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Full Length Research Paper

How do External Public Loan affect Economic Growth in Nigeria

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This study investigated whether or not external loans (debts) drive economic growth in Nigeria using an econometric approach to investigate the significant effect of economic relationship between external loan stock and economic growth in Nigeria. The study ascertained whether there is true significant effect of Nigeria's borrowing with London club of creditors (LC), Paris club of creditor (PC) and Multilateral creditors (MC) on economic growth proxied by Gross Domestic product (GDP) in Nigeria for the period 1999-2013. The data for the study were mainly secondary data sourced from Central Bank of Nigeria Annual Report and Statistical Bulletin, Debt Management Office (DMO) and Federal Office of Statistics (FOS). The data were equally subjected to statistical analysis with the use of Coefficient of Multiple Determination, F-Statistics and Durbin Watson statistics. The t-test statistics was employed in testing the hypotheses. The results of the study established that an increase in Nigeria's borrowing with London Club of creditors (LC), Paris Club of Creditors (PC) and Multilateral Creditors (MC) bring about increase in Gross Domestic Product (GDP) in Nigeria. It was also established that there exists significant effects of the external loan variables (LC, PC and MC) on economic growth variable (GDP). The implication of the study is that if the government can contract loan for the promotion of economic growth through investment in capital formation and other social overhead capital, will on the long run affect the economic growth in Nigeria positively. We therefore recommend that there is need for fiscal discipline and high sense of responsibility in the economy as it relates to handling of public funds. In view of the negative contribution of external debt to economic growth, it is further recommended among others, that cost-benefit analysis, prioritization of projects, absorptive capacity of the economy, investment on productive self-financing projects, probity as well as accountability in handling government resources and debt sustainability should form the basis for contracting external debt finance.

Keywords: External Debt, Economic Growth, Paris Club of Creditors, London Club of Creditors, Multilateral Creditors

INTRODUCTION

Sustainable economic growth is a major concern for any sovereign nation most especially the Less Developed Countries (LDCs) which are characterized by low capital formation due to low levels of domestic savings and investment (Adepoju, Salau and Obayelu, 2007). It is

expected that these LDC's when facing a scarcity of capital would resort to borrowing from external sources so as to supplement domestic saving. Soludo (2003) asserted that countries borrow for two broad reasons; macroeconomic reason that is to finance higher level of

consumption and investment or to finance transitory balance of payment deficit and avoid budget constraint so as to boost economic growth and reduce poverty. The constant need for governments to borrow in order to finance budget deficit has led to the creation of external debt.

Borrowing by countries occurs as a result of their inability to generate enough domestic savings to carry out productive activities (Eboigbe and Idolor, 2013). Such external borrowings by countries are meant to supplement the domestic savings and allow such countries to carry out productive activities (Anyanwu, 1991). A country can also borrow in the short-term, from external sources to finance current account deficit arising from external disturbances in order to shore up external reserves position and strengthen external liquidity position in the future. Ajayi (1991) further posits that foreign borrowing is desirable and necessary to accelerate economic growth, provided they are channeled to increase the productive capacity of the economy and promote economic growth and development.

The ultimate aim of the government of any country is to achieve a well developed economy which can be depicted by the realization of macroeconomic objectives of equitable income distribution and economic growth. Consequently, various policies and strategies can be adopted in the realization of these objectives.

The neo-classical economic postulated a positive relationship between external loan, economic growth and development (Milton, 1999). Based on that, Nigeria in her bid to grow and develop in addition to her ability to generate loan internally, thought it wise to fill both the domestic savings gap and foreign exchange gap through foreign loans.

However, from early 1980, growth in external loan and huge debt services obligations, coupled with dwindling export earning gave birth to what we now regarded in the finance literature as the Nigeria's external loan crises. Attempts to cope with the loan crisis through the adoption of IMF supported programmes further compounded the excruciating loan problems (Isa, 2004).

Nigeria resorts to external borrowing to bridge the domestic resources gap in order to accelerate economic development. This then means that Nigeria can resort to external borrowing provided that the proceeds are utilized in productive way that will facilitate the eventual servicing and liquidation of the loan (Ajisafe, 2006).

