

AN ASSESSMENT OF THE EFFECTS OF EXTERNAL DEBT ON NIGERIA'S ECONOMIC GROWTH

By

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ABSTRACT

This study assesses the effects of external debt on Nigeria's economic growth from 1980 to 2024. The persistent rise in Nigeria's external borrowing, despite the 2005 Paris Club debt relief, has ignited critical debates regarding fiscal sustainability and macroeconomic stability. Using secondary time-series data sourced from World Bank, the study employed the Autoregressive Distributed Lag (ARDL) model to analyze the relationship between external debt stock, debt servicing, exchange rates, inflation, and GDP. The findings revealed a dual-effect "debt paradox": while external debt stock exhibits a positive and significant relationship with economic growth in the long run, the immediate burden of debt servicing and currency depreciation exerts a statistically significant negative pressure on growth. The Error Correction Term indicates a relatively slow adjustment speed of 14.4% toward long-run equilibrium. The study concluded that while borrowing is necessary for infrastructure, the current cost of servicing exceeds the productive benefits in the short term. It recommends aggressive debt-servicing management, diversification of the export base to stabilize the exchange rate, and a shift towards concessionary long-term loans to mitigate the crowding-out effect on public investment.

1.0 INTRODUCTION

At the global level, external debt has long been recognized as both an opportunity and a challenge for economic development. Many countries, particularly in the developing world, rely on foreign borrowing to bridge the gap between limited domestic resources and the demand for investment in infrastructure, health, education, and other critical sectors. The World Bank (2004) defines external debt as any debt owed to non-residents, repayable in foreign currency, goods, or services. When effectively managed, external debt provides much-needed capital to stimulate growth, reduce poverty, and support macroeconomic stability. However, when poorly managed, excessive debt can trigger a cycle of debt overhang, where servicing obligations crowd out vital public spending and undermine economic performance (Albert, Brain & Palitha, 2005). Thus, external borrowing is often described as a double-edged sword in global development discourse.

At the regional level, Africa's experience with external debt reflects both the benefits and pitfalls of borrowing. Throughout the 1980s and 1990s, many African countries experienced a debt crisis, as declining commodity prices and rising debt-servicing costs created fiscal imbalances and limited their capacity for development (Maghyere & Hashemite, 2003; Sanusi, 2003). The Highly Indebted Poor Countries (HIPC) initiative, spearheaded by the International Monetary Fund (IMF) and World Bank, as well as debt forgiveness from bilateral and multilateral creditors, provided temporary relief and a fresh start for several African economies. Nevertheless, many countries have continued to accumulate external debt in the 21st century to finance infrastructure, industrialization, and poverty alleviation programs. This has reignited concerns about sustainability, given the burden of rising debt-service obligations in relation to limited fiscal revenues (Berensmann, 2004).

There is a historical and cyclical relationship between Nigeria and external borrowing. After attaining independence, the nation initially depended on debt to finance significant infrastructure and development initiatives. However, the oil boom of the 1970s led to a period of huge borrowing predicated on optimistic future earnings. Only after the historic debt forgiveness under the Paris Club deal in 2005 could Nigeria recover from the catastrophic debt crisis caused by the decline of oil prices in the 1980s (Adegbite, 2020). This pardon was viewed as a fresh start, a chance to escape the crippling debt-servicing cycle that has impeded economic expansion for many years according to Central Bank of Nigeria (CBN, 2018). Ironically, Nigeria's external debt stock has risen to previously unheard-of heights in recent years. As of mid-2023, Nigeria's external debt was above \$40 billion, according to figures from the Debt Management Office (DMO, 2023). In the face of fiscal deficits made worse by volatile oil prices throughout the world and the requirement to boost a flagging economy, in order to finance infrastructure development and national budgets, successive governments have once again resorted to borrowing from outside sources. Government representatives and other proponents contend that this debt is necessary to create a resilient economy, citing the backing of vital industries including agriculture, transportation, and electricity (Okonjo-Iweala, 2021). There is a growing chorus of public critics and economists who are deeply concerned. They contend that Nigeria's economic stability is currently seriously threatened by the growing debt load and its high service expenses. According to Odusola (2022), paying off these loans takes up a significant amount of government revenue, taking money away from vital public services like healthcare and education. This leads to a vicious cycle in which fresh loans are taken out just to pay back previous ones, which raises concerns about intergenerational equity and the sustainability of debt (Budina, 2019). Insufficient domestic cash (revenue) required for investments that would promote economic growth and development is a feature of emerging nations, including Nigeria. Nigeria lacks sufficient funding for growth and development projects like roads, power, pipe-borne water, and so on due to the country's incapacity to diversify its revenue sources, corruption, and poor management (Udeh, Ugwu, and Onwuka 2016). To get past this Nigeria turned to borrowing from outside sources due to a lack of funds.

A country's debt may originate internally (from within) or externally (from outside). According to the World Bank (2004), external debt is any debt due to non-residents that can be repaid in the form of foreign money, food, or services. Both scholars and policymakers continue to doubt the impact of a nation's external debt on investment and economic growth. Regarding the effect of external debt on economic growth, opinions have differed. Although external debt can be used to boost the economy, each time a country accrues significant debt, servicing and repaying the debt will consume a sizable

amount of public spending and foreign exchange gains, resulting in significant opportunity costs (Albert, Brain, and Palitha, 2005).

Reducing poverty and promoting sustainable economic growth are hampered by excessive external debt (Maghyere and Hashemite, 2003; Sanusi, 2003; and Berensmann, 2004). A common aspect of the economic management of many emerging countries, including Nigeria, is external debt. It describes the percentage of a nation's debt that is borrowed and repayable in foreign currency from foreign lenders, including bilateral creditors, international financial organizations, and foreign governments (World Bank, 2023). Although foreign borrowing is frequently seen as a helpful instrument for funding budget deficits, building infrastructure, and promoting economic expansion, questions about its viability and efficient usage still exist (Ajayi & Oke, 2012).

In Nigeria's past, external debt has served two purposes: first, it has given the government access to money for development, particularly during times of low revenue and shocks to the world oil price; second, poor debt management, corruption, and an over-reliance on borrowing have led to growing debt service obligations that put a strain on the country's economy (Iyoha, 1999; CBN, 2022). Concerns over the long-term impacts on the nation's economy, investment, and welfare have been raised repeatedly by the increase in the external debt stock since the late 1980s and the resulting debt servicing obligations (Ezeabasili, Isu & Mojekwu, 2011).

The effects of growing external debt go beyond macroeconomic metrics to more general concerns like employment, poverty alleviation, and budgetary sustainability because Nigeria is Africa's largest economy. In order to create efficient debt management plans that strike a balance between the need for development funding and economic stability, policymakers, researchers, and stakeholders must have a thorough understanding of the type, trend, and effects of external debt on the Nigerian economy (Okonjo-Iweala, 2018). According to Udoffia and Akpanah (2016), external debt is defined as packages that include financial and technical requirements related to management that come from outside the nation and are intended to support economic growth and development. These packages must be repaid in foreign currency at a predetermined future date. Bilateral loans are external borrowings from foreign nations, whereas multilateral loans are loans from multinational organizations such as the World Bank, International Monetary Fund, Africa Development Bank, London Club, Paris Club, etc. According to Soludo (2003), nations borrow money for two primary and general reasons: (1) macroeconomic rationale, which is to fund increased investment, increased consumption, or a temporary balance of payments deficit in order to reduce nominal interest rates overseas due to a shortage of domestic long-term credit; (2) to get around budgetary restrictions. This suggests that nations take out loans to boost economic development and growth while also lowering poverty. In Nigeria, the rate of external borrowing has been steadily increasing, from \$28 million in 1958 to over \$30 billion in 2005 before debt relief. However, economic growth has not been increasing steadily, and the government intends to borrow more.

