywords: government debt; growth rate of gross domestic product; exchange rate; auto regressive distributed lag model; statistical significance

● INTRODUCTION

Achieving economic growth is an issue across countries of the world especially countries with low capital formation thereby making government of this struggling nations to source for debts in order to embark on infrastructural development. According to International Monetary Fund (2024), government debt in Nigeria has risen significantly in recent decades, raising worries about its sustainability and possible effect on growth of the economy. This rapid debt accumulation is partly due to a combination of factors, including shortfalls in government revenue collection, increased funding of infrastructure and societal programs, and the need to respond to economic shocks like the COVID-19 pandemic (Onafowora & Owoye, 2019). As noted by S.C. Alagoa *et al.* (2023), challenge that many developing nations have been confronting from the onset of 21st century is the pace of national debt. Thus, if public debt is not managed effectively, rising national debt levels can be detrimental to economic growth worldwide (Ogbonna, 2019). Every level of government will be willing to evade on its debt to institutions like International Monetary Fund, along other entities like the World Bank and regional development banks. However, these institutions are empowered by the international community to prevent such defaults. As noted by I. Ajayi & D. Edewusi (2020), these institutions are equipped to monitor countries and intervene in financial matters to prevent defaults and maintain stability in global finance.

On the other hand, the nation would cover the debt if state or local governments defaulted on their obligations. According to A.A. Rafindadi & A. Musa (2019), public debt may be divided into two categories: short-term debt, which is intended to be paid off in one or two years, and long-term debt, which is projected to persist for a longer length of time. A. Yusuf & S. Mohd (2021) asserted that a country's economy will greatly impact when employing aggressively domestic borrowing, for the fact local interest rates are greater than international ones, paying off domestic debt accounts for sizeable portion of revenue of the government. When the amount of outstanding debt rises, the cost of borrowing domestically and can also grow rapidly, particularly in undeveloped financial sector. S.C. Alagoa *et al.* (2023) opined that lower investment eventually results in lower output levels and a smaller steady-state capital stock. Thus, a longer period of debt would result in poorer overall output, which would then lead to decreased spending and worse economic wellbeing. Á. Dombi & I. Dedák (2018) opined that the burden of public debt is another name for this, which decreases with each generation and leaves behind a lower total stock of capital.

Despite massive endowed resources and possible ability of attaining economic growth, the country has faced challenges in achieving consistent and inclusive growth patterns. Factors such as debt servicing costs, debt

management strategies, and revenue mobilisation efforts have implications for key indicators of economy like that of gross domestic product (GDP), employment, and income distribution. Concerns have been expressed over the likely impacts of Nigerian growing public debt on the nation's growth (Adebiyi & Musliudeen, 2023), and also concerns about the capacity of government to set off its debt and the sustainability of its finances have been raised by the mounting debt load. According to A. O'Neill (2023), the national budget's heavy reliance on debt payment places further pressure on government coffers and restricts financing for vital areas like social services and infrastructure development. Moreover, the volatility of global financial markets and variations in oil prices, a significant source of government income, heighten the dangers associated with large levels of debt, potentially destabilising Nigeria economy.

Several studies, such as G.O. Ugwuanyi *et al.* (2021) argued a positive impact existed between public debt and growth of the economy especially the impact of foreign debt to growth of the economy. K.O. Onyele & E.O. Nwadike (2021) reported significant but negative correlation existed between public debt and growth of the economy. Furthermore, the previous studies concentrated on external debts on growth of the economy while neglecting domestic debt on growth of the economy. The previous studies also neglected debt servicing and growth rate of economy in Nigeria. Hence, their works on debt burden variables could be difficult not to be biased which was caused from these ignored variables and therefore, reliance on these works should be carefully done. Moreso, the previous studies neglected the direction of Granger causality that existed between debt burden and growth rate of economy in Nigeria. Therefore, the purpose of this study was to examine how domestic debt, foreign debt and debt servicing will impact economic growth in Nigeria.

