Debt management and economic growth in Nigeria: performance, challenges and responsibilities

~ **Yusuf Babatunde Rahman** *(Lagos State University, Nigeria*)
~ **Idowu Khadijat Adeola** *(Lagos State University, Nigeria*)
~ **Okunnu Mustapha Abiodun** *(Lagos State Polytechnic, Nigeria*)
~ **Adeyemi Oludare Tolulope** *(Lagos State Polytechnic, Nigeria*)

Abstract: *There is no one entity solely responsible for the debt crisis Nigeria found itself in by the early 1980s: not the Nigerian government, the banks, not the creditor governments. The increase in the Nigeria debt crises has been caused by a lot of factors that have forced their way into the country's administration over the years. The major cause of Nigeria's debt crises is the change in the economic fortune in the oil sector.*

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How do we assess the debt crisis in which Nigeria found itself? What are the lessons to be learned? Certainly, these are some of the most important questions to be studied as the country embarks with a clean slate with private and bilateral lenders after the long sought-after debt restructuring deal that came in April 2006. This paper analyzes the lessons to be learned from Nigeria's debt history, looking especially at the phenomenon of oil-led spending and borrowing that occurred during 1986-2006. Its objective is to determine whether Nigeria received a higher credit-rating than its domestic and macroeconomic fundamentals would have otherwise justified due to its oil revenues, and whether the debt-repayment crisis arose because oil windfalls from the early 1980s were not used to retire its debt.

Keywords: External Debt, Internal Debt, Debt Rescheduling, Debt Repudiation, Debt-servicing capacity, Debt Forgiveness.

Introduction and Background

The origin of the gloomy Nigerian debt situation can be traced back to the late 1970s when there was the need to finance the widening deficit gap created by profligate spending. This marked the beginning of the end of the oil boom era which was characterized by falling foreign exchange earnings and rising fiscal deficits and external borrowing. Nigeria's foreign debt quadrupled from $9 billion in 1980 to $ 36 billion in 1990. These debt obligations accumulated and crystallized into what is today known as the Paris Club debts, promissory notes and par bonds. The Paris Club debt component, which was a mere $5.39 billion in 1983, graduated to $21.6 billion in 1999. (Simbowale, etal.2004)

One major obstacle for Nigeria's economic development over the last two decades has been its crippling debt overhang. In April 2006, Nigeria ordered a final debt repayment to rich lending nations, completing Africa's biggest debt relief deal. This and other debt restructuring agreements in the last few years have reduced Nigeria's external debt to only 6% of its GDP. But the interest in Nigeria's debt has not dissipated since the Paris Club deal. On the contrary, now that the whole process has been completed, analysts (both international and local) are enabled to assess fully its possibilities. Some analysts have said that the successful completion of this deal would help redeem Nigeria's reputation in international financial circles, and prevent a repeat debt crisis. Others believe that, because of Nigeria's oil dependence, the country could face the same pattern of debt accumulation and mismanagement that heralded calls for debt relief in the first place.

The current scenario of low debt levels and high oil prices (and revenues) mean that Nigeria's financial position is quite similar to what it was in the 1970s. Hence, determining the policy steps that should have been taken in the past could shape opinion about how to manage the country's new borrowing to avoid a debt crisis similar to the one from which it has just emerged.

This paper seeks to analyze how Nigeria's policies mishandled its debt accumulation. Dividing Nigeria's debt history into two major periods (1979-1985 and 1986-2006), the paper would make use of the latter for analyses. To what the degree was Nigeria's External and Internal debts have on total debts of the nations between 1986-2006.

Literature Review

Most studies of external debt in Africa appear to have focused on regions, especially the Sub-Sahara, which tended to give little attention to the peculiarity of individual countries. Furthermore, other studies dwell on country groupings based on certain characteristics (e.g. oil-exporting countries) or inter-country comparison.

Barro (1979) proided the foundation for a neoclassical theory of debt management with testable implications for the management of public debt, under the assumption that governments behave in the manner that theory suggests would be optimal. And in fact, for industrial economies, the evidence is at least roughly consistent with the predictions of the theory.