It is important to state that it is not good for more emphasis to be placed on the negative impact of debt. This study would examine whether external debt in Nigeria fosters economic growth or not, and the government would receive the necessary recommendations. This is because of the morbid fear of debt, which would lead to debt avoidance when it would have boosted the economy by bringing in the much-needed capital for investment and economic growth. Researchers' empirical findings about the effect of external debt on economic growth are also inconclusive. Researchers like Ajayi and Oke

(2012), Sulaiman and Azeez (2012), Odubuasi, Uzoka and Anichebe (2018), Ndubuisi (2017), and Elwasila (2018) all discovered that external debt had a favorable effect on economic growth.

1.1 **Statement of the Problem**

Over the past three decades, Nigeria has experienced significant fluctuations and a renewed escalation in its external debt profile, despite the substantial debt relief obtained in 2005. Following the Paris Club debt forgiveness, which significantly reduced Nigeria's external debt burden, external borrowing has again increased markedly. By 2023, Nigeria's total public debt had exceeded US\$102 billion, with external debt accounting for a sizeable proportion (World Bank, 2023). This renewed accumulation reflects persistent fiscal deficits, declining oil revenues, exchange rate pressures, and rising public expenditure needs, raising serious concerns about debt sustainability and long-term economic performance.

In development theory and global practice, external debt is not inherently detrimental to economic growth. Several countries across the world have successfully utilized external borrowing to accelerate GDP growth and structural transformation. Economies such as South Korea, China, and Vietnam effectively leveraged external debt to finance industrialization, infrastructure, and human capital development, resulting in sustained economic growth and rising per capita income. These countries demonstrate that when external debt is prudently managed and invested in productive sectors, it can serve as a catalyst for economic expansion rather than a constraint.

Similar experiences are evident in Africa. Countries such as Rwanda, Ethiopia, and Morocco have used external borrowing to finance large-scale infrastructure projects, expand productive capacity, and stimulate growth, while maintaining relatively strong GDP performance. In West Africa, Ghana and Senegal have recorded periods of sustained GDP growth alongside rising external debt, supported by improvements in public investment management, export diversification, and institutional reforms. These cases illustrate that the relationship between external debt and economic growth is conditional on governance quality, fiscal discipline, and the productivity of debt-financed expenditure.

Nigeria's experience, however, contrasts sharply with these success stories. Despite extensive external borrowing, economic growth has remained sluggish, per capita income growth has been weak, and development outcomes have been disappointing. External borrowing has often been justified as necessary for financing infrastructure and bridging the savings–investment gap, yet the rising burden of debt servicing has increasingly constrained fiscal space. According to the Central Bank of Nigeria (2022), debt service payments absorb a substantial share of government revenue annually, crowding out expenditure on education, healthcare, and growth-enhancing infrastructure.

Despite institutional reforms such as the establishment of the Debt Management Office in 2000, Nigeria's external debt has continued to rise without commensurate improvements in GDP growth and development outcomes. The central problem, therefore, is why Nigeria has been unable to replicate the positive external debt–growth experiences observed in other countries. This raises the critical question of whether Nigeria's external debt has supported economic growth or instead generated debt overhang effects, fiscal stress, and macroeconomic instability, necessitating an objective empirical investigation of the impact of external debt on Nigeria's economic performance.

1.2 **Research Question**

What is the impact of external debt stock on Nigeria's economic growth and development?

1.3 **Objectives of the Study**

The main objective of this study is to examine the effects of external debt on the Nigerian economy. The specific objectives are to: examine the relationship between external debt and economic growth in Nigeria.

1.4 **Research Hypothesis**

The study will test the following hypothesis:

H₀₁: External debt stock has no significant impact on Nigeria's economic growth and development.

2.0 **LITERATURE REVIEW**

2.1 **Concept of Debt**

In its most basic economic definition, debt is an amount of money borrowed by one party from another with the understanding that it would be paid back later, nearly always with interest (Cecchetti, 2021). This financial commitment, which applies to both individuals and organizations as well as sovereign nations, is an essential instrument for promoting investment and balancing consumption over time. When fiscal expenditures continuously exceed public revenue from sources such as taxes and royalties, national governments accumulate public debt (IMF, 2023). In order to fulfill its operational responsibilities, carry out capital projects, and promote economic growth—particularly during times of economic downturn or income shortfalls—the state must borrow money due to the funding gap created by this budget deficit (World Bank, 2022).

External Debt or Foreign Debt constitutes money borrowed from foreign lenders, which can include other sovereign governments, international financial institutions (e.g., the International Monetary Fund and World Bank), and private commercial banks (Reinhart & Rogoff, 2010). External debt is typically denominated in foreign currencies (such as US Dollars, Euros, or Special Drawing Rights), which introduces additional layers of risk, including exchange rate volatility and exposure to shifts in global interest rates (Odusola, 2022).

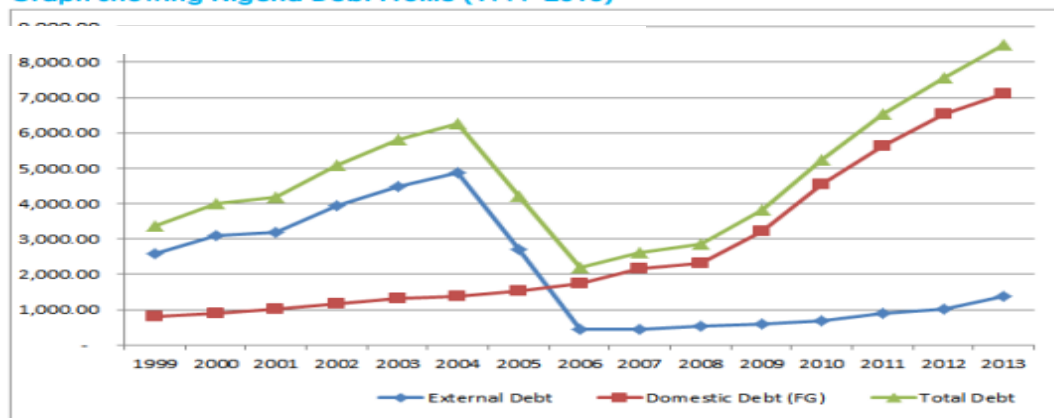
The pre-independence period is where Nigeria's debt originated. Up until 1978, the amount of the debt was minimal. Prior to 1978, the majority of the debt was accumulated through long-term loans from official and multilateral institutions like the World Bank and the nation's primary trading partners. Since the loans were taken out on favorable conditions, the debts did not pose a significant strain on the economy. Additionally, the nation received a lot of money from oil, particularly during the 1973–1976 oil boom. In 1964, the Italian government granted Nigeria its first external loan of US\$13.1 million from the Paris Club of Creditor Nations for the construction of the Niger Dam.