● MATERIALS AND METHODS

This study adopted *ex post facto* research design which is appropriate because it analyse fact before the commencement of the study. The study utilised secondary data which was sourced from the Central Bank of Nigeria Annual Statistical Bulletin (n.d.) ranging over 1992 to 2023, Nigeria Bureau of Statistics (TAX-to-GDP..., 2022; Nigerian domestic..., 2024) and World Development Indicators (n.d.). The data was analysed using auto regressive distributed lag (ARDL) model. In a single-equation model, ARDL models are employed in investigating the dynamic associations with data that are time series in nature. The autoregressive side of the dependent variable's gives a value that may depend on prior realisations of the variable itself, as well as the current and historical values of other explanatory variables (the distributed lag part). The variables can

as well be classified as nonstationary, stationary, or a combination of the two.

The ARDL model is effective when distinguishing between the long- and short-term impacts and to examine cointegration – or, more broadly, as well as to determine whether the variables of interest have a long-term relationship – in its equilibrium correction representation. Cumulative sum of recursive residuals (CUSUM) tests was also employed in the study so as to check the stability or otherwise of the data. The study considered 1992 to 2023 because the data for 2024 is yet to be published. Model specification – the modified model is stated as follows:

$$EG = f(DD, FD, DS, INT, EXR, INF). \tag{1}$$

Econometrically, the model is stated as:

$$EG_t = \beta_0 + \beta_1 DD_t + \beta_2 FD_t + \beta_3 DS_t + \beta_4 INT_t + \beta_5 EXR_t + \beta_6 INF_t + \varepsilon_t, \tag{2}$$

where EG_t – economic growth (proxy with growth rate of gross domestic product) at time t ; DD_t – domestic debt; FD_t – foreign debt; DS_t – debt servicing; INT_t – interest rate; EXR_t – exchange rate; INF_t – inflation rate; β_0 – constant term; $\beta_1, \beta_2, \beta_3, \dots$ – coefficients to be estimated; ε_t – error term. Using, the Granger causality model, one can analyse the association between both dependent and independent variables. For this analysis, the two primary Granger causality models are shown:

$$Y_{it} = \sum_{i=1}^n \alpha_{11i} X_{t-i} + \sum_{j=1}^n \beta_{11j} Y_{t-j} + \mu_{11t}; \tag{3}$$

$$X_{it} = \sum_{i=1}^n \alpha_{21i} Y_{t-i} + \sum_{j=1}^n \beta_{21j} X_{t-j} + \mu_{21t}, \tag{4}$$

where Y stands for economic growth; X stands for external debt, debt servicing, interest rate, capital, labour and technology. The measurements of variables are shown in Table 1.

Table 1. Measurement of Variables

Variables	Proxy Measurements	Symbol	Expected sign
Economic growth	This serves as dependent variable that measures economic growth	EG	EG_t
Domestic debt	% of GDP	DD	$\beta_1 > 0$
Foreign debt	% of GDP	FD	$\beta_2 > 0$
Debt servicing	% of total revenue	DS	$\beta_3 < 0$
Interest rate	Monetary policy rate (MPR)	INT	$\beta_4 < 0$
Exchange rate	Official exchange rate (NGN/USD)	EXR	$\beta_5 > 0$
Inflation rate	Consumer price index (CPI)	INF	$\beta_6 < 0$

Source: created by the authors

Economic growth is the dependent variable while domestic debt, foreign debt, debt servicing, interest rate, exchange rate and inflation are the independent variables. Economic growth is the continuous increase in the level of output of a country’s goods and services produced for a given time period as compared to a preceding era. The portion of a nation’s overall government debt that is owing to domestic lenders is known as domestic debt while that of the one owned to foreign lenders are known as foreign debt. Debt servicing is the cost charged on debt. Interest rate is the price tag by Central Bank of Nigeria on loans. Exchange rate which is one of the control variables is the rate at which a country’s currency is changed for a foreign currency. Finally, inflation

rate is the persistent increase in the prices of goods and servicing of a country. The Philip Peron (PP) test, the augmented Dickey-Fuller (ADF) test and Granger-causal effect test were used.

● RESULTS AND DISCUSSION

To ascertain whether the variables are stationary, the unit root test is considered and the sequence of integration can be inferred from their stationarity. The cointegration test requires knowledge of the variables’ integration sequence. Table 2 indicates that while economic growth, inflation, interest rates, and exchange rates were stagnant following the initial differencing, domestic product and foreign debt remained at the same level.