In the 1950's, countries were encouraged to borrow abroad and create an environment conducive to boost her economic growth. In the process, little attention was paid to the liabilities side of the current account deficits, which increased the external indebtedness of those countries (Maureen, 2001). As a matter of fact foreign borrowing can be explained in terms of the technical, managerial and financial requirements necessary to support development programmes and economic growth.

Between the 2000's and 2013, deficit on the current account financed by borrowing abroad was highly favoured as a way of boosting economic growth (Nassar and Ajiafe, 2006).

The origin of Nigeria's external loan dates back to 1958 when a sum of US\$ 28 million was contracted for railway construction (Ajayi, 2000). Between 1958 and 1977, the resort to foreign debt was minimal as loan contracted during the period were the congressional debts from bilateral and multilateral sources with long payment period and lower interest rates constituting about 78.5 percent of the total debts stock. However, with the increase in external loan and difficult in repayment in 1982, pressure soon mounted on the various sectors of the economy resulting in huge balance in government finance, low international reserves, deficits in the balance of payments and the accumulation of trade arrears in respect of insured and uninsured trade credits.

Hence, the government approached the creditors for debt relief leading to the restructuring with the Paris Club in 1986, 1989, 1991 and 2005. It was the same loan that was being rescheduled three times, but with different maturities. During this period, interest and late interest were capitalized thereby making the debt to grow even worse when no new loans were contracted.

Nigeria, in 2006 eventually sealed the Paris Club deal by paying a total of US \$ 12.124 billion to get a write off of US \$ 18 billion loans from the Paris Club. Though, the civil society and some critical Nigerians seriously opposed the decision of Obasanjo to pay the amount of \$ 12.124 billion at a go to Paris Club, at a time when servicing external loan, having a heavy toll on the national economy.

Yet, the Obasanjo government went ahead to release to total of US \$ 126 billion to the creditors, and at the same time negotiated with the London Club for a similar debt deal. Nigeria debt to the London Club by then was US \$ 2 billion. According to guardian's newspaper report, President Olusegun Obasanjo had on May 24, 2006 informed the senate of his government's readiness to pay off. Nigeria last batch of outstanding debts owned the London club amounting to ₦ 279.5 billion.

It is widely recognized in the international community that excessive foreign indebtedness in most developing countries is a major impediment to their economic growth and stability (Adu, 2004; Mutasa, 2003). Developing countries like Nigeria have often contracted large amount of external debts that has led to the mounting of trade debt arrears at highly concessional interest rates. Gohar and Butt (2012) opined that accumulated debt service payments create a lot of problems for countries especially the developing nations reason being that a debt is actually serviced for more than the amount it was acquired and this slows down the growth process in such nations. The inability of the Nigerian economy to meet its debt service payments obligations has resulted in debt overhang or debt service burden that has militated

against her growth and development (Audu, 2004).

Huge external debt does not necessarily imply a slow economic growth; it is a nation's inability to meet its debt service payments fueled by inadequate knowledge on the nature, structure and magnitude of the debt in question" (Were, 2011). It is no exaggeration that this is the major challenge faced by the Nigerian economy. The inability of the Nigerian economy to effectively meet its debt servicing requirements has exposed the nation to a high debt service burden. The resultant effect of this debt service burden creates additional problems for the nation particularly the increasing fiscal deficit which is driven by higher levels of debt servicing. This poses a grave threat to the economy as a large chunk of the nation's hard earned revenue is being eaten up. Nigeria's external debt outstanding stood at US\$28.35 million in 2001 which was about 59.4% of GDP from US\$8.5 million in 1980 which was about 14.6% of GDP (WDI 2013). The debt crisis reached its maximum in 2003 when US\$2.3 billion was transferred to service Nigeria's external debt. In the year 2005 the Paris Club group of creditor nations forgave 60% (US\$18 billion) of US\$30.85 billion debt owed by Nigeria.