In general, Nigeria borrowed very little from foreign lenders. However, Nigeria went through a period of significant borrowing from 1971 to 1981. As Nigeria started significant growth and reconstruction projects following the civil war, different levels of government obtained loans. As the Federal Government started to guarantee several unprofitable loans made by private banks, state governments, and parastatals, the borrowing kept up. Between 1970 and 1977, Nigeria had very little debt, particularly external debt, which was less than US\$600 million. Early in the 1970s, Nigeria had an oil boom, which provided the country with a wealth of cash to fund government-planned

initiatives. However, oil prices fell between 1980 and 1982, which caused oil revenues to drop from US\$25 billion in 1980 to US\$12 billion in 1982 and US\$6 billion in 1986. Nigeria saw wasteful spending, unprofitable ventures, white elephant projects, etc. in the 1980s. For example, only one project proved feasible out of 63 that were conducted and for which US\$2.6 billion was borrowed (Baba, 2012). The years 1986–1992 were marked by debt reduction plans and debt rescheduling. In order to reschedule loans of US\$7.0 billion, US\$6.0 billion, and US\$3.0 billion, respectively, the Nigerian government made many journeys to the Paris Club in 1986, 1989, and 1991.

Additionally, at a discount of almost 60%, the Nigerian government traveled to the London Club to swap US\$2.1 billion in Par Bonds for US\$5.6 billion in commercial bank debt. Due to additional borrowing from the Paris Club, exorbitant interest rates, penalties, and unpaid arrears, Nigeria's debt profile skyrocketed by 1992. Nigeria's economic measures, meantime, were unable to satisfy the IMF's standards for debt reduction. Nigeria experienced a significant debt overhang between 1993 and 1998 when its payment to the Paris Club fell significantly short of the agreed-upon sum following significant payment in 1992, even as arrears grew instead of fresh credit, and new payments were made by the multilateral creditors. As a result, Nigeria's overall debt servicing load (both domestic and foreign) surpassed the Federal Capital Budget by 2004. For example, the Paris Club received US\$1.0 billion in 2004, which accounted for 70% of the whole budget for education. Nigeria has about US\$32.0 billion in total debt as of the end of 2005, of which US\$30.8 billion was outstanding to the Paris Club. When Nigeria returned to democratic administration in 1999, it launched an unrelenting push to reduce its debt. Prior until 2005, Nigeria's debt was approximately \$46.2 billion USD. While the total amount of domestic debt was \$10.3 billion, the amount of external debt was \$35.9 billion. After the debt write-off, domestic debt increased to \$13.8 billion in 2005, but external debt decreased to \$3.5 billion, resulting in a total public debt of \$17.3 billion and an 11.8% debt-to-GDP ratio. As of September 2013, Nigeria owed \$58,643.18 million in governmental debt (DMO, 2014). Since 2005, domestic bond market borrowing has been the primary source of funding for Nigeria's government deficits. Nigeria's debt profile from 1999 to 2013 is depicted in the graph below. From 1999 to 2004, external debt was greater than domestic debt, but from 2005 to 2013, domestic debt rose.

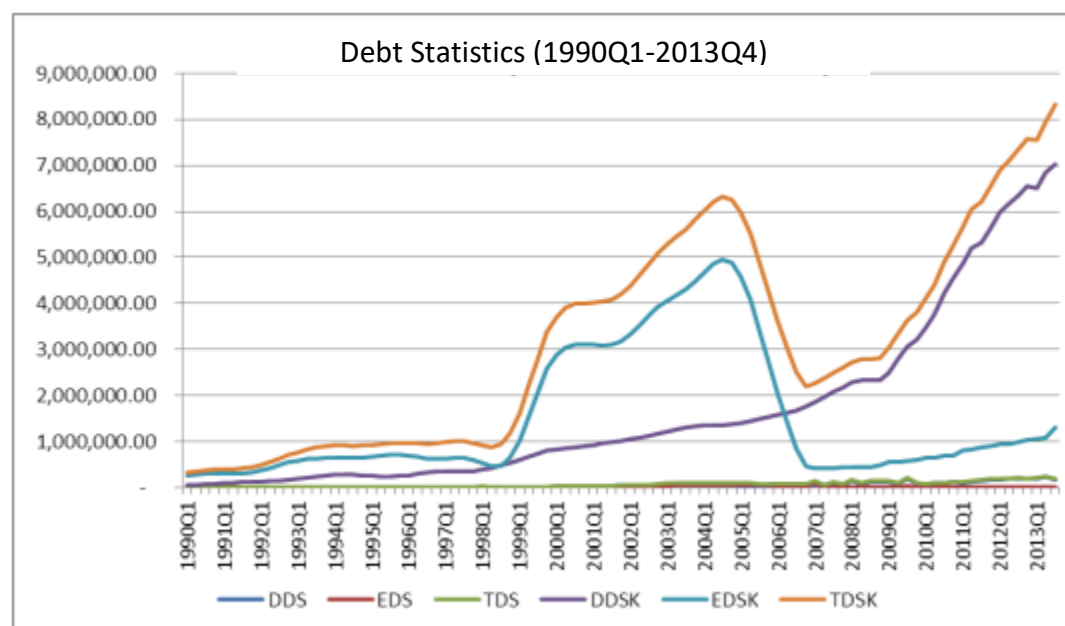
Graph showing Nigeria Debt Profile (1999-2013)



Source: CBN Data

Fig.1: Graph Showing Nigeria's Debt Profile (1999-2013)

In Nigeria, the changing domestic debt profile from the 1960s to date, could be linked to major factors such as high budget deficits; low output growth; large expenditure growth; high inflation rate; and narrow revenue base witnessed since the 1980s. Output growth declined as it recorded annual average values of 5.9% in 1980–1984, 4% in 1990–1994 and 2.8% in 1998–1999, respectively. Public expenditure as a percentage of GDP increased from 13% in the 1980 – 1989 to 29.7% in the 1990–1994 periods. This increased public expenditures to GDP ratio resulted from fiscal policy expansion embarked upon during the oil boom era of the 1970s. However, as the oil boom declined in the 1980s, priorities of government expenditure did not change. As at September 2014, the total domestic debt outstanding was N9,358.67 billion, this was N2,239.67 billion or 31.46 per cent higher than its level of N7,119.00 billion as at end-December, 2013. New domestic debt borrowing in 2015 is estimated at N570.00 billion, decreasing by 12.81 per cent from N653.72 billion recorded in fiscal 2014.



Source: compiled from CBN Data various years.

Fig. 2: Debt Structure (1990-2013)

DDS Domestic Debt Service in Million Naira, EDS External Debt Service in Million Naira, TDS Total Debt Service in Million Naira, DDSK Domestic Debt Stock in Million Naira, EDSK External Debt Stock in Million Naira, TDSK Total Debt Stock in Million Naira, The "Dutch Disease" and Competitiveness.

Heavy reliance on external borrowing, particularly when linked to resource exports like oil, can trigger a phenomenon known as "Dutch Disease." Large inflows of foreign currency from debt can lead to the appreciation of the real exchange rate, making a country's non-resource exports (like manufactured goods and agricultural products) more expensive and less competitive on the global market (Corden & Neary, 1982). This can stifle the growth of other critical sectors of the economy,

leading to an unhealthy dependence on a single commodity and undermining long-term, diversified growth (Adewuyi, 2019).

2.2 **Debt Overhang and Discouraging Private Investment**

A high level of external debt can create a "debt overhang," which is a situation where the existing debt stock is so large that investors anticipate future taxes will be raised significantly to service it. This expectation discourages both domestic and foreign private investment, as investors fear that the returns on their investments will be taxed away to pay creditors (Krugman, 1988). The resulting decline in capital formation hampers productivity, job creation, and overall economic growth, creating a self-reinforcing cycle of stagnation (Elbadawi et al., 2017).