Table 2. Test results of unit root

Variable	ADF test		PP test		Order of integration, ADF	Order of integration, PP
	Test statistic	p value	Test statistic	p value		
Economic growth	-4.235292	-3.568379	-4.173127	-3.568379	I(1)	I(1)
Domestic debt	-4.453421	-3.568379	-4.483427	-3.568379	I(0)	I(0)
Foreign debt	-4.151845	-3.568379	-3.981778	-3.568379	I(0)	I(0)
Debt servicing	-5.724267	-3.574244	-12.629551	-3.568379	I(1)	I(1)
Inflation	-76.42913	-3.568379	-67.595591	-3.568379	I(1)	I(1)
Interest rate	-4.178832	-3.580623	-11.83347	-3.568379	I(1)	I(1)
Exchange rate	-3.825221	-3.568379	-3.825221	-3.568379	I(1)	I(1)

Source: created by the authors

A combination of the I(0) and I(1) series was given as shown by the unit root test. This suggests that the ARDL limits test is appropriate method in determining the long-

run relationship (cointegration). Table 3 demonstrates the bound F statistic 10.312347 is higher to the upper critical value with 4.01 at the level of significance of 5%.

Table 3. ARDL bound test for economic growth

Test statistic	Value	K
F statistic	10.312347	6
Critical value bounds		
Significance	I0	I1
10%	2.45	3.52
5%	2.86	4.01
2.5%	3.25	4.49
1%	3.74	5.06

Source: created by the authors

Implying a long-term link among the selected variables, with this result, authors could move forward to estimate the ARDL model. The R^2 of 0.896048 indicates to have good fit to the data (Table 4). This indicates that 89.6% of *EG* changes can be attributed to variations in

interest rates, inflation, exchange rates, domestic and foreign debt, and debt payments. *F* statistic with 5.070470 and its *p* value of 0.006289 demonstrate the model's statistical significance. This suggests that the model is suitable for forecast.

Table 4. Long-run results for economic growth

Regressor	Coefficient	Standard error	t statistics	p value
Dependent variable: <i>EG</i>				
Domestic debt	-0.008394	0.003376	-2.486163	0.0322
Foreign debt	0.360653	0.018996	2.582642	0.0022
Debt servicing	-0.120965	0.011716	-10.324620	0.0000
Interest rate	-0.000135	0.001889	-0.071292	0.9455
Exchange rate	0.331152	0.002122	4.369829	0.0014
Inflation	-0.000431	0.001102	-0.390995	0.7040
C	15.471930	6.244072	2.477859	0.0327
R^2			0.896048	
Adjusted R^2			0.719329	
S.E of regression			38.30385	
F statistic			5.070470	
Prob (F statistic)			0.006289	
Durbin Watson			2.115241	

Source: created by the authors

Table 4 showed the domestic debt's coefficient value to be -0.008394, while the *p* value is 0.0322, revealing negative significant influence of domestic debt on growth of GDP. Conversely, foreign debt shows positive and significant impact on *EG* with the coefficient value of 0.360653 as well as the *p* value of 0.0022, of which servicing of debt has a negative and influence with the coefficient value of -0.120965 and *p* value of 0.0000. Interest rates as well as

inflation have negative and insignificant contemporaneous influence on GDP (*p* values of 0.9455 and 0.7040, respectively), as can be observed from their coefficient values of -0.000135 and -0.000431. It is clear from the exchange rate coefficient value of 0.331152 and the *p* value with 0.0014 that exchange rates significantly and negatively lagged impact on Nigeria's economic growth. The outcome of this model's brief dynamics is shown in Table 5.