Despite the debt relief of US\$18 billion received by Nigeria from the Paris club in 2005 the situation remains the same (Bakare, 2010). The question then becomes why has external borrowing not accelerated the pace of growth of the Nigerian economy?

According to UNCTAD (2000) report, real GDP capital in the LDCs as a whole grew at an average of only 0.9% during 1990-1998 and 3.6% during 2000-2008. This implies that Nigeria's GDP per capital is by far below the average of the LDCs. The problem of this study now is the implication of the Nigeria debt burden, which is the threat. This debt has posed towards the realization of the economic growth objective of the country given that Nigeria whose problems of economic growth and social backwardness are supposed to reserve is currently one of the most dilapidated by sovereign loan crisis. With debt persistence and increment courtesy of huge debt services, lots of trade-off has been occurring which would have been an alternative to boasting economic growth.

The trade off shows that in 2001 for example, Nigeria spends US \$ 1.3 billion on external loan services payments and this translated to six times the budgetary allocation to education and ten times the budgetary allocation to health for the year Arikawe (2003). Can we say that loan services payment has any effect on economic growth? This then perfectly fits with the report from the jubilee research which highlighted that the poorest countries are still paying debt services of US \$ 8 billion per year whereas if the rich donor and creditors countries were to make available only 0.1% of their GDP, vast improvements would be achieved in the lives of millions of people in such countries. Thus the essence of this study is to examine the effect of external loan on the economic growth of Nigeria from 2000-2013. Hence, the

hypothesis remains thus, 'there is no significant effect of Nigeria's borrowing with Paris Club of Creditors, London's Club of creditors and Multilateral Creditors on Economic Growth as proxied by GDP'.

2.0 Literature Review

The motive behind external debt is to boost economic growth and development of any nation but as a result of future high debt service payments, it poses a serious threat to the economy of that nation. Economic researchers have therefore sought out to investigate the implication of external debt burden on the economies of debtor nations and have come up with diverse views.

Suliman (2012) carried out a study on the effect of external debt on the economic growth of Nigeria. Annual time series data covering the period from 1970-2010 was used. The empirical analysis was carried out using econometric techniques of Ordinary least squares (OLS), Augmented Dickey-Fuller unit root test, Johansen Co-integration test and error correction method. The co-integration test shows long-run relationship amongst the variables and findings from the error correction model revealed that external debt has contribute positively to the growth of the Nigerian economy. In addition the study recommends that the Nigerian should ensure political and economic stability so as to ensure effective debt management. An empirical investigation conducted by (Audu, 2004) examines the impact of external debt on the economic growth and public investment of Nigeria. The study carried out its analysis using time series data covering the period from 1970-2002. The Johansen Co-integration test and Vector Error correction method econometric techniques of estimation were employed in the study. The study concluded that Nigeria's debt service burden has had a significant adverse effect on the growth process and also negatively affected public investment. Another study by Ogunmuyiwa (2011) examined whether external debt promotes economic growth in Nigeria using time-series data from 1970-2007.

Empirical Review

Equation was estimated using econometric techniques such as Augmented Dickey-Fuller test, Granger causality test, Johansen co-integration test and Vector Error Correction Method (VECM). The results revealed that causality does not exist between external debt and economic growth in Nigeria. Ayadi and Ayadi (2008) examined the impact of the huge external debt, with its servicing requirements on economic growth of the Nigerian and South African economies. The Neoclassical growth model which incorporates external debt, debt indicators, and some macroeconomic variables was employed and analyzed using both Ordinary Least Square (OLS) and Generalized Least Square (GLS) techniques of estimation. Their findings revealed that debt and its servicing requirement has a negative impact

on the economic growth of Nigeria and South Africa.

Faraji and Makame (2013) investigated the impact of external debt on the economic growth of Tanzania using time series data on external debt and economic performance covering the period 1990-2010. It was observed through the Johansen co-integration test that no long-run relationship between external debt and GDP. However the findings show that external debt and debt service both have significant impact on GDP growth with the total external debt stock having a positive effect of about 0.36939 and debt service payment having a negative effect of about 28.517. The study also identified the need for further research on the impact of external debt on foreign direct investments (FDIs) and domestic revenues.