2.3 **Concept of External Debt**

External debt is formally defined as the portion of a country's total debt that is owed to foreign creditors and must be repaid in foreign currency, goods, or services (World Bank, 2022). This distinguishes it critically from domestic debt, which is denominated in the local currency. The landscape of external creditors is diverse, encompassing:

Bilateral Creditors: Other sovereign governments (e.g., through agencies like China's Exim Bank or France's AFD)., Multilateral Creditors: International financial institutions such as the International Monetary Fund (IMF), the World Bank, and regional development banks like the African Development Bank (AfDB)., Private Creditors: Commercial banks, bondholders, and other private financial institutions operating in the international capital market (DMO, 2023).

Sound economic theory serves as the foundational justification for borrowing from outside sources. It enables a country to close the savings-investment gap, which is the difference between low domestic savings and high investment demands (Chenery & Strout, 1966). Governments can finance vital infrastructure projects that are necessary for long-term economic growth but require money beyond their immediate fiscal capability by obtaining foreign capital, such as ports, railroads, and power plants (Adewumi, 2021).

However, under some circumstances, this tool becomes a major burden. When borrowed money is utilized to finance recurring budgets rather than investments that spur growth, corrupt practices, or inefficient spending, mismanagement takes place (Okonjo-Iweala, 2018). More importantly, when a nation's debt servicing commitments devour an unmanageable amount of its foreign exchange profits and government revenue, a repayment capability crisis occurs. This is generally driven by variables such as a decrease in export commodity prices (e.g., oil), a devaluation of the local currency (which increases the local currency cost of servicing foreign debt), or a significant rise in global interest rates (Reinhart & Rogoff, 2010).

Furthermore, the liquidity constraint referred to as 'crowding out' effect of debt, that is, the need to service debt reduces funds available for investment and growth. Debt servicing is like the proboscis of mosquito for sucking out blood from its victim. The guiding rules to debt to be taken into account in debts management are, debt to GDP ratio, which global maximum ratio is 40%; total debt to total revenue ratio and debt to debt service ratio. Efficient debt management strategy should result in debt service ratio between 20-25% of GDP (Omoruyi, 1996).

2.4 **Concept of Economic Growth**

The core definition of economic growth is the steady, long-term rise in the actual output of goods and services generated inside a nation's boundaries; this is commonly expressed as the annual percentage change in GDP or GNI (Mankiw, 2021). This measure is the main way to assess the growth and well-being of an economy. A growing population, increased productivity through the adoption of new technologies and the development of human capital, and the creation of productive job opportunities are all indicators of true economic growth, which goes beyond simple population growth (World Bank, 2022).

Nigeria's economic growth has been marked by notable volatility and inconsistency, a pattern commonly referred to as "boom-and-bust" cycles. The nation's strong reliance on crude oil exports, which provide the great majority of its foreign exchange profits and a sizable portion of its government revenue, is inextricably related to this pattern (CBN, 2023). As a result, the Nigerian economy's performance is extremely vulnerable to changes in the price of oil globally. While price crashes result in recessions, fiscal crises, and devaluations, periods of high oil prices stimulate economic growth and increased public spending (Adewuyi, 2019).

Other structural flaws have also been made worse by this reliance on resources. By promoting currency appreciation and diverting resources from other tradable sectors, the oil industry has stifled industrialization and economic diversification, a phenomenon known as the "Dutch Disease" that pushes out manufacturing and agricultural exports (Corden & Neary, 1982). Additionally, because the government frequently finds it difficult to adapt spending to match changing income, oil revenue volatility has resulted in ongoing fiscal imbalances and chronic budget deficits (Odusola, 2022).

A vicious cycle results from the regular use of significant external borrowing to fund these budget deficits. Later, the heavy burden of debt servicing is imposed by the debt that was accrued during economic downturns in order to sustain the economy. Important public investments in infrastructure, health, and education—the same areas required to create diversified and sustainable growth—are immediately crowded out when a significant amount of government revenue is devoted to servicing external debt, as the IMF (2023) points out. As a result, Nigeria's external debt load is a major impediment to its long-term economic development and stability rather than just a sign of its growth issues (Budina, 2019).

2.5 **Debt and Fiscal Sustainability**

The ability of a government to sustain its current tax, spending, and other policies over the long term without endangering its solvency or adding to an unmanageable debt load is the basic definition of fiscal sustainability (IMF, 2023). It denotes a situation in which a government can fulfill its financial commitments, including paying off its current debt, without turning to unwarranted future borrowing, inflation-causing monetization, or significant, detrimental changes to its fundamental operations (CBN, 2022).

A long-term equilibrium in which revenue generation (mainly from taxes and other non-oil sources) is steady and predictable enough to comfortably cover its expenditure patterns (both capital and recurring) and debt servicing costs is what defines a sustainable fiscal system. This equilibrium guarantees that debt repayment can be accomplished without displacing vital public investments in

social services, infrastructure, and human capital—all of which are the main drivers of sustained economic growth (World Bank, 2022).

2.6 **Theoretical Review**

2.6.1 **Debt Overhang Theory**

The "debt" overhang theory is mainly credited to Paul Krugman (1988) and Jeffrey Sachs (1989). The debt overhang theory is predicated on the idea that expected debt service is likely to increase as a function of the nation's output level if debt will eventually surpass the country's ability to repay it. As a result, current foreign creditors effectively "tax" away a portion of the returns from domestic investments, discouraging both domestic and future foreign investors from making such investments (Claessens, 1996). Because a portion of any gain in output and exports will go toward paying off the external debt, the debtor nation only partially benefits from such conditions.

According to the notion, lowering debt will boost one's ability to invest and repay debt, increasing the likelihood that the remaining amount will be paid back. The debtor is considered to be on the "wrong side" of the debt Laffer curve when this effect is significant. The relationship between the size of debt and the amount owed is referred to in this instance as the debt Laffer curve. Nonetheless, the concept of the debt Laffer curve also suggests that there is a threshold at which taking on more debt spurs expansion (Elbadawi et al., 1996). Lensink and White (1999) contend that there is a threshold at which taking on more debt is harmful to growth, citing the debt Laffer curve. The obligation to service debt limits cash available for investment and growth, a phenomenon known as the "crowding out" effect. For any given amount of future debt, a decrease in the current debt service should consequently result in an increase in the current investment (Cohen, 1993). Lack of access to global financial markets and the impact of the debt stock on the overall degree of economic uncertainty are two more ways that the requirement to service a significant quantity of external commitments can impact economic performance (Claessens, 1996). Three arguments could be made for why debt might be better than money printing or taxing. First of all, debt promotes a more egalitarian way for a nation to take advantage of long gestation periods for investment. Second, by streamlining a more effective process for implementing countercyclical measures or covering urgent expenditure requirements. Regular tax adjustments may result in economic uncertainty and efficiency losses. The stability benefit of debt over taxes and senior age comes in third. But debt must be paid back. Simply put, borrowed funds are taxation that has been postponed. As a result, how the money is used and how the returns compare to the cost of borrowing become very important. Infrastructure spending by the government has the potential to accelerate socioeconomic development and progress (Were, 2001; Soludo, 2003; Ogunmuyiwa, 2011).

The debt overhang causes this investment strike, which in turn results in slower economic development. A decrease in private investment restricts the generation of jobs, capital formation, knowledge transfer, and productivity gains (World Bank, 2022). As a result, the economy is unable to provide the growth required to break free from the debt trap, resulting in a vicious cycle whereby high debt leads to poor growth, which further exacerbates the unsustainable debt load (Reinhart & Rogoff, 2010). As a result, improving investor perceptions of debt sustainability is not just a financial concern; it is also a crucial precondition for attracting the private investment required for Nigeria's sustained economic growth.