Edo (2002) analyzes the African debt problem, with particular reference to Nigeria and Morocco, and finds that fiscal expenditure, balance of payments and global interest rate are the crucial factors in explaining the accumulation of external debt in the two countries. One of his policy suggestions is a sustained export promotion programme that would generate increases in foreign earnings needed to service the debt. He also suggests that both countries should restructure and develop their capital markets to reduce exposure to the vagaries of the global interest rate.

Traditionally the practice of debt management has focused on either minimizing the interest cost of borrowing, supporting short term interest rates set by monetary policy makers or assisting capital markets through providing appropriate amounts of risk free assets and liquidity at key maturities (Missale, 1999).

Nigeria's External Debt Problem

A. Origin & Sources

For many years there has been little agreement over the exact scale and composition of Nigeria's external debt stock. The origin of Nigeria's external debt dates back to 1958, when a sum of US$28 million was contracted for railway construction. Between 1958 and 1977, the resort to foreign debt was minimal, as debts contracted during the period were the concessional debts from bilateral and multilateral sources with longer repayment periods and lower interest rates. From 1978, following the collapse of oil prices, which exerted considerable pressure on government finances, Nigeria was unable to shift gears in the face of changing economic fortunes and adopted a policy of deficit financing. It became necessary to borrow for balance of payments support and project financing. The first major borrowing of US$1 billion, referred to as the "jumbo loan" was contracted from the international capital market (ICM) in 1978, increasing the total external debt stock to US$2.2 billion. Thereafter, the borrowing epidemic continued with the entry of state governments into external loan contractual obligations. While the share of loans from bilateral and multilateral sources declined substantially, borrowing from private sources at stiffer rates increased considerably. Thus, the debt stock grew rapidly from $3.4 billion in 1980 to $17.3 billion in 1985 and $32.9 billion in 1990, Ogbe (1992).

Nigeria's external debt stock has been heavily skewed by the Paris Club of creditors, to which the country owes 80% of its external debt. This is mainly publicly guaranteed private sector debt (guaranteed by the export credit agency of country in which these commercial creditors operate) that crystallized into official bilateral debt.

Background

1973-1985 was the period of Nigeria's Third and Fourth National Development Plans, which were launched against a background of abundant financial resources following sharp increases in both the price of crude oil (1973-74) and Nigeria's level of production. In nine months from late 1973 to mid-1974, the government's "oil revenues almost quintupled because of much higher prices, greater production, and an increase in its share of the oil revenues through greater public ownership and higher taxes and royalties" Gelb (1988). The unusually favorable financial circumstances that the country found itself in during the early 1970s generated optimism both locally and internationally. The response of the government to the unexpected windfall was to expand the economy through public spending. As the government embarked on elaborate post-civil war reconstruction plans, it looked externally for additional funding. Nigeria's creditworthiness abroad was automatically enhanced by the era of high (yet volatile) prices of crude oil in which it found itself.

Background: The Establishment of Debt Management Office

The Debt Management office commenced operations on October 4 2000. Prior to the establishment of the office, debt management in Nigeria was characterized by several major shortcomings, particularly the diffusion of debt management responsibilities across numerous agencies, leading to inefficiencies and coordination problems. During that era, debt management functions were split among as many as seven different government departments and agencies.

In the Ministry of Finance alone, four departments were involved in external debt management:

- Department of External Finance – responsible for all Paris Club debts and for the management of all debt statistics.
- Multilateral Institutions Department – responsible for relationships with all multilateral institutions (except for the African Development Bank) and for the management and servicing of multilateral debt.
- African and Bilateral Economic Relations Department – had oversight for ADB, ECOWAS and all non-Paris Club Bilateral debts.
- Treasury Department, Office of the Accountant General of the Federation – preeminent in the debt service process and responsible for issuing mandates to the Central Bank for payment of external creditors.