Safdari and Mehrizi, (2011) analyzed external debt and economic growth in Iran by observing the balance and long term relation of five variables (GDP, private investment, public investment, external debt and imports). Time series data covering the period 1974-2007 was used and the vector autoregressive model (VAR) technique of estimation was employed. Their findings revealed that external that has a negative effect on GDP and private investment and public investment has a positive relationship with private investment.

Ejigayehu (2013) also analyzed the effect of external debt on the economic growth of eight selected heavily indebted African countries (Benin, Ethiopia, Mali, Madagascar, Mozambique, Senegal, Tanzania and Uganda) through the debt overhang and debt crowding out effect with ratio of external debt to gross national income as a proxy for debt overhang and debt service export ratio as a proxy for debt crowding out. Panel data covering the period 1991-2010 was used. The empirical investigation was carried out on a cross-sectional regression model with tests for stationarity using Augmented Dickey Fuller tests, heteroskedasticity and ordinary regression. The concluding result from estimation showed that external debt affects economic growth through debt crowding out rather than debt overhang.

In another study on external debt relief and economic growth in Nigeria, Ekperiware and Oladeji, (2012) examined the structural break relationship between external debt and economic growth in Nigeria. The study employed the se o quarterly time series data of external debt, external debt service and real GDP from 1980-2009. An empirical investigation was conducted using the chow test technique of estimation to determine the structural break effect of external debt on economic growth in Nigeria as a result of the 2005 Paris Club debt relief. The result of their findings revealed that the 2005 external debt relief caused a structural break effect in the relationship between external debt and economic growth. Based on these findings they concluded that the external

debt relief made available resources for growth-enhancing projects.

Adedeji (1989), contends that the continued fragmentation of African products and factor markets have exacerbated the lopsided nature of development, openness and external dependence of African has deepened its economic crisis. This affects foreign resources inflows necessary for the development process.

The issues of over dependence of western economies are another factor that affected the debt crisis. The Nigerian economy has been highly dependent on the economies of developed countries for productive capital, financial resources, technical and expatriate skills, food and even the export market for its products. The cyclical crisis of the advanced countries are consistently and systemically transmitted to the country as the derivative crisis of global capitalistic production, while the country is persistently denied autonomous development dynamism, as it becomes a bugger for resolving the crisis of western Europe (Nkwoke,1988).

A classical example of the nature of dependence of Nigeria on external economies was the devaluation of the naira in 1973 as a result of the devaluation of the US Dollar about the same period. This was because the naira exchange was pegged to the dollar and the depreciation suffered by the dollar were translated to the Nigerian economy and this scenario was consistent.

He suggested that the liquidity affects results from the fact that there are only limited resources to be divided among consumption investment external transfers to service existing debt. the study made use of investment equation models and then concluded that the disincentive arises because expectations of future burden tend to discouraged current investment.

Ajiafe (2006) investigates the external loan and foreign private investment in Nigeria, a test for causality. The study made use of both conventional F-test to determine the causality and unit root test known as classical unit root test to determine the order of integration of the variables. The findings of the study show that there existed a bi-directional relationship between external loan and foreign investment in Nigeria. The result of the analysis suggests that external loan contributes significantly to foreign private investment in Nigeria.

METHODOLOGY AND DATA

The research work was to determine the effect of external loan on the economic growth in Nigeria (1999-2013). The study takes expose-facto research design which involves historic secondary data generated from the research variables based on time-series data gotten from records and publications of Debt Management Office (DMO),

Table 1. Regression Result of the effect of Nigeria's borrowing with London's Club of creditors on GDP

Variable	Coefficient	St. Error	t-Statistic	Prob.
C	33515.11	12054.96	2.780194	0.0134
LC	1.542317	0.146840	10.50342	0.0000
PC	0.999422	0.010138	98.58323	0.0000
MC	0.973112	0.043459	22.39164	0.0000

Source: E-views 6.0

Table 2. Regression Result of the effect of Nigeria's borrowing with Paris Club of creditors on GDP.