Table 5. Short run and diagnostics tests results

Growth rate of GDP				
Regressor	Coefficient	Standard error	t statistics	p value
D(<i>EG</i> (-1))	-0.145868	0.150792	-0.967348	0.3562
D(Domestic debt)	-0.282159	0.138237	-2.041128	0.0685
D(Foreign debt)	0.015633	0.004235	3.691479	0.0042
D(Debt servicing)	-0.003388	0.000833	-4.067095	0.0023
D(Interest rate)	0.002922	0.001023	2.857311	0.0170
D(Exchange rate)	0.001536	0.001032	1.488356	0.1675
D(Inflation)	-0.001405	0.000692	-2.029828	0.0698
CointEq(-1)	-1.384582	0.073964	-5.199605	0.0004
Diagnostic tests				
Test	F statistic		Prob. Value	
Breusch-Pagan Godfrey serial	1.917899		0.2270	
Breusch-Pagan-Godfrey heteroskedasticity	0.437217		0.9384	

Source: created by the authors

The established long-term link of the model's variables is validated by its negative but significant estimate of $CointEq(-1)$. It shows the $CointEq(-1)$ to be -1.384582 , with significance at 1 percent. Implying the next quarter period should account for approximately 1.38 percent of the long-run equilibrium deviations. The diagnostic test also showed that there is no misspecification mistake and that no issue with serial correlations

existed. For the fact that the statistics are not significant and the test's null hypothesis of equal variance cannot be rejected, therefore the Breusch-Pagan heteroskedasticity statistics of 0.437217 with p values of 0.9384 imply that there is no heteroskedasticity in the models. The investigation's next stage involved determining whether long-run coefficient stability could be achieved using the CUSUM tests (Fig. 1).

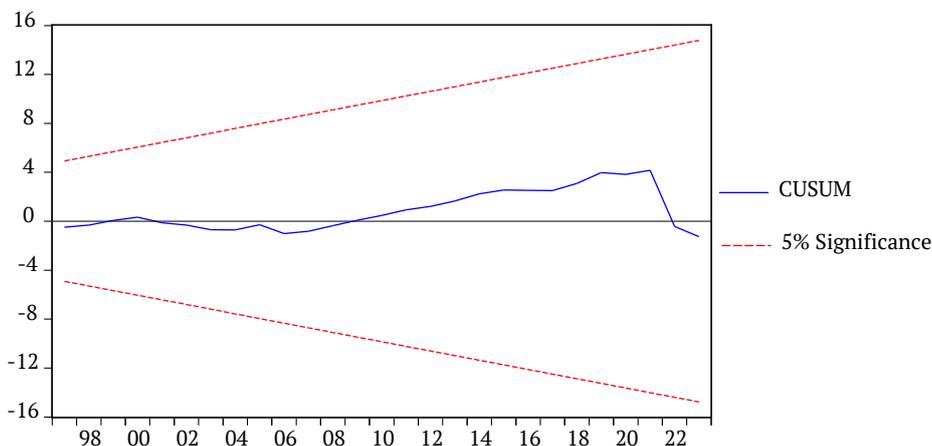


Figure 1. CUSUM test

Source: created by the authors

To ensure stability, the cumulative is expected to remain between the two crucial lines at the 5% significance level. If not, there is a problem with instability. Figure 1 showed that the CUSUM plot is located in between the

two important borders, implying the model are stable. The study examined the causal relationship of public debt and growth of economy using the Granger-causal effect test (Table 6).

Table 6. Causality for public debt and economic growth

Null hypothesis	Obs	F statistic	Prob.
DD does not Granger cause EG	33	6.46700	0.0032
EG does not Granger cause DD		6.11860	0.0057
EXD does not Granger cause EG	33	0.04913	0.9522
EG does not Granger cause EXD		1.08380	0.3537
DS does not Granger cause EG	33	2.19830	0.1320
EG does not Granger cause DS		5.96567	0.0341
INF does not Granger cause EG	33	0.87528	0.4291
EG does not Granger cause INF		1.69403	0.2042
INT does not Granger cause EG	33	1.48435	0.2459
EG does not Granger cause INT		5.86484	0.0082
EXTE does not Granger cause EG	33	0.02884	0.9716
EG does not Granger cause EXTE		1.63620	0.2149