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In the mid 1970s, the interest earned on foreign loans was substantially higher than on domestic loans. Undoubtedly, the collective behaviour of the world banking community after the first and second oil shocks reflected insufficient attention to the efficiency of the projects they were financing and to the soundness of the economic policies of the debtor countries whose balance-of-payments deficits they were helping to meet. This was in part due to the limited time available during the rush of events for the bankers, governments, and international institutions to think through the ramifications of such large-scale, unprecedented, and urgent borrowing and lending and to relate these to changing trends in terms of trade, interest rates, and financial flows and investment, Samuels (1986); but it was also partly due to the Cold War interests taking precedence over the viability of the projects for which these loans were acquired and the feasibility of repayment.

Methods or ways of Repayment of Public Debts

The methods of repayment of public debts are as follows:

- ***Debt Rescheduling:*** This involves the rearrangement of terms of debt like the adjustment of interest rate grade period, principal repayment and maturity, importantly, the strategy does not cause any reduction in the stock debts rather it facilitates management of debt by providing relief. For instance, Nigeria negotiated services of rescheduling arrangements with the Paris Club of Creditors between 1986 and 1991 to which more than half of the external debt is owed. However, the use of this method has been argued against because it will only lead to the postponement of the evil day of the debtor nation like Nigeria.
- ***Debt Equity Conversion:*** The Nigerian government is currently applying debt equity swap, i.e. converting foreign debts into equity in local companies. Under this system, there are some advantages that could be obtained in one hand and loss encountered on the other hand. It makes the economic environment attractive for foreign investments. It also reduces the outstanding stock of the external debts, a situation that will reduce debt service burden. Disadvantages of this method include the fact that the fear of foreign domination in terms of ownership of assets may be counter productive in relation to our economic growth and development. Also debt conversion leads to large increase in money supply that may complicate the problems of inflation.
- ***Ban on External Borrowing***: This is just a temporary measure to stop the

government from further borrowing, i.e. putting a ban on borrowing for a particular period of time.

➤ ***Debt Repudiation:*** This involves disowning the debt completely. Many Economists had advocated this. According to Fidel Castro, there is no sense in a developing country like Nigeria paying back debts owing, especially foreign debts, because through colonization African countries had more than paid for debts. However, there is possibility of sanction from the International Monetary Fund (IMF) and the World Bank if Nigeria should repudiate.

➤ ***Debt Forgiveness:*** This arise when the creditor nation decides to forget or write off the debt. Paris Club has taken this option in favour of some debtors in the past. Recently, the club agreed to write off $30 billion being owed by Nigeria. This is based on the agreement that the country will pay the remaining $12.4 billion between now and the 1st quarters of 2006. (EIU, 2005)

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Table 1: *Nigerian Debt Profile (# Million)*

Year	External Debt	Internal Debt	Total Debt
1986	41,452.4	28,440.0	69,892.4
1987	100,789.1	36,790.6	137,579.7
1988	133,956.3	47,031.1	180,987.4
1989	240,393.7	47,051.1	287,444.8
1990	298,614.4	84,124.6	382,739
1991	328,054.3	116,900.2	444,254.5
1992	544,264.1	161,900.2	706,164.3
1993	633,144.4	261,093.6	894,238.0
1994	648, 813.0	259,360.9	908,173.9
1995	716, 865.6	248,774.6	965,640.2
1996	617, 320.0	343,674.1	960,994.1
1997	595, 931.9	359,029.1	954,961.0
1998	633, 017.0	537,409.9	1,170,426.9
1999	2,577,383.4	794,806.3	3,372,189.7
2000	3,097,383.8	898,253.9	3,995,637.7
2001	3,176,291.0	1,016,974.0	4,193,265
2002	3,780,208.9	1,166,000.7	4,946,209.6
2003	4,478,329.3	1,329,680.0	5,808,009.3
2004	4,890,269.6	1,370,325.1	6,260,594.7
2005	2,695,072.2	1,525,906.6	4,220,978.8
2006	451,461.7	1,753,259.0	2,204,720.7

Source: Central Bank of Nigeria's Statistical Bulletin (2007)

Problems of Debt Management in Nigeria

There are lots of problems that militate against effective debt management in Nigeria and some of them are stated below;

• Scarcity of Statistical Data: Scarcity of statistical data on both internal and external debt is a major problem in Nigeria's debt management because Nigeria has been calculating its internal and external debt grossly, under its estimation of the actual debt. That is, Nigeria has been basing the calculation of its debt on assumption.