2.6.2 *Crowding Out Effect Theory*

The crowding-out effect is a fundamental macroeconomic phenomenon that occurs when excessive government borrowing from the domestic financial market reduces the availability of loanable funds for private sector investment (Bernheim, 1989). This operates through two primary channels: the fiscal channel (direct reduction in public investment) and the financial channel (increased cost of credit).

In the Nigerian context, this effect is acutely felt. Firstly, the fiscal channel is activated by the high cost of servicing both domestic and external debt. With debt servicing consuming a vast portion of federal government revenue—reaching as high as 96% in the first quarter of 2023 according to the Central Bank of Nigeria (CBN, 2023)—critical capital expenditure on productive sectors such as infrastructure, education, and healthcare is drastically reduced. This diverts resources away from public investments that are essential for long-term growth and private sector productivity (World Bank, 2022).

Therefore, Nigeria's high debt burden creates a vicious cycle: it forces reduced public investment while simultaneously discouraging and constraining the private investment needed to compensate for it. This dual mechanism of crowding-out significantly hampers the country's overall economic development and diversification efforts (Odusola, 2022).

From the reviewed literature, it is evident that external debt plays a dual role in the Nigerian economy. On one hand, it provides necessary capital for bridging budget deficits and financing development projects; on the other hand, excessive accumulation and poor utilization of debt create serious economic challenges, including debt overhang, crowding out of investment, and fiscal unsustainability. Theoretical perspectives show that debt can either stimulate or hinder growth, depending on its management. Empirical evidence underscores that Nigeria's external debt has often been associated with adverse effects on growth due to poor debt management practices.

The literature reveals a gap in understanding the extent to which Nigeria's rising external debt profile impacts economic sustainability, particularly in light of current global shocks such as fluctuating oil prices and exchange rate volatility. This study seeks to fill this gap by examining the effects of external debt and its servicing on Nigeria's economic development.

2.7 **Empirical Review**

External debt payment has a major negative impact on economic growth in the medium and long term, according to a large body of empirical research on the Nigerian economy (Ijirshar, 2019; Joseph & Godoo, 2021). These studies, which examine data from 1980 to 2024, show that the large and increasing fiscal allocations for debt payment have a noticeable crowding-out impact, limiting public spending in sectors that are essential for promoting sustainable economic growth. For example, because a significant amount of government revenue is pre-allocated to fulfill foreign debt obligations, capital expenditures on social services (like health and education) and infrastructure (like power and transportation) are continuously constrained (Ojo, 2020).

A study titled "Implication of External Debt on the Nigerian Economy: Analysis of the Dual Gap Theory" was conducted by Hassan, Sule, and Abu (2015). The study used the ordinary least squares approach to analyze data and covered the years 1986 to 2013. The analysis found that external debt, which has grown significantly over the years, contributed very little to real gross domestic product, and that the effect of government debt on economic growth throughout the reviewed period was negligible. According to the study's findings, if excessive borrowing is not stopped, the economy will continue to deteriorate, leading to the implementation of a surplus budget and causing unemployment, total investment, reserves, exchange rates, inflation, and poverty to rise.

In a study by Adegbite, Ayadi, and Ayadi (2008), external debt was demonstrated to have a detrimental influence on Nigeria's economic growth due to misapplication of borrowed funds and high debt payment costs. However, Ezeabasili, Isu, and Mojekwu (2011) found that foreign debt and growth had a positive short-term association, but a negative long-term effect.

Ibi and Aganyi (2015) examined how Nigeria's external debt affected the country's economic expansion. To determine if external debt, the ratio of external debt to exports, and other economic control variables promote economic growth, econometric techniques such as variance decomposition and impulse response from Vector Auto Regression (VAR) were used. The results of the two-stage data processing showed a weak causal relationship between Nigeria's economic development and external debt. The authors conclude that this suggests that it is impossible to predict whether Nigeria's economic growth would accelerate or decelerate based on external debt.

Adeniran, Azeez, and Aremu (2016) used the Granger Causality/Wald Test and the Vector Error Correction Model to conduct a study on "External debt and economic growth in Nigeria from 1980 – 2014." The empirical results obtained using variance decomposition and impulse response analysis showed that Nigeria's real GDP per capita development is considerably hampered by the service payments on its external debt.

Mohamed (2018) evaluated the influence of external debt on the economic growth of Sudan from 1969 to 2015. The vector error correction technique (VECM) was used to evaluate the time series data that was gathered for the investigation. GDP served as the study's dependent variable, while the external debt to exports ratio served as a stand-in for the variable of interest, which was external debt. Foreign direct investment and the exchange rate were included to the model as control variables. The analysis's conclusions showed that whereas the control variables—the exchange rate and foreign direct investment—had a negative effect on Sudan's economic growth, external debt had a favorable effect.

Matuka and Asafo (2018) examined the effect of external debt on Ghana's economic growth from 1970 to 2017 using co-integration analysis and an error correction model. The analysis of time series data showed that, both in the short and long term, external factors positively affect Ghana's economic growth. The relationship between external debt and economic growth in emerging economies was empirically examined by Shkolnyk and Koilo (2018). ARDL and correlation analysis were used to gather and examine time series data from 2006 to 2016. The analysis's findings demonstrate that macroeconomic instability and a high amount of external debt restrict economic growth in developing nations like Ukraine. The study recommended that the public debt management model of emerging economies should be improved.

3.0 METHODOLOGY

The research used secondary data from the World bank, Central Bank of Nigeria, Debt management Office of Nigeria, and from the International Monetary Fund. Using these sources ensures reliability, objectivity, and consistency of the variables under investigation.

The data was used to evaluate whether rising external debt in Nigeria has a statistically significant impact on economic growth over the selected period. By employing econometric techniques such as multiple regression and time-series analysis, the study provided evidence-based insights that can guide policy makers in managing Nigeria's external borrowing to promote sustainable economic growth.

3.1 Model Specification

The model for the study was specified to establish the relationship between external debt, debt servicing, and economic growth in Nigeria. It is expressed as:

The ARDL representation is:

$$\begin{aligned} \Delta LNGDP_t = & \alpha_0 + \sum_{t=1}^p \alpha_{1i} LNGDP_{t-1} + \sum_{t=1}^q \alpha_{2i} \Delta LNEXDS_{t-1} + \sum_{t=1}^q \alpha_{3i} \Delta LNDS_{t-1} \\ & + \sum_{t=1}^q \alpha_{4i} \Delta EXR_{t-1} + \sum_{t=1}^q \alpha_{5i} \Delta INFL_{t-1} + \alpha_{6i} BREAK_{2016} \\ & + \gamma_7 LNGDPI_{t-1} + \gamma_8 LNEXDS_{t-1} + \gamma_9 EXR_{t-1} + \gamma_{10} INFL_{t-1} + \delta ECT_{t-1} \\ & + U_{t-1} \end{aligned}$$

Where:

$\alpha_{1i} - \alpha_{5i}$ = The model short-run dynamic coefficients for converging to equilibrium.

$\gamma_7 - \gamma_{11}$ = the model Long-run coefficients.

$LNGDP$: log of Gross domestic product. (*Dependent variable*)

$LNEXDS$: Log of external debt stock

$LNDS$: Log of debt service

EXR : Exchange rate (Nominal)

$INFL$: Inflation rate

$BREAK_{2016}$: Dummy variable for structural break in 2016 accounting for recession

ECT_{t-i} = Error correction term (lagged residual from the cointegration equation).

δ = Speed of adjustment coefficient, expected to be negative and significant.

U_{t-1} = stochastic term

3.2 Analysis and Discussion

The data employed for the empirical analysis covered the period of thirty years and data was collected from CBN Annual Report 1994 to 2024. The table below shows data used for the analysis of the study.