Source: created by the authors

The findings demonstrated that domestic debt and EG have a reciprocal relationship. The findings indicated that there is only one direction of causal relationship between growth of economy and servicing of debt. The study therefore recommends that Nigerian government should make more use of foreign debt to internal debt because of the low interest of foreign debt to domestic debt which will help in reducing the debt burden. This study also recommends that government of Nigeria should make effort in reducing the debt-revenue ratio by paying some affordable debt as soon as possible and seeks for ways of enjoying

debt forgiveness by multinational banks. To improve production performance of Nigeria, the government in the country and pertinent monetary authorities should implement an appropriate exchange rate policy that will permit a realistic and stable exchange rate. Interest rate impact negatively on the economic growth in Nigeria therefore policy makers in Nigeria should try to manage the interest rate in such a way that will enhance the economic growth. The government ought to persist in executing broader reforms and suitable measures that guarantee the efficient transfer of all debt inflows into the real sector, so fostering

transformed enduring growth rate of the economy. Debt of a nation should be decided by the present macroeconomic parameters/indicators based on the tolerance limitations set by the national assembly, debt management office and the economic team for the benefit of the nation. Sovereign nations that are concerned with sustainable economic growth, especially the less developed countries, which are characterised with poor capital formation as a result of low levels of domestic savings and investment should turn to borrowing from outside sources in order to augment domestic saving whenever they are faced with a lack of capital.

The study aligns with theory of Keynesian economics (Kur *et al.*, 2021). According to Keynesian economics, government action, including borrowing to finance deficit spending can be used to boost economic growth, especially when the economy is experiencing a downturn or recession. Keynesians contend that deficit spending can assist in igniting the economy's productive capacity and fostering growth at times of underutilised resources, such as high unemployment and idle capacity. There is a multiplier impact, which argues of an initial increase in spending of government can leads to a bigger rise in overall activities of the economy, is a key idea in Keynesian economics (Eichner, 2023). Fiscal policy deficit spending in particular is viewed as a vital instrument for increasing demand and restarting the economy in such circumstances.

ARDL model was employed to consider debt of government and growth of economy. The dependent variable used is growth rate of GDP of which the independent variables are domestic debt, foreign debt, debt servicing, interest rate and inflation as well as exchange rate. However, it was revealed domestic debt to be negative but significant determinant of growth of the economy which is consistent with the results of D. Didia & P. Ayokunle (2020) and C.K. Eke & N.E. Akujuobi (2021) that shows domestic debt are detrimental to growth of the economy. Therefore, null hypothesis of domestic debt does not significantly affect growth of the economy should not be accepted. This is consistent with neo-classical growth theory. Neoclassical economics places a strong emphasis on how effectively market processes distribute resources and foster economic expansion (Eke & Akujuobi, 2021). It makes the case that interference from the government, particularly deficit spending, can skew signals from the market and cause resources to be misallocated, which will eventually hurt chances for long-term growth, as noted by I. Ajayi & D. Edewusi (2020). The idea of rational expectations, which postulates that economic agents' base decisions on their reasonable expectations of future outcomes, is a concept that neoclassical economists frequently include into their analyses (Yusuf & Mohd, 2021). According to this concept, consumers and businesses may modify their behavior to decrease consumption and investment if they anticipate future tax rises or inflation brought on by rising levels of government debt (Eke & Akujuobi, 2021).

The result of the study further revealed that all foreign debts are significant determinants of economic growth which is consistent with the result of M. Matandare & J. Tito (2018) and I. Ajayi & D. Edewusi (2020). Based on these, the null hypothesis of foreign debts does not affect significantly the growth of the economy in Nigeria should be rejected. The result of the study also showed that all

exchange rates are significant determinants of growth rate of the economy which is consistent to the result of G. Ani & S. Nwannebuike (2021) and E. Nyeche (2024). This is consistent with the theory of purchasing power parity. The purchasing power of nations' currencies, which is substantially influenced by inflation, plays a vital role in shaping the course of foreign exchange rate swings. Policymakers and other economic stakeholders can effectively manage the subtleties of exchange rate swings by understanding the dynamics of buying power and how it interacts with. As a result, well-informed choices can be taken to use exchange rate dynamics to improve national economies and promote long-term, sustainable growth and development. In summary, the trajectory of variations in foreign exchange rates is mostly determined by the purchasing power of a country's currency, which is heavily impacted by inflation.