Variable	Coefficient	St. Error	t-Statistic	Prob.
C	48480.00	12094.74	4.008383	0.0009
LC	1.521134	0.168534	9.025685	0.0000
PC	0.990306	0.010901	90.84248	0.0000
MC	1.050909	0.035484	29.61680	0.0000

Source: E-views 6.0

Table 3. Regression Result of the effect of Nigeria's borrowing with Multilateral of creditors on GDP.

Variable	Coefficient	St. Error	t-Statistic	Prob.
C	240519.60	22392.08	10.74128	0.0000
LC	-0.05857	0.009618	-6.08972	0.0000
PC	3513.066	266.6481	13.17492	0.0000
MC	0.50726	0.056493	27.84681	0.0000

Source: E-views 6.0

Federal Office of Statistics (FOS), Central Banks of Nigeria (CBN) economic and financial review, general polices articles as well as business and economic journals and internets borrowing.

Model Specification

Considering the functional relationship, the linear function of the relationship could be stated as follows: $y = b_0 + b_1X_1 + b_2X_2 + b_3X_3 + \mu_t \dots 1$

Where: y = Economic growth proxied by GDP; b_0 = Constant term of regression model; b_1 = Regression coefficient of X_1 ; b_2 = Regression coefficient of X_2 ; x_1 = London's Club of creditors; x_2 = Paris Club of creditors; x_3 = Multilateral creditor; μ_t = Standard Error term. Considering the function notation, the models could be specified as follows: $GDP = f(LC, PC, MC) \dots 2$

However, the linear function of the above notation is stated as follows:

$$GDP = b_0 + b_1LC + b_2PC + b_3MC + \mu_t \dots 3$$

Where: GDP = Gross Domestic Product; LC = London's Club of creditors; PC = Paris Club of creditors; MC = Multilateral creditor

Analytical Techniques

The analytical techniques or method of data analysis

adopted in this study is the use of multiple linear regression analysis. In view of this, the following measures were used to evaluate the results; The Coefficient of Multiple Determination (R^2), F – Statistics Durbin Watson Statistics and t-test to test the significance of the individual parameter estimates.

RESULTS AND DISCUSSION

Given that the model has been specified in the previous chapter, it is hereby estimated and presented. In all the models structured, the variables used are annual time seires data ranging from 1999 – 2013.

The aim of the study is to examine the effect of external loan on the economic growth of Ngeria. Therefore, the empirical data associated with this and related statistics/regression results are stated below as follows:

Analysis of the Results

The first table regressed London's Club of creditors loan borrowed by Nigeria on economic growth (GDP). Thus, from a careful examination of the regression result and related statistics, the following facts emerged. The coefficient of the constant term is 33515.11. The associated t-value is statistically significant at 5% percent level. At zero performance of the independent variables,

GDP will increase by 33,515.11. The regression coefficient of London's Club loan borrowed by Nigeria (LC) carries a positive sign and the t-value is statistically significant at 5%. The significance is ascertained as the 0.05 (5%) level of significance) is greater than p-value of the regression coefficient of LC (0.000). The computed coefficient of multiple of determination ($R^2 = 0.9998$) shows that 99.98% of the total variation in the GDP accounted for, by the independent variables (LC, PC, and MC). The value of Durbin Watson (DW) is 1.91. Using 5% level of significance, and $K^1 = 4$ (four) and $N = 12$ degrees of freedom, the tabulated lower (dL) and upper limits of Durbin Watson statistics are 0.92 and 1.812 respectively. Since the computer Durbin statistics (1.91) is greater than the upper limit (1.812), there is no evidence of autocorrection in the model.