Table 1: Data used for the analysis of the study showing External Debt Stock, Total Debt Service, Gross Domestic Product (GDP) and Official Exchange Rate.

YEAR	EXTERNAL DEBT STOCK USD	TOTAL DEBT SERVICE USD	GDP CONSTANT USD	GDP GROWTH ANNUAL PERCENT	OFFICIAL EXCHANG E RATE NGN PER USD
1980	8938210283	502977021.2	160616000000	160616000000	0.546780892
1981	11445499562	901445497.7	139531000000	139531000000	0.617708175
1982	11992466650	1406438335	130038000000	130038000000	0.673461262
1983	17576996153	1877675212	115833000000	115833000000	0.724409851
1984	17783310907	3057491743	114540000000	114540000000	0.766527449
1985	18655375059	3825665434	121313000000	121313000000	0.893774083
1986	22215781654	1670752905	121387000000	121387000000	1.754523004
1987	29024891233	914108447.1	125272000000	125272000000	4.016037344
1988	29624118543	2054690889	134459000000	134459000000	4.536966667
1989	30121991493	2063342335	137040000000	137040000000	7.364735
1990	33458483418	3285164234	153179000000	153179000000	8.038285
1991	33526931287	2856327131	153728000000	153728000000	9.909491666 999999
1992	29018663728	2360072769	160847000000	160847000000	17.298425
1993	30699263746	1428898007	157574000000	157574000000	22.0654
1994	33092276818	1809673346	154714000000	154714000000	21.996
1995	34094439060	1747670394	154601000000	154601000000	21.89525833
1996	31414754639	2152812518	161088000000	161088000000	21.884425
1997	28467535604	1361418564	165820000000	165820000000	21.88605
1998	30313714708	1275115636	170100000000	170100000000	21.886



1999	29095550937	974367450.9	171094000000	171094000000	92.3381
2000	33514256077	1729267864	179675000000	179675000000	101.6973333
2001	34976644764	2468039551	190308000000	190308000000	111.23125
2002	36779630348	1430090086	219481000000	219481000000	120.5781583
2003	41856858871	1627895017	235606000000	235606000000	129.22235
2004	45910626686	1705135681	257401000000	257401000000	132.888025
2005	33654648315	8800306825	273974000000	273974000000	131.2743333
2006	17491682579	6700510063	290575000000	290575000000	128.6516667
2007	19484330677	1002007180	309728000000	309728000000	125.8081083
2008	20418957893	427512564.4	330679000000	330679000000	118.5666667
2009	22748897640	426303505.6	357255000000	357255000000	148.88
2010	29148883009	306840267.7	385856000000	385856000000	150.2975
2011	34129232146	351584895.6	406337000000	406337000000	153.8625
2012	39282745539	251848162.5	423525000000	423525000000	157.5
2013	42604005424	393046581.3	451780000000	451780000000	157.3116667
2014	46672476310	264009952.9	480286000000	480286000000	158.5526417
2015	45024833872	397181921.7	493027000000	493027000000	192.4403333
2016	43735939489	354770627	485055000000	485055000000	253.492
2017	65142821170	343981136.1	488964000000	488964000000	305.7901092
2018	69440288785	1433646566	498366000000	498366000000	306.0836882
2019	81342753975	1390412932	509372000000	509372000000	306.9209515
2020	87591245939	1565836452	476930000000	476930000000	358.8107973
2021	96254706294	2645681990	482221000000	482221000000	401.1520292
2022	103064000000	2912559297	503047000000	503047000000	425.9791581

2023	102473000000	3567378890	519783000000	519783000000	645.1940679
2024	108758000000	3859888449	540898000000	540898000000	1478.965197

Source: World Bank, 2026

Table 2: Augmented Dickey-Fuller Unit Root Test

VARIABLE	ADF (LEVEL)	P-VALUE (LEVEL)	ADF (1 ST DIFF)	P-VALUE (1 ST DIFF)	ORDER OF INTEGRATION
LNGDP	-0.297	0.922	-4.481	0.0001	I(1)
LNDS	-1.901	0.328	-4.500	0.0042	I(1)
LNEXDS	-2.229	0.338	-5.592	0.0001	I(1)
INFL	-3.140	0.037	-		I(0)
EXR	-0.884	0.994	-4.193	0.0897	I(1)

Source: Researchers 'Computation using Stata 15

It is crystal clear from the table above, The Augmented Dickey–Fuller unit root test results, log of GDP, log debt service, log external debt stock and exchange rate are non-stationary at levels, as the null hypothesis of a unit root cannot be rejected at conventional significance levels. Nevertheless, after taking first differences, all these variables turned out stationary, showing that that they are integrated of order one. However, the logged inflation is stationary at levels, implying integration of order zero. Generally, the outcome shows a blend of I(0) and I(1) variables with no I(2) variables, thereby satisfying the necessary preconditions for applying the ARDL approach to examine long-run and short-run relationships among the variables.

The study moved further test for multiple break test to examine if there are some possible breaks in the data. Accordingly, Bai-Perron global vs, none was carried out and the results is as shown below:

Table 3: Multiple Tests for Structural Breaks

** Bai-Perron (Econometric Journal, 2003) critical values.					
Estimated break dates:					
1: 2005					
2: 2002, 2009					
3: 1998, 2004, 2009					
4: 1998, 2003, 2008, 2014					
5: 1998, 2003, 2008, 2016, 2020					

Source: Researcher's computation using E-view 13

The multiple unit test suggests the possibility of the above break points. In this light, the study attempts to include significant break dates such as 2016 in the model. This date corresponds to the 2015/2016 recession in Nigeria. It equally included 2007 and 2003 as fixed regressors corresponding period debt relief and global financial crisis. However, only 2016 tuned out to be to be significant.

3.3 ARDL Bound Test

Table 4: Pesaran, Shin, and Smith (2001) ARDL Bounds Test Results

Test Statistic	Value	10percent I(0) I(1)		5percent I(0) I(1)		1percent I(0) I(1)		Decision
F-statistic	9.08	2.63	3.77	3.17	4.50	4.39	5.91	Cointegration confirmed

Source: Researchers' computation using E-view 13

The results of the Pesaran, Shin, and Smith (2001) ARDL bounds test revealed that the computed F-statistic of 9.08 exceeds the upper bound critical values (I(1)) at all conventional significance levels. This indicates the presence of a statistically significant long-run cointegration among the variables LNGDP, LNDS, LNXDS, INFL, and EXR

Table 5: ARDL Cointegration Results

Dependent Variable: D(LNGDPC)

ARDL(1,1,0,1,0)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
COINTEQ*	-0.143977	0.058253	-2.471585	0.0185
LNXDS(-1)	0.068689	0.016122	4.260524	0.0001
LNDS	-0.046041	0.017901	-2.572071	0.0145
EXR(-1)	0.000777	0.000254	3.061262	0.0042
INFL	-0.000986	0.000409	-2.410265	0.0213
DUM2016	-0.139863	0.028388	-4.926897	0.0000
C	3.086287	1.869111	1.651206	0.1076
R-squared	0.604499	Mean dependent var	0.027596	
Adjusted R-squared	0.514099	S.D. dependent var	0.053360	

S.E. of regression	0.037195	Akaike info criterion	3.565011
Sum squared resid	0.048423	Schwarz criterion	3.200063
Log likelihood	87.43023	Hannan-Quinn criter.	3.429670
F-statistic	6.686931	Durbin-Watson stat	1.767332
Prob(F-statistic)	0.000027		

* p-values are incompatible with t-bounds distribution.