To examine the causal effect of public debt on growth of economy in Nigeria, we employed granger causality test and it was shown a bi-directional granger-causal effect of domestic debt and growth of the economy while a one-way causal relationship existed between economic growth and debt servicing. Hence, the hypothesis of no causal effect of public debt on growth of the economy should be rejected. This is consistent with the studies of K.O. Onyele & E.O. Nwadike (2021) and S.C. Alago *et al.* (2023), which assumed that when government source for loans in the domestic economy affects the availability of loans for other productive activities by private sector while external debt serves as extra financial inflows which developing economy like Nigeria lacks which can help to augment the financial resources in the country. The study revealed that domestic debt is a negative but significant determinant of economic growth. The result of the study further revealed that all foreign debts are significant determinants of economic growth which. The study revealed further that there is bi-directional causality between domestic debt and gross domestic product while a one-way causal relationship existed between gross domestic product and debt servicing.

● CONCLUSIONS

Considering the findings from the tests and regressions of this study, the study concluded a negative relationship between domestic debt and economic growth. The study concluded that foreign debts are significant determinants of economic growth which. Servicing of debt often result to burden on the country revenue thereby affecting the available funds for developmental projects that can enhance the economic growth. The study thereby concluded that public debt affects economic growth in Nigeria. Therefore, when faced with a lack of capital, less developed nations should look to borrowing from outside sources to augment domestic saving. Moreover, the volatility of global financial markets and variations in oil prices, a significant source of government income to Nigeria has necessitated the need to turn on foreign debt in financing public facilities as government expenditure stimulates the economy by providing cash to consumers and businesses, which then raise spending and spark other cycles of investment and consumption.

The initial effect of government expenditure on economic output is increased by this multiplier effect. Concerns about the Nigerian government's capacity to pay off its debt and the sustainability of its finances have been

raised by the mounting debt servicing load therefore efforts should be made to reduce the debt servicing through seeking for debt forgiveness or debt restructuring thereby giving the economy ample opportunity to invest in developmental projects. To enhance Nigeria's production performance, the government and relevant monetary authorities must develop an appropriate exchange rate policy. Given the lack of data for 2024 at the time of the study,

taking it into account in analysis may be an area for further research.

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● CONFLICT OF INTEREST

None.

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Державний борг, погашення боргу та економічне зростання в Нігерії

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Анотація. Державний борг є важливим інструментом, який уряди використовують для фінансування державних витрат, особливо в ситуаціях, коли складно підвищувати податки та скорочувати видатки. Наразі Нігерія страждає від високих витрат на обслуговування боргу, який до кінця першого кварталу 2024 року становитиме 1,12 мільярда доларів США. У цій роботі досліджено вплив державного боргу на економічне зростання в Нігерії. Для аналізу вторинних даних, отриманих зі статистичного бюлетеня Центрального банку Нігерії з 1992 по 2023 роки та Індексу світового розвитку, було використано авторегресійну модель із розподіленим лагом. Дослідження показало, що існує значний, але негативний зв'язок між внутрішнім боргом та економічним зростанням у довгостроковій перспективі зі значенням коефіцієнта $-0,008394$ на 5 % рівні значущості. Існує також значний і позитивний вплив зовнішнього боргу на економічне зростання в довгостроковому періоді зі значенням коефіцієнта $0,360653$ на 5 % рівні значущості. Погашення боргу має негативний зв'язок з економічним зростанням в Нігерії з коефіцієнтом $-0,120965$ на 1 % рівні значущості. Дослідження також показало двосторонній вплив внутрішнього боргу на зростання економіки Нігерії, тоді, як між економічним зростанням та обслуговуванням боргу був виявлений односторонній причинно-наслідковий зв'язок. У дослідженні зроблено висновок, що державний борг має значний вплив на зростання економіки Нігерії. Уряд Нігерії повинен докласти зусиль для зменшення співвідношення боргу до доходів шляхом якнайшвидшого погашення доступного боргу, а також шукати шляхи списання боргу міжнародними банками. Дослідження рекомендує уряду Нігерії більше використовувати зовнішній борг, ніж внутрішній, через низький відсоток зовнішнього боргу по відношенню до внутрішнього, що допоможе зменшити борговий тягар.

Ключові слова: державний борг; темпи зростання валового внутрішнього продукту; обмінний курс; авторегресійна модель з розподіленим лагом; статистична значущість