Table 2 specifically considered the regression of Paris Club of creditors loan borrowed by Nigeria on GDP. The coefficient of the constant term is 48480.33. The associated t-value is statistically significant at 5% percent level. At zero performance of the independent variables, GDP will increase by ₦ 48,480.33K. The regression coefficient of Paris Club loan borrowed by Nigeria (PC) carries a positive sign and the t-value is statistically significant at 5%. The significance is ascertained as the 0.05 (5% level of significance) is greater than p-value of the regression coefficient of LC (0.000). The computed coefficient of multiple of determination ($R^2 = 0.999756$) shows that 99.9756% of the total variation in the GDP accounted for, by the independent variables (LC, PC, and MC). The value of Durbin Watson (DW) is 1.18. Using 5% level of significance, and $K^1 = 3$ (three) and $N = 12$ degrees of freedom, the tabulated lower (dL) and upper limits of Durbin Watson statistics are 1.026 and 1.669 respectively. Since the computer Durbin Watson statistics (1.18) lies between the lower and upper limit of the tabulated statistics, we conclude that there is inconclusive evidence regarding the presence or absence of autocorrelation in the model.

Using 5% level of significance, it is found that the T-calculated value of regression coefficient of LC in the first is 10.5 while its tabulated value is 2.120. Using a two tailed test, this value falls within the critical region. Thus, H_0 is rejected and we concluded that Nigeria's borrowing with London's Club of creditors has a significant effect on GDP in Nigeria.

In the second model, the T-calculated value is 90.84. Using 5% level of significance, the F-tabulated value is 2.179. Since the T-cal is greater than (>) T-tab, we reject the null hypothesis and conclude that there is a significant effect of Nigeria's borrowing with Paris Club of Creditors and GDP in Nigeria.

In the third model, the T-calculated value of the regression coefficient of MC is -6.089 while its T-tabulated value is 2.101. Using a two tail test, this value falls within the critical region. Thus, H_0 is rejected and we

concluded that Nigeria's borrowing with Multilateral Creditors has a significant effect on GDP in Nigeria.

It was established in the first model that Nigeria's borrowing with London's Club of creditors has a significant effect on GDP in Nigeria. It was also found that there is a positive relationship between Nigeria's borrowing with London Club of creditors and GDP in Nigeria. This finding met a prior expectation. Thus, it is estimated from the result that N1 increase in Nigeria's borrowing with London Club of creditors will lead to an increase in GDP by 1.54.

From the second model, the result shows that there is a significant relationship between Nigeria's borrowing with Paris Club of creditors and GDP in Nigeria. More so, it was found that N1 increase in Nigeria's borrowing with Paris Club of creditors, on the average will result to increase in GDP by 99. The result findings imply that increase in Nigeria's borrowing with Paris Club of creditors will increase GDP in Nigeria.

There is a negative relationship found between Nigeria's borrowing with Multilateral Creditors and GDP in Nigeria in the third model. The result findings showed that Nigeria's borrowing with Multilateral Creditors has a significant effect on GDP in Nigeria. Thus, it was estimated from the result that N1 increase in Nigeria's borrowing with Multilateral Creditors will bring about increase in GDP by 6k.

CONCLUSION / RECOMMENDATIONS

Conclusion

This study examined the effects of external loan on the economic growth of Nigeria from 2000 – 2013. Empirical results have shown clearly a positive relationship between Nigeria's borrowing with Lond Club of creditors (LC) and that of paris Club of creditors (PC) on economic growth (GDP) in Nigeria. There exists a negative relationship between Nigeria's borrowings with Multilateral Creditors (MC) on economic growth (GDP) in Nigeria. It was found and established that the three independent variables of Nigeria's external loan (LC, PC and MC) have significant effect on the dependent variable, that is, economic growth proxied by GDP in Nigeria.

The policy implication of the study is that if the government can contract loan for the promotion of economic growth through investment in capital formation and other social overhead capital, will on the long-run affect the economic growth of Nigeria positively.

Recommendations

In line with the findings of the study, the study

recommend as follows:

1. There is need for government to pay in important role in stimulating the economy from the loan relief initiatives by targeting at productive public investment.
2. There is also need for fiscal discipline and high sense of responsibility in the economic as it relates to handling of public funds. This should be the watch-wood for our country's leaders.

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