** Zero-lag variable.

Source: Researcher's computation using E-view 13

The study estimated model ARDL (1,1,0,1,0) using Error Correction Form (ECM) procedure. This specification captures both short-run dynamics and long-run equilibrium adjustment.

Error Correction Mechanism (COINTEQ) It is negative and statistically significant, which confirms that a long-run equilibrium relationship exists among the variables. The value suggests a relatively slow speed of adjustment. About 14.4% of the "errors" or deviations from the long-run equilibrium are corrected each year. It takes roughly 7 years for the economy to fully return to its trend following a shock.

The coefficient of external debt stock (LNEXDS) is positive (0.0686) and highly significant at 1 percent level of significance. This suggests that in the long run, external debt has a positive relationship with GDP, potentially that external debt stock may support growth of the Nigerian economy.

Debt Servicing (LNDS) is a negative and significant impact (-0.046041; $p = 0.0145$). Every 1% increase in debt servicing reduces GDP per capita growth by 0.046%. This confirms the "crowding out" effect where money meant for development is diverted to pay interest.

Exchange Rate (EXR) is positive (0.0007) and significant at 1 percent level ($p = 0.0042$) indicates that in the long run, an increase in the exchange rate (depreciation) is associated with higher nominal GDP, possibly through export competitiveness or inflationary valuation.

Inflation (INFL) turns out to be negative and significant (-0.0009; $p = 0.0213$) as expected. High inflation erodes purchasing power and hinders economic growth.

The dummy representing 2016 recession in Nigeria is highly significant and negative (-0.139). It shows that the 2016 economic crisis caused a substantial downward shift in GDP.

3.4 **Long-run Coefficients**

External Debt Stock (LNEXDS) is positive (0.477085) and significant (0.0372), at 5 percent level. This suggests that in the long run, external debt has a positive relationship with GDP, potentially implying that these loans were used for productive infrastructure.

Debt Servicing (LNDS) is a negative and significant impact (-0.319785 ; $p = 0.0000$). Every 1% increase in debt servicing reduces GDP per capita growth by 0.046%. This confirms the "crowding out" effect where money meant for development is diverted to pay interest.

The positive coefficient (0.005399) of Exchange rate (EXR) indicates that in the long run, an increase in the exchange rate (depreciation) is associated with higher nominal GDP per capita, possibly through export competitiveness or inflationary valuation.

Inflation (INFL) variable is negative and significant -0.006847 ; $p = 0.0678$). This implies that high inflation erodes purchasing power and hinders economic growth.

Table 6: Long-run Coefficients

Variable *	Coefficient	Std. Error	t-Statistic	Prob.
LNEXDS	0.477085	0.221361	2.155234	0.0372
LNDS	-0.319785	0.059563	-5.368843	0.0000
EXR	0.005399	0.000971	5.562559	0.0000
INFL	-0.006847	0.003647	-1.877176	0.0678

Note: * Coefficients derived from the CEC regression.

Source: Researcher's computation using E-view 13

4.0 DISCUSSION OF RESULTS

The findings of this study reveal a strong and significant relationship between Nigeria's external debt and economic performance. The ARDL regression results show that external debt stock exerts a positive and significant impact on GDP growth, as reflected in the coefficient of 0.477085 ($p < 0.0372$). This implies that increases in external borrowing, when properly utilized, have historically supported economic expansion by financing infrastructure, investment projects, and budgetary needs. This answers the first objective and research question by confirming that external debt stock contributes meaningfully to Nigeria's economic growth.

However, the results also indicate that debt servicing exerts a negative but statistically insignificant effect on GDP (coefficient = -0.319785 , $p > 0.0000$). The negative sign suggests that high repayment obligations can constrain fiscal space and crowd out critical development spending. This addresses the second objective and highlights the risk that excessive debt servicing may threaten fiscal sustainability if borrowing continues to rise without corresponding revenue growth.

The relationship between GDP and other macroeconomic variables presents a mixed picture. Inflation shows a significant negative relationship with GDP (coefficient = -0.006847, $p > 0.0678$). This implies that high inflation erodes purchasing power and hinders economic growth.

The positive coefficient (0.005399) of nominal Exchange rate (EXR) indicates that in the long run, an increase in the exchange rate (depreciation) is associated with higher nominal GDP, possibly through export competitiveness or inflationary valuation. This finding indicates foreign exchange pressures may contribute to currency depreciation, which in turn can dampen economic growth. This addresses the third objective by showing that while inflation remains relatively stable, exchange rate volatility remains a critical channel through which external debt influences economic performance.

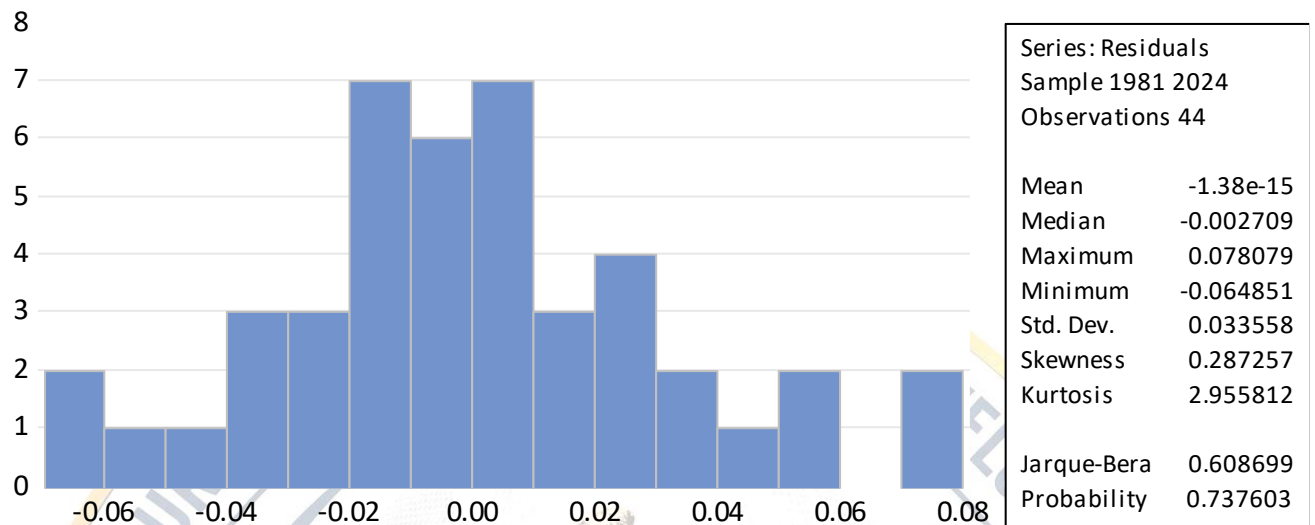
From a policy perspective, the study provides important implications for Nigeria's long-term economic development. The high R-squared value (0.64) indicates that external debt and related macroeconomic factors collectively explain over 64% of the variation in GDP, underscoring their relevance for growth planning.

In summary, the study concludes that Nigeria's external debt can be a tool for stimulating economic growth if efficiently managed, but the associated risks of exchange rate depreciation and servicing burdens must be carefully monitored. Sustainable debt policies, transparent project financing, and export diversification are essential to balance the short-term growth benefits of borrowing with the long-term goal of economic stability and fiscal sustainability.

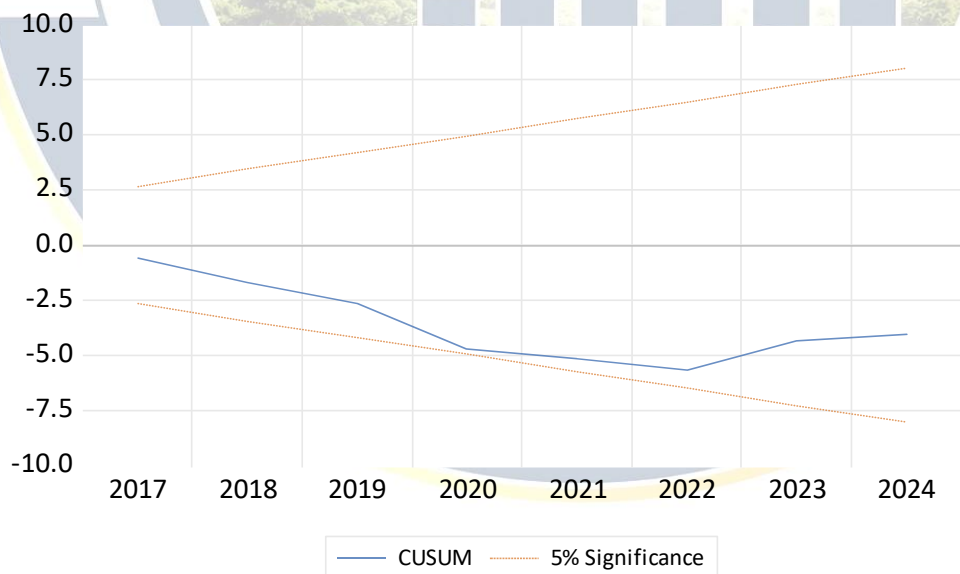
The F-statistic of 67.75 and a p-value of 0.000 confirm that these predictors jointly have a significant relationship with GDP.

Concluding the discussion, the study asserts that external Debt Stock may support growth in the long run, the actual act of servicing that debt (LNDS) and sudden currency depreciations are immediate drags on the Nigerian economy. The 2016 recession had a lasting negative impact that the country is still adjusting to at a rate of 14.4% per year.

The Breusch-Pagan test for serial correlation gives a probability of 0.4455. This indicates that the model is free from autocorrelation and that the model's error terms does not follow previous values. With respect to model specification, the Ramsey RESET test produces a probability of 0.8082, indicating that the null hypothesis of correct model specification cannot be rejected. This implies that the functional form of the ARDL-ECM model is correctly specified and free from omitted variable bias or incorrect functional representation. (BOJEDS)

**Fig. 3:** Residual Normality Test**Source:** Researchers Computation Using Stata 15

From Figure 4.1, the residual normality test presented in the histogram and accompanying statistics indicates that the residuals of the estimated model are normally distributed with minimum variance and constant mean, since probability value is Jarque-Bera statistic of 0.608699 with an associated probability of 0.737603 (greater than 0.05) confirms that the null hypothesis of normality cannot be rejected.

**Fig. 4:** CUSUM Test**Source:** Researcher's computation using E-View 13

The structural stability of the estimated model was verified using the CUSUM test (Figure 4.2). Since the CUSUM statistic stays well within the 5% significance bands, the study fail to reject the null hypothesis of parameter stability. This confirmation of dynamic stability ensures that the estimated coefficients are not biased by structural breaks, validating the model's suitability for analyzing the drivers of Nigeria's economic growth

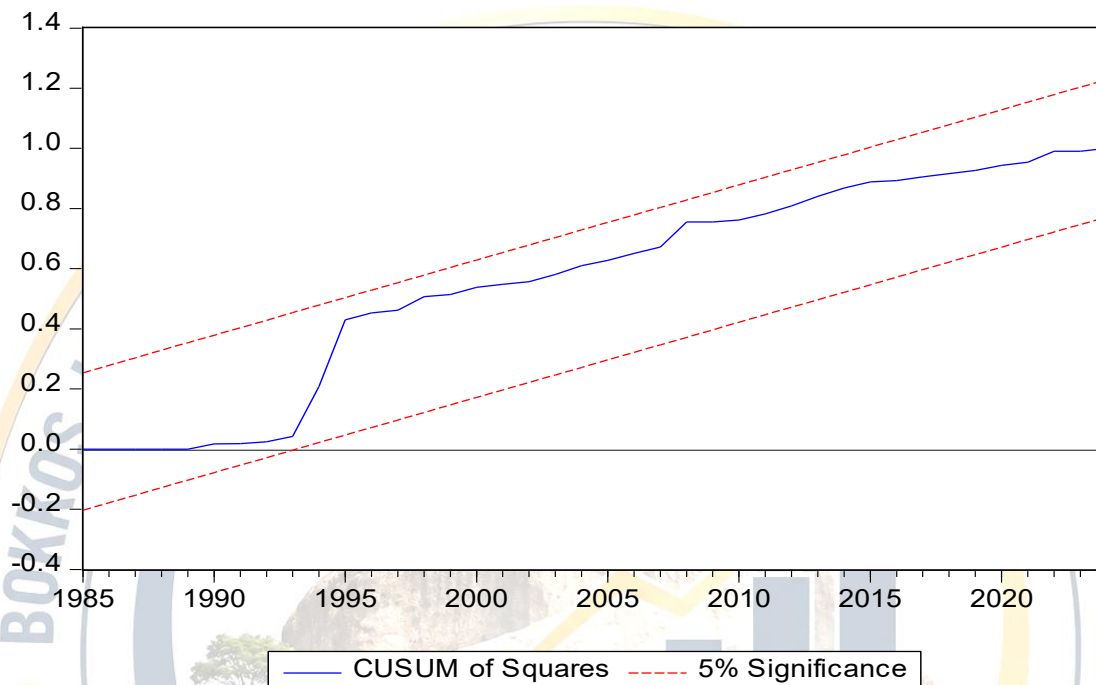


Fig. 5: CUSUM of Square

Source: Researcher's computation using E-View 13

Structural stability of the ARDL model is confirmed by the **CUSUM of Squares** test. The plot shows that the squared residuals stay within the critical 5% bounds from 1985 to 2024, indicating that the model parameters are stable over time and the results are statistically robust.

5.0 CONCLUSION

Based on the empirical evidence, this study concludes that external debt is a "double-edged sword" for Nigeria. While the accumulation of debt stock appears to correlate with growth in the long-run equilibrium, the short-run reality is dominated by the liquidity constraints imposed by debt servicing. The findings suggest that Nigeria is currently caught in a cycle where the cost of maintaining debt outweighs the immediate economic benefits derived from the borrowed funds. The slow speed of adjustment (14.4%) implies that once the economy faces a debt-related shock, the recovery process is prolonged. Therefore, the "Giant of Africa" cannot simply borrow its way to prosperity without addressing the structural inefficiencies that lead to currency volatility and the high cost of debt management. In finality, for external debt to be a catalyst for growth in Nigeria, it must be strictly tied to self-liquidating projects that generate enough foreign exchange to facilitate repayment without straining the national budget.

The government should adopt strict borrowing guidelines to ensure that external loans are secured only for projects with clear economic benefits and measurable returns capable of servicing the debt.

Borrowed funds must be directed toward revenue-generating investments such as infrastructure, energy, manufacturing, and export-oriented industries to enhance economic productivity and foreign exchange earnings. Nigeria should strengthen debt management strategies, including the establishment of sinking funds and improved revenue mobilization, to meet debt servicing obligations without jeopardizing development spending. Transparent monitoring mechanisms and stronger fiscal discipline are necessary to curb corruption, reduce misappropriation of borrowed funds, and ensure that loans achieve their intended developmental impact. The government should intensify efforts to expand the tax base, improve tax compliance, and harness non-oil sectors to reduce dependence on external financing.



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