• Institution Arrangements: Institutional arrangements for external debt management is a hindrance to its effective management in Nigeria, that is, the Central Bank of Nigeria (CBN) is taking care of the private sector short term trade debt while the Federal Ministry of Finance creates the erroneous impression that external debt management is one integrated activity.

• Ineffective Law and Regulation: Another dimension to the institutional problem is the neglect or ineffectiveness of law and regulation. If the provision of the Public Bodies Act of 1965 were put into effective use, it could have forged a cohesive link in the statistical data on external borrowing of Federal, State governments and the parastatals, a situation where information on foreign borrowing is picked by bits is detrimental to her national economy.

• Low Yield on Debts Instruments: The low rate of interest that were administered on debts instruments for a long time prior to the introduction of Structural Adjustment Programme (SAP) in 1986 made the instruments very unattractive giving low yield vis-à-vis other instrument outlets. (Anaro, 2005)

Methodology

The study uses data of the Country's External and Internal Debt for the period from 1986-2006. These data were gathered from secondary, specifically Central Bank of Nigeria's Statistical Bulletin. The method of analysis was based on correlation coefficient between Total debts and internal and External Debts of the Country. Bar chart and control chart were also used to show the trend of the internal and external debts. Regression analysis was used to show the relationship between the total, internal and external debts.

Model Specification

$TB = A_0 + B_1IB + B_2EB + \mu$

Where TB = Total Debts

IB = Internal Debts

EB = External Debts

μ = Error Term

Table 2: *Model Summary-Dependent Variable*

	Constant	IB	EB	R2	F-Stat	Adj R^2
	64.994	-0.778	0.944			
	(1.273)	(-8223.4)	(29.7791)	0.980	109.500	0.950
Std Error	51.056	0.59				
Probability	0.219	0.000	0.000			

Findings and Discussion

Table 2 below shows the data used in running the regression equation specified for this study. The summary of the regression results for the equation is presented below, and the data used covers the period of 1986-2006, a period of twenty-one years.

From the result above it could be observed that the coefficient of the equation R squared is 0.980 which is considered to be high. This indicates that about 98% of the variation in Nigeria's total debts is explained by variation in her internal and external debts. The F-statistics of 109.500 with probability of 0.000 also indicates that the regression equation can be relied upon in making valid inference about debt management strategies in Nigeria.

The OLS regression estimation in the table above shows that internal debt has negative relationship with dependent variable (TB), this shows that internal debt has no significant influence on total debts in the model.

However, external debt has a positive relationship with the dependent variable (TB) indicate an increase in the Nigeria's total debt stock is significantly dependent on the external debt or borrowing. The coefficient of correlation (Adj. R2) of 0.950 also indicate a very strong correlation between total debt stock and external debt. The estimated regression equation shows that the larger the accumulated (total) debt stock of Nigeria's leading to lower debt payment and lower growth. The T-Statistic value for the external debt is greater than that of internal debt and its significance at 0.000.

Therefore, we accept our postulation that external debt has a higher degree of effect on total debt than internal debt in Nigeria during 1986-2006. The economic implication is that the volume of Nigeria's total debt accumulated over time is built upon external debt with internal debt contributing lower proportion.

Conclusion

The central focus of this study was to establish the effect of Internal and External Debts on the country's debt profile. The study was able to highlight some lessons learnt from Nigeria's debt history, looking especially at the phenomenon of oil-led spending and borrowing that occurred during 1986-2006. The paper determined whether Nigeria received a higher credit-rating than its domestic and macroeconomic fundamentals would have otherwise justified due to its oil revenues, and whether the debt-repayment crisis arose because oil windfalls from the early 1980s were not used to retire its debt.

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