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DOMESTIC AND FOREIGN DEBT BURDEN: IMPERATIVE FOR ECONOMIC PERFORMANCE IN NIGERIA

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Abstract

The present investigation looks at the comparative impact of domestic and foreign debt on Nigeria's GDP growth over the period of 1981 to 2023, using statistical models to analyze their contributions. The findings reveal that domestic debt consistently exhibits a statistically significant and positive relationship with GDP, making it a more effective tool for economic growth. In contrast, foreign debt shows a weaker and less consistent contribution, largely due to Nigeria's vulnerability to external shocks, exchange rate fluctuations, and the high cost of servicing external loans. The analysis aligns with economic theories, such as the Keynesian perspective and the Debt Overhang Hypothesis, highlighting the benefits of productive domestic borrowing and the risks associated with excessive reliance on foreign debt. Policymakers are urged to prioritize sustainable domestic debt utilization while adopting a cautious approach to foreign borrowing, focusing on projects with clear economic benefits. The study concludes that Nigeria is better off leveraging domestic debt to drive GDP growth, complemented by strategic foreign borrowing for high-impact projects. A balanced debt strategy, coupled with structural reforms such as improved revenue mobilization, fiscal discipline, and economic diversification, is recommended to achieve long-term economic resilience and sustainable growth.

Keywords: Domestic Debt, Foreign Debt, Debt Overhang, Debt Burden, Economic Performance.

1.0 Introduction

Public debt has long been a critical component of fiscal policy in both developed and developing economies. Governments often resort to borrowing as a means of addressing budget deficits, financing infrastructural projects, and stimulating economic growth, especially in periods of economic downturn or resource inadequacy. In the Nigerian context, the reliance on public debt has been a consistent feature of economic policy, stemming from the country's need to fund ambitious development plans amidst fluctuating oil revenues and limited non-oil revenue streams. Since independence in 1960, Nigeria has faced significant challenges in balancing its fiscal requirements with sustainable debt practices, a situation that has intensified in recent years due to the global economic environment and domestic fiscal pressures.

The evolution of Nigeria's public debt profile is deeply rooted in its economic history. In the post-independence era, external borrowing was initially used to finance capital-intensive projects, particularly in the agriculture and industrial sectors. However, the oil boom of the 1970s led to a significant shift in economic policy, with increased reliance on oil revenues and a neglect of other critical sectors such as agriculture and

manufacturing. The oil price collapse in the 1980s exposed the fragility of this mono-commodity economy, prompting Nigeria to turn to external lenders, including multilateral institutions like the International Monetary Fund (IMF) and the World Bank, to stabilize its economy. By the 1990s, Nigeria had accumulated unsustainable levels of external debt, leading to a debt crisis that severely constrained its fiscal space and undermined economic growth (Ayadi & Ayadi, 2008).

In 2005, Nigeria achieved significant debt relief through negotiations with the Paris Club, resulting in a substantial reduction of its external debt stock. This development marked a turning point in Nigeria's debt strategy, with a deliberate shift towards domestic borrowing as a means of financing budget deficits. Domestic debt was perceived as a safer and more sustainable alternative, given its insulation from exchange rate fluctuations and global market shocks. However, the resurgence of external borrowing in recent years, driven by dwindling oil revenues and the need to fund critical infrastructure projects, has reignited concerns about Nigeria's debt sustainability. By 2023, Nigeria's total public debt had surpassed $100 billion, with a notable increase in external debt obligations (Debt Management Office, 2023).

This reliance on debt has sparked intense debates in academic and policy circles regarding its implications for economic growth. Theoretically, the connection between growth and debt growth is multifaceted. Keynesian theory advocates for the strategic use of debt to finance productive investments that can stimulate economic growth and job creation (Keynes, 1936). However, the Debt Overhang Hypothesis posits that excessive debt can discourage investment and stifle growth by creating uncertainty about future fiscal policies (Krugman, 1988). Empirical studies on Nigeria have produced mixed findings. Although some scholars contend that domestic debt boosts growth, due to its alignment with local economic conditions (Oke & Sulaiman, 2012), others caution against the risks of debt mismanagement and inefficiencies in public spending (Adesola, 2009). In addition, how well government budgets are implemented matters a great deal. When public funds—including borrowed resources—are properly managed and utilized, they can positively influence economic performance (Onyemaechi & Clever, 2026).

In the contemporary Nigerian economy, the challenges associated with debt management are further exacerbated by structural weaknesses and governance issues. The country's heavy dependence on oil revenues, which account for over 70% of government income, makes its fiscal position highly vulnerable to global oil price shocks. This volatility often necessitates borrowing to bridge budget deficits, but the utilization of borrowed funds has been marred by corruption, inefficiency, and a lack of transparency in public finance management. Furthermore, in 2022, the high cost of debt payment accounted for more than 90% of Nigeria's total revenue, raises concerns about the sustainability of current borrowing practices and their impact on economic growth and development (BudgIT, 2023).

Despite these challenges, there is a growing recognition of the potential benefits of a well-structured debt strategy. Domestic debt, for instance, offers advantages such as lower exposure to exchange rate risks and the potential for stimulating local financial markets. Conversely, external debt, when accessed on concessional terms, can provide much-needed funding for large-scale infrastructure projects that are critical for economic transformation. The key question, therefore, is not whether Nigeria should borrow but how to optimize its debt portfolio to achieve sustainable growth.

Problem Statement

Nigeria's economic trajectory has been characterized by a persistent struggle with debt management and sustainable development. Since gaining independence in 1960, the country has relied heavily on public debt to finance developmental projects and bridge fiscal deficits, particularly in periods of economic volatility and oil price shocks. However, the effectiveness of this borrowing strategy in driving economic

growth remains a contentious issue in both policy and academic circles. Despite its abundant natural and human resources, Nigeria has grappled with economic stagnation, a high poverty rate, and rising debt burdens, raising concerns about the implications of its debt structure for long-term development.

Historically, Nigeria's debt landscape has undergone significant transformations. In the 1980s and 1990s, the country faced a severe external debt crisis, with foreign debt levels exceeding sustainable thresholds. This crisis culminated in the Paris Club debt relief initiative in 2005, which temporarily alleviated Nigeria's debt burden. However, the post-relief era has witnessed a resurgence of debt accumulation, with the composition of debt shifting towards a combination of domestic and foreign borrowing. According to recent statistics, in 2023, Nigeria's entire governmental debt had risen to more than $100 billion, with domestic debt accounting for approximately 61% and foreign debt comprising the remaining 39% (Debt Management Office, 2023). This trend has reignited debates about the optimal debt strategy for achieving sustainable growth. Despite increased government spending and rising public debt, Nigeria’s economic growth has remained inconsistent. This situation raises important concerns about how effectively fiscal policies are implemented, as evidence suggests that when budgets are poorly executed, the potential benefits of public debt on economic performance are often weakened (Onyemaechi & Clever, 2026).

Theoretically, the role of public debt in economic development is subject to divergent perspectives. Keynesian economics underscores the potential of debt-financed government spending to stimulate economic growth, particularly in underdeveloped economies with significant infrastructure deficits (Keynes, 1936). This view suggests that borrowing, whether domestic or foreign, can be a viable tool for financing growth-enhancing projects, provided the funds are used efficiently. On the other hand, the Debt Overhang Hypothesis posits that excessive debt, particularly external debt, can act as a drag on growth by creating uncertainty and discouraging investment (Krugman, 1988). These theoretical contentions highlight the need for empirical analysis to determine how different forms of debt influence growth in specific contexts, such as Nigeria.

Empirical literature on the subject presents mixed findings. Studies like those by Reinhart and Rogoff (2010) argue that high levels of debt, irrespective of type, tend to impede growth, especially in countries with weak institutional frameworks. Conversely, Ayadi and Ayadi (2008) found that domestic debt plays a more significant role in stimulating growth in African countries compared to foreign debt, which is often associated with high servicing costs and exchange rate volatility. In the Nigerian context, several studies have reported contrasting results. For instance, Oke and Sulaiman (2012) emphasize the positive impact of domestic debt on GDP growth, citing its relative stability and alignment with local economic conditions. However, other scholars, such as Adesola (2009), highlight the risks of debt mismanagement and argue that neither domestic nor foreign debt has significantly contributed to Nigeria's economic transformation.

Despite the extensive body of literature, critical gaps remain. Many studies fail to provide a comparative analysis of the growth implications of domestic versus foreign debt, especially in a country like Nigeria, where structural inefficiencies and governance challenges complicate the debt-growth relationship. Additionally, few studies incorporate the dynamic nature of debt impacts, which can vary over time and across economic cycles. Addressing these gaps is essential for informing policy decisions on debt management and economic planning.

This study seeks to bridge these gaps by providing a comprehensive analysis of the impact of domestic and foreign debt on Nigeria's economic growth. By examining the historical trajectory, theoretical underpinnings, and empirical evidence, the study aims to shed light on the relative effectiveness of domestic and foreign borrowing in driving sustainable development. This is

particularly relevant in the current context, where rising debt levels and declining revenue streams pose significant challenges to Nigeria's fiscal sustainability and economic resilience.

2.0 Literature Reviews

2.1 Conceptual Framework

Domestic Debt

Domestic debts are defined as the amount of a nation's debt that is borrowed from within its borders, according to Ozurumba and Kanu (2014). Typically, the Nigerian central bank, deposit money banks, discount stores, and other non-bank financial institutions provide these loans. Debt instruments like Treasury bills, Treasury certificates, and Treasury bonds are examples of domestic debts, which are debts that originate within a nation's borders. Private sector investment is crowded by domestic debt, according to Kumhof and Tanner (2005), because government securities in developing nations are seen as an effort by banks to protect against excessive private sector credit risk. Okonjo-Iweala (2010) found that Nigeria's economy has made reducing domestic debt a top priority because the country's debt profile has been skyrocketing and, if left unchecked, could have negative effects like stunting GDP growth and driving out private sector investment.

External Debt Stock

The World Bank (2023) defines the total external debt stock as the sum of all public and publically guaranteed debt, private nonguaranteed long-term and short-term debt, and IMF credit utilization. This all-inclusive indicator covers all of a nation's debt commitments to foreign lenders, including liabilities from the public and private sectors.

Comparably, the United Nations Conference on Trade and Development (UNCTAD) (2024) states that a nation's total external debt stock comprises all of its external liabilities that must be repaid in foreign currency, goods, or services. This highlights the significance of this metric in evaluating a nation's financial commitments to the rest of the world and its effects on economic stability and growth.

Foreign debts or external borrowings are obligations owed by the government to multilateral organizations, the London Club, the Paris Club, foreign promissory notes, and other undeclared external borrowings, according to CBN (2010). Therefore, the term "external debt" describes the funds that are utilized in a nation but are not produced domestically or derived in any manner from local residents, whether they be individuals or corporations.

Gross Domestic Product

The monetary worth of goods and services generated in an economy over time, regardless of the nationality of the individuals who produced them, is what CBN (2017) defines as economic growth. Depreciation is not subtracted in its computation. Economic growth, according to the International Monetary Fund (2012), is the rise in the market value of the goods and services generated in an economy over time. Adams (2004) states that when a nation's total commodities and services rise in comparison to prior years, economic growth is evident. This is a reference to a sustained rise in a nation's physical output.

2.2 Theoretical review

The theoretical framework underpinning this study rests primarily on the **Keynesian economic theory** proposed by John Maynard Keynes in 1936 and the **Debt Overhang Hypothesis** introduced by Paul Krugman in 1988. These theories provide the conceptual basis for analyzing the role of domestic and foreign debt in influencing economic growth, particularly in developing economies like Nigeria.

2.2.1 Keynesian Theory of Debt

Keynesian economics highlights the importance of government action, particularly fiscal policy, in fostering and stabilizing economic expansion. Keynes (1936) maintained that in times of economic recession or slow expansion, governments could stimulate aggregate demand

through increased public expenditure, often financed by debt. This debt-driven fiscal expansion can, in theory, enhance economic activity by creating jobs, boosting consumption, and fostering investments. In the context of Nigeria, the reliance on domestic debt aligns with Keynesian thought, as domestic borrowing allows the government to fund infrastructure projects and other developmental activities without being overly exposed to external vulnerabilities. However, a key assumption of this theory is that the borrowed funds must be channeled into productive ventures that generate returns exceeding the cost of borrowing. When this assumption is violated, debt can exacerbate fiscal imbalances rather than stimulate growth.

2.2.2 Debt Overhang Hypothesis

The **Debt Overhang Hypothesis**, advanced by Krugman (1988), posits that excessive debt, particularly external debt, can hinder economic growth by creating a disincentive for investment. The hypothesis is based on the idea that when a country's debt levels are perceived as unsustainable, future income is expected to be taxed heavily to repay creditors, reducing the incentive for both domestic and foreign investors to commit resources. In the Nigerian context, the heavy reliance on foreign debt, often associated with high servicing costs and exchange rate volatility, reflects this dynamic. The Debt Overhang Hypothesis explains why foreign debt has a weaker and less consistent impact on Nigeria's GDP growth compared to domestic debt, as observed in this study.

Both theories share certain assumptions relevant to the study. For Keynesian economics, the effectiveness of debt-financed government spending assumes that the economy operates below full capacity, and that there is sufficient fiscal discipline to ensure the borrowed funds are used efficiently. Meanwhile, the Debt Overhang Hypothesis assumes rational behavior among investors and creditors, as well as a clear link between perceived debt sustainability and investment decisions.

However, these theories also have limitations. Keynesian economics has been critiqued for underestimating the risks of fiscal deficits and inflation arising from excessive borrowing. In Nigeria, poor fiscal discipline and corruption often undermine the productive use of borrowed funds, diluting the theoretical benefits of Keynesian debt-financed growth. Similarly, the Debt Overhang Hypothesis does not fully account for the complex dynamics of developing economies, where structural issues, governance challenges, and global economic conditions can exacerbate the adverse effects of foreign debt beyond what the theory predicts. For example, Nigeria's oil-dependent economy is highly sensitive to global oil price shocks, which further complicates its debt management strategies.

2.3 Empirical Review

Domestic debt and Economic Growth

Geda and Yimer (2024) used annual data from 1980 to 2021 to examine the dynamic effects of public debt on Ethiopia's economic growth. Public debt impedes long-term growth, according to empirical findings derived from the Autoregressive Distributed Lag (ARDL) modelling approach. Debt is therefore a double-edged sword for Ethiopia's economic development. On the one hand, public debt can finance infrastructure projects and other initiatives that help boost the economy. High debt levels, however, can impede economic expansion. To lessen the negative effects of public debt on economic growth, policymakers can implement prudent fiscal restraint, mobilize domestic revenue to meet the nation's expanding financing needs, implement effective debt management techniques to guard against corruption and debt abuse, and better prioritize needs.

A country's total public debt due to domestic lenders is referred to as its internal or domestic debt, according to Johnson, (2024). Several components and principal holders of the nation's domestic debt are discussed in this article. Numerous economic issues, including debt

overhang, increased debt servicing costs, volatile exchange rates, and crowding out effects on the private sector, have been brought on by the nation's rising domestic debt profile.

Using the Keynesian perspective and debt overhang theory, Onuoha (2024) sought to examine the mediating function of public spending in the relationship between domestic debt and economic development. A time series data set (from 1981 to 2020) was used in the study, and it was taken from the Central Bank of Nigeria (CBN) statistical bulletin for 2021. Following the pre-estimation Augmented Dickey-Fuller unit root test, structural equation modelling was used to examine the mediation effect of public spending. Overall, the study's findings show that public spending and domestic debt significantly boost economic growth. The analysis also reveals that the relationship between domestic debt and economic development is somewhat mediated by governmental spending.

Yusuf and Mohd (2023) use the Nonlinear Autoregressive Distributed Lag approach to investigate the unequal effect of public debt on economic development in Nigeria between 1980 and 2020. While debt service payments supporting the debt overhang concept activated a symmetric effect that stifles growth, empirical evidence showed that external debt has a major positive and symmetric impact on economic growth in both the short and long term. Growth was asymmetrically and linearly slowed by domestic debt in the short and long terms, respectively. Conversely, retaining foreign reserves showed a symmetric short-term impact on growth incentive and an unbalanced long-term impact.

Foreign Debt and Economic Growth

The relationship between Nigeria's RGDP and external debt (EXD) was empirically examined by Uwakaeme (2024), who included the nominal foreign exchange rate (NFXR) and external debt interest charges (EDIC) as control variables. CBN is the source of the study data, which covers the years 1980–2022. Granger Causality tests, the Error Correction Model (ECM), and the Co-integration technique were used in the study's econometric analysis. In the long term, the chosen explanatory variables significantly impacted Nigeria's RGDP, according to the empirical studies. EXD and EDIC established independent relationships with RGDP, whereas NFXR had a unilateral relationship with RGDP, according to the Granger Causality test. This suggests that NFXR determines RGDP without any feedback. In the long term, Nigeria's RGDP growth process adapts slowly to changes in the chosen time series, as indicated by the significant and negatively signed ECM coefficient, which suggests a policy lag impact.

Maharani and Widyastuti (2024) compared three different sources of Indonesian governmental income to promote economic growth—bonds, Sukuk, and foreign debt—in order to examine the country's incapacity to address its expenditure issues. Time series data, a type of secondary data, is used in the study's quantitative methodology. Indonesia's economic growth is negatively impacted by foreign debt, but positively by bonds and sukuk. This suggests that Indonesia's economic development in 2016–2023 is significantly impacted by the foreign debt, sukuk, and bond variables.

Beha and Ruxho (2024) examined the relationship between public debt and economic growth in eleven newly admitted Central and Southeast European EU member states between 2000 and 2021. The relationship between public debt and GDP growth is examined using a panel Autoregressive Distributed Lag (ARDL) model, which takes into consideration factors including trade openness, population growth, inflation, and foreign direct investment. The findings show that rising public debt levels and GDP growth are significantly correlated negatively, with the effect being most noticeable in Balkan nations. This inverse relationship, which is noticeable over the short and long terms, indicates that less economically developed areas are more sensitive to governmental debt.

The impact of external debt and debt servicing on the expansion of the Nigerian economy was

studied by Ejaigbe et al. (2024) in both the short and long term. Using data from 1981 to 2023, the study estimated the short- and long-term equilibrium using the Autoregressive Distributed Lag and Vector Error Correction Model. The study's conclusions showed that external debt and Nigeria's economic growth are related in both the short and long term. That the economy benefits from external debt both now and in the future. Additionally, it discovered that the Nigerian economy is negatively impacted both immediately and over time by debt servicing.

Domestic, Foreign Debt and Economic Growth

Bakker, et al. (2024) analyzed the main differences between the internal and external debts of the state, their impact on the economy, and important aspects in management. Public debt, which includes both foreign and domestic funding, is crucial for funding infrastructure projects, boosting economic growth, and filling budget shortfalls. Domestic debt, obtained through local sources in national currency, allows for maintaining state sovereignty and leaving interest payments in the domestic economy. However, it may compete with the private sector. Foreign debt is raised in foreign currency and, although it serves as a source of investment, it increases risks related to exchange rate fluctuations and may cause international political restrictions.

Ndu (2024) investigated the impact of debt repayment on the growth of Nigeria's economy. Thus, this study's specific goals are to ascertain how servicing foreign debt affects GDP and to investigate how servicing domestic debt affects GDP. To address the issues raised by the independent factors on the dependent variable, two null hypotheses were examined. Using GDP as the dependent variable dimension, we used SPSS to examine our results using ordinary least square regression. The study spanned the years 2005–2021. Due to the nature of the data being analyzed, this study used an ex post facto design. The researchers chose this design because they wanted to provide an unrestricted interface of the data without any tampering. Nonetheless, the results showed that both domestic and foreign debt servicing significantly affect GDP.

The impact of Nigeria's national debt on its economic performance between 1981 and 2023 was examined by Chigbata et al. (2024). Secondary data were extracted from the Central Bank of Nigeria's statistical bulletin for a range of years, covering a 43-year period from 1981 to 2023, in accordance with the ex-post facto study approach taken. Domestic debts have a considerable and positive impact on Nigeria's GDP, whereas foreign debts have a significant but negative impact, according to the results of the hypothesis testing using Ordinary Least Square regression. In conclusion, promoting stability and economic progress requires efficient management of both foreign and domestic debt.

The influence of foreign loan components on the expansion of the Nigerian economy was examined by Amadi et al. in 2024. The study used time series data from 1986 to 2023 using an econometric analytical approach based on the Autoregressive Distributed Lag (ARDL) technique. A long-term association between the variables employed in the study was indicated by the empirical data from ARDL. Whereas global debt has a negligible positive impact on economic growth, bilateral debt and debt service payments have a substantial negative impact. Furthermore, every year, 95 percent of the short-term imbalance is fixed.

3.0 Methodology

The research design used in this study is ex post facto. The dependent variable is economic growth as measured by GDP, while the independent variables are foreign and domestic debt. The Central Bank of Nigeria Bulletin provided the annual secondary data used in the study, which covered the years 1981–2023.

In accordance with economic theory, this study used multiple regression to estimate GDP as a function of both domestic and foreign debt.

The model's functional forms are expressed as follows:

Model 1

GDP = *f*(DD, FD) ……..…….….. (1)

Model 2

GDP = *f*(DD) ……..…... (2)

Model 3

GDP = *f*(FD) ……...… .. (3)

Econometrically, the above model can be re-organized as follows:

$InGPDt = \alpha_0 + \alpha_1 InDD_{t-1} + \alpha_2 lnFD_{t-1} + \mu_t$……..... (4)

$InGPDt = \beta_0 + \beta_1 InDD_{t-1} + \mu_t$…….…….... (5)

$InGPDt = \infty_0 + \infty_1 lnFD_{t-1} + \mu_t$……..……..... (6)

Where:

GDP = Gross Domestic Product (a proxy for economic growth)

DD = Domestic Debt

FD = Foreign Debt

β_0, β_1, - β_2 = parameter estimates

μ = stochastic error term

4.0 Data Presentation and Analysis

Table 1: Descriptive statistics result

	LNGDP	LNDD	LNFD
Mean	3.890721	2.942913	2.878718
Median	4.060753	3.066699	2.838747
Maximum	5.370006	4.726385	4.582289
Minimum	2.143984	1.048931	0.367580
Std. Dev.	1.081888	1.018734	0.948292
Skewness	-0.308388	-0.273157	-0.702184
Kurtosis	1.668949	1.954292	3.229072
Jarque-Bera	3.855866	2.493935	3.627630
Probability	0.145449	0.287375	0.163031
Sum	167.3010	126.5452	123.7849
Sum Sq. Dev.	49.16022	43.58837	37.76883
Observations	43	43	43

Source: *E-Views 10 output extract*.

Table 1 shows the statistical description of each variables, these includes: LNGDP, LNDD and LNFD with their respective Mean (3.890721, 2.942913, 2.878718**)** which is the average sum of all the variables, the median value of the LNGDP, LNDD and LNFD which are 4.060753, 3.066699 and 2.838747 are slightly higher than the mean, indicating a slight skewness in the data set. The Standard Deviation indicates a moderate level of variability in LNGDP (1.081888) which implies that the economy has experienced fluctuations in growth within the study period. The moderate standard deviation of 1.018734 (LNDD) indicates that the domestic debt values have been fluctuating, which may raise concerns about debt sustainability while the standard deviation of LNFD (0.948292) indicates that the foreign debt values have been fluctuating, which may expose the country to exchange rate risks.

There are three types of kurtosis: mesokurtic (when the kurtosis coefficient is = 0), platykurtic (when the kurtosis coefficient is < 0), and leptokurtic (when the kurtosis coefficient is > 0). Skeweness indicates the degree of asymmetry of the distribution, which can be either positively or negatively skewed. The result shows that the

skewness and kurtosis values of LNGDP is slightly negatively skewed (-0.308388) and has a relatively low kurtosis value (1.668949), indicating a fairly symmetrical distribution, the LNDD is highly negatively skewed (-2.73157) and has a relatively high kurtosis value (1.954292), indicating a highly asymmetrical distribution while LNFD is moderately negatively skewed (-0.702184) and has a relatively high kurtosis value (3.229072), indicating a fairly asymmetrical distribution. The Jarque-Bera test statistics and p-values (0.145449, 0.287375 and 0.163031) indicate that all the employed variables are normally distributed.

Stationarity Test

According to econometric theory, variables that must be included in a regression model must pass a stationarity test in order to produce a realistic (non-spurious) result at the 1%, 5%, or 10% level of significance. This study checked for stationarity using the unit root test.

Table 4.2: Presentation of Results of Unit Root Test: (Augmented Dickey Fuller) at Level and First Difference.

Variable	Level I(0)				1st Difference I(1)				Order of Integration
	ADF T-statistics	5% Crit value	P-value	Remark	ADF T-statistics	5% Crit value	P-value	Remark	
D(LnGDP)	-1.498001	-2.933158	0.5249	Non-stationary	-3.543503	-2.935001	0.0116	Stationary	I(1)
D(LnDD)	-0.672384	-2.933158	0.8427	Non-stationary	-3.923198	-2.935001	0.0042	Stationary	I(1)
D(LnFD)	-1.070057	-2.935001	0.7185	Non-stationary	-4.918234	-2.935001	0.0002	Stationary	I(1)

Note: Statistical decisions are based on 5% level of significance.

Source: Author's computation.

For the ADF unit root test to be considered stationary, the ADF test statistic value must be higher than the critical value at the 5% absolute term, according to the decision rule. The results of the Augumented Dickey Fuller (ADF) unit root test statistics shows that all employ variables like LNGDP, LNDD and LNFD are stationary at first difference at 5 percent critical value.

Graphical Presentation of the Trends of Domestic and Foreign Debt Contributions to Gross Domestic Product in Nigeria

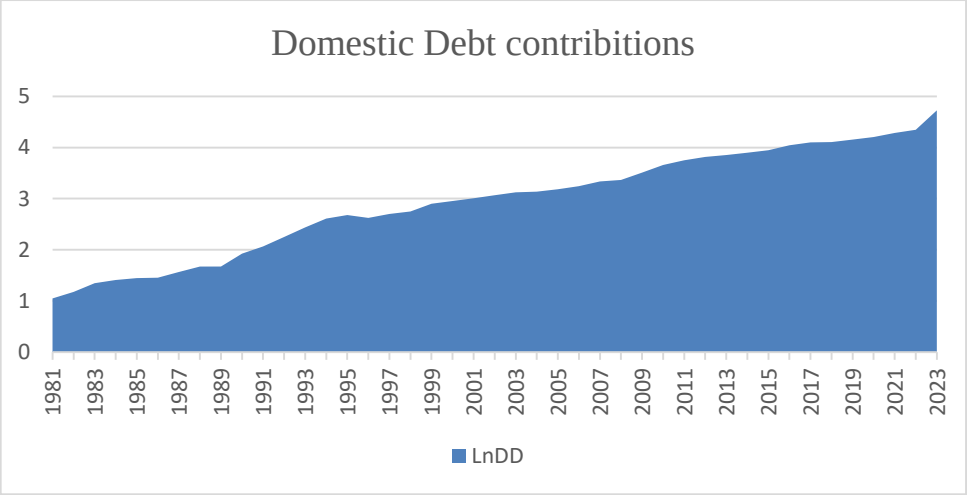

Figure 4.1: Pictoral representation of trends of Domestic Debt (LnFD) in Nigeria for the periods 1981

to 2023.

The above graph in Figure 1 shows an upward increase in domestic debt in Nigeria over the period 1981 to 2023. From 2007 to 2017, there was a steady increase that was ascribed to the issuance of Nigeria Treasury Bills and Federal Government Bonds to finance budget deficits, extend the debt portfolio's maturity structure, and expand the domestic debt market.

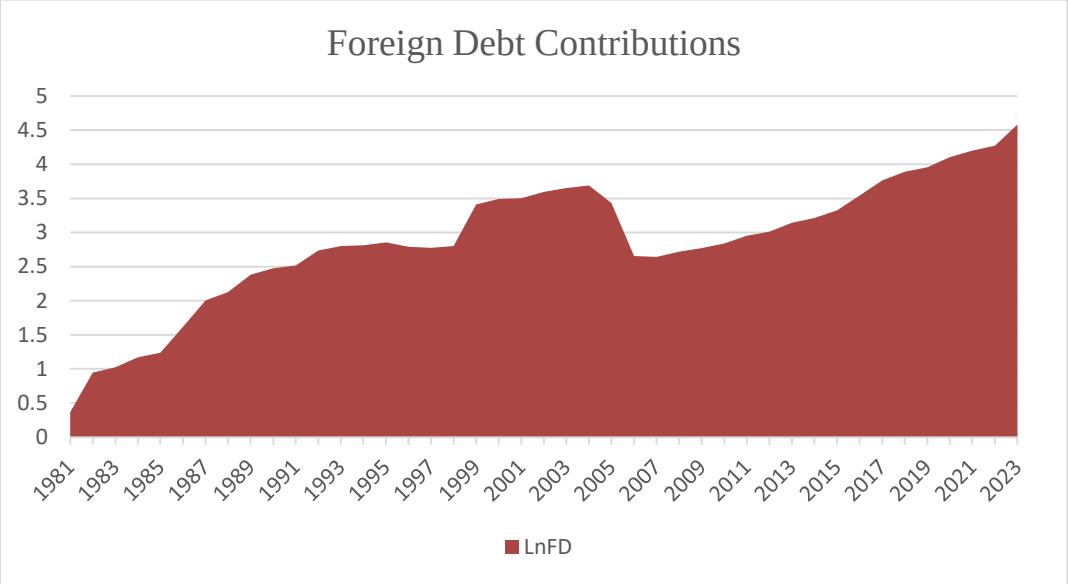

Figure 4.2: Pictoral representation of trends of Foreign Debt (LnFD) in Nigeria for the periods 1981 to 2023.

Figure 2 above presents the trend of foreign debt (LnFD) contribution in Nigeria from 1981 to 2023. Over this period, Nigeria's foreign debt constantly grew from 1981 to 1994 and maintain a slight fluctuation till 1997, external debt servicing experience a rise in 1997 till 1999 and kept an increase gradually until 2003. Following the implementation of economic and debt management reforms, there was a progressive decrease in external debt from 2003 to 2005. Additionally, the Paris and London Club loan obligations were withdrawn. Due to new loan disbursements from China, the accumulation of arrears, the country's debt portfolio's exposure to foreign exchange, and the depreciation of the Nigerian Naira relative to the US dollar, the British pound sterling, and the Japanese yen, it continued to rise from 2008 until 2023.

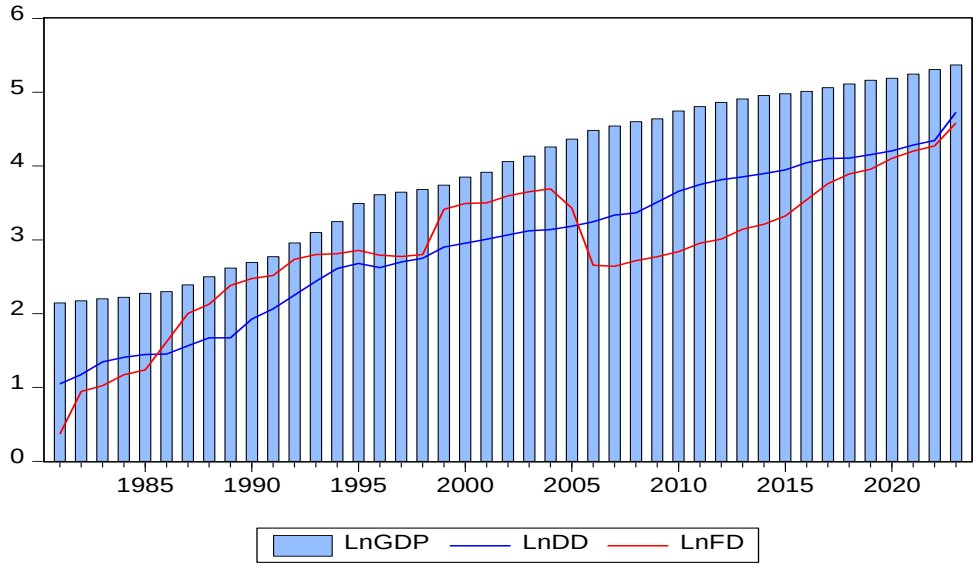

Figure 4.3: Pictoral representation of trends of Gross Domestic Product (GDP), Public Debt from:

Domestic Debt (LnDD) AND Foreign Debt (LnFD) in Nigeria for the periods 1981 to 2023.

Source: E-Views 13 output extract.

The graph above shows the contribution of public debt (domestic and foreign) to economic performance in Nigeria spanning from 1981 to 2023. It is clearly seen that the Nigeria economy depend more on foreign debt when compared to domestic debt.

Multivariate Analysis

The results from the three models examining the relationship between Gross Domestic Product (GDP) and the independent variables of domestic debt (DD) and foreign debt (FD) provide a comprehensive view of the interactions among these variables in Nigeria's economic context. Each model's estimation sheds light on specific dynamics and implications for economic performance.

Table 3: Co-integration Test

Date: 12/11/24 Time: 11:45
Sample (adjusted): 3 43
Included observations: 41 after adjustments
Trend assumption: Linear deterministic trend
Series: LNGDP LNDD LNFD
Lags interval (in first differences): 1 to 1

Unrestricted Cointegration Rank Test (Trace)

Hypothesized No. of CE(s)	Eigenvalue	Trace Statistic	0.05 Critical Value	Prob.**
None	0.350684	28.87325	29.79707	0.0636
At most 1	0.237111	11.16796	15.49471	0.2014
At most 2	0.001745	0.071613	3.841466	0.7890

Trace test indicates no cointegration at the 0.05 level
* denotes rejection of the hypothesis at the 0.05 level
**MacKinnon-Haug-Michelis (1999) p-values

Source: *E-Views 10 output extract*.

The cointegration result above exhibits that, at the 0.05 level, the Trace test reveals no cointegration. This suggests that there is no long-term relationship between the regressors and regressand variables, allowing for the use of the Vector Autoregression (VAR) estimate.

Table 4: Model 1 Result: GDP = f (DD, FD)

Vector Autoregression Estimates
Standard errors in ( ) & t-statistics in [ ]

	LNGDP	LNDD	LNFD
LNGDP(-1)	1.162963	-0.172740	-2.201770
	(0.15805)	(0.35836)	(0.72907)
	[7.35813]	[-0.48203]	[-3.01998]
LNGDP(-2)	-0.242394	0.229931	1.301514
	(0.14180)	(0.32151)	(0.65410)
	[-1.70941]	[0.71515]	[1.98977]
LNDD(-1)	0.275174	1.188600	0.274460

	(0.09965)	(0.22594)	(0.45967)
	[2.76138]	[5.26058]	[0.59708]
LNDD(-2)	-0.225638	-0.282893	0.779851
	(0.10905)	(0.24727)	(0.50305)
	[-2.06905]	[-1.14409]	[1.55025]
LNFD(-1)	0.008798	0.050965	0.921098
	(0.03398)	(0.07704)	(0.15674)
	[0.25891]	[0.66150]	[5.87649]
LNFD(-2)	0.029659	-0.012814	-0.079216
	(0.03185)	(0.07221)	(0.14690)
	[0.93134]	[-0.17747]	[-0.53925]
C	0.096135	0.024632	1.105482
	(0.06109)	(0.13851)	(0.28180)
	[1.57367]	[0.17783]	[3.92297]
R-squared	0.999013	0.994051	0.966962
Adj. R-squared	0.998839	0.993001	0.961132
Sum sq. resids	0.042300	0.217462	0.900075
S.E. equation	0.035272	0.079975	0.162705
F-statistic	5736.961	946.8509	165.8532

Determinant resid covariance (dof adj.)	1.88E-07
Determinant resid covariance	1.07E-07
Log likelihood	154.4959
Akaike information criterion	-6.511995
Schwarz criterion	-5.634312
Number of coefficients	21

In **Model 1**, where GDP is expressed as a function of both domestic debt (DD) and foreign debt (FD), the results from the vector autoregression (VAR) estimation illustrate the significant influence of lagged variables on GDP. The coefficient of the first lag of GDP (LNGDP(-1)) is strongly positive (1.162963), indicating that previous economic performance has a substantial and self-reinforcing impact on current GDP levels. Its associated t-statistic of 7.35813 is highly significant, confirming the robustness of this relationship. Conversely, the second lag of GDP (LNGDP(-2)) shows a smaller negative effect (-0.242394), suggesting diminishing returns or possible adjustment effects over longer lag periods.

The role of domestic debt in GDP dynamics is nuanced. The first lag of domestic debt (LNDD(-1)) positively impacts GDP (coefficient of 0.275174, significant at 2.76138), reflecting the potential stimulatory effects of domestic borrowing. However, the second lag (LNDD(-2)) has a negative coefficient (-0.225638), albeit significant, pointing to potential crowding-out effects or longer-term repayment challenges associated with domestic debt. For foreign debt, the direct effects on GDP are less pronounced. The coefficients of the first and second lags of foreign debt (LNFD(-1) and LNFD(-2)) are relatively small and not statistically significant, implying that foreign borrowing may not directly drive economic growth but could have other indirect influences.

The goodness-of-fit measures in this model are exceedingly high, with an R-squared value of 0.999013, indicating that the model explains almost all the variability in GDP. The F-statistic further confirms the overall significance of the model. Nonetheless, the potential for over fitting should be considered, given the high explanatory power.

Standard errors in ( ) & t-statistics in [ ]

Table 5: Model 2 Result: GDP = F(DD)

Vector Autoregression Estimates

	LNGDP	LNDD
LNGDP(-1)	1.295950	-0.132923
	(0.14403)	(0.30683)
	[8.99758]	[-0.43321]
LNGDP(-2)	-0.415831	0.123770
	(0.12413)	(0.26443)
	[-3.35008]	[0.46807]
LNDD(-1)	0.278935	1.216380
	(0.10281)	(0.21902)
	[2.71305]	[5.55371]
LNDD(-2)	-0.154486	-0.210751
	(0.10992)	(0.23415)
	[-1.40549]	[-0.90005]
C	0.134099	0.098274
	(0.05194)	(0.11066)
	[2.58157]	[0.88809]
R-squared	0.998845	0.993854
Adj. R-squared	0.998717	0.993171
Sum sq. resids	0.049505	0.224660
S.E. equation	0.037083	0.078997
F-statistic	7784.277	1455.350
Determinant resid covariance (dof adj.)		8.54E-06
Determinant resid covariance		6.58E-06
Log likelihood		128.2329
Akaike information criterion		-5.767459
Schwarz criterion		-5.349515
Number of coefficients		10

In **Model 2**, where GDP is modeled solely as a function of domestic debt (DD), the dynamics suggest a more streamlined interaction. The first lag of GDP (LNGDP(-1)) again demonstrates a robust and positive effect (coefficient of 1.295950, t-statistic of 8.99758), reinforcing the role of historical GDP levels in determining current performance. The second lag (LNGDP(-2)) has a negative but significant influence, indicating a balancing adjustment over time. Domestic debt's impact is significant through its first lag (LNDD(-1)), with a coefficient of 0.278935 and a t-statistic of 2.71305, suggesting that domestic borrowing positively affects economic growth in the short term. However, its second lag (LNDD(-2)) shows a negative but insignificant coefficient, which may imply that prolonged reliance on domestic debt could impose costs or inefficiencies in resource allocation.

The R-squared for Model 2 is also exceptionally high (0.998845), underscoring the strong predictive capacity of the model. This suggests that GDP in Nigeria can be significantly explained by historical GDP levels and domestic debt, though potential multicollinearity or over fitting concerns may arise from such a high explanatory

power.

Table 6: Model 3 Result GDP = F(FD)

Vector Autoregression Estimates
Date: 12/02/24 Time: 21:38
Sample (adjusted): 1983 2023
Included observations: 41 after adjustments
Standard errors in ( ) & t-statistics in [ ]

	LNGDP	LNFD
LNGDP(-1)	1.248857	-1.372204
	(0.15860)	(0.76182)
	[7.87422]	[-1.80123]
LNGDP(-2)	-0.289108	1.355139
	(0.15122)	(0.72635)
	[-1.91186]	[1.86568]
LNFD(-1)	0.029439	1.162336
	(0.03219)	(0.15461)
	[0.91460]	[7.51802]
LNFD(-2)	0.013658	-0.179784
	(0.03320)	(0.15949)
	[0.41133]	[-1.12725]
C	0.088926	0.293178
	(0.03130)	(0.15036)
	[2.84088]	[1.94989]
R-squared	0.998791	0.956110
Adj. R-squared	0.998657	0.951233
Sum sq. resids	0.051826	1.195736
S.E. equation	0.037942	0.182249
F-statistic	7435.227	196.0562
Determinant resid covariance (dof adj.)		4.76E-05
Determinant resid covariance		3.67E-05
Log likelihood		93.00421
Akaike information criterion		-4.048986
Schwarz criterion		-3.631041
Number of coefficients		10

In **Model 3**, where GDP is expressed as a function of foreign debt (FD) alone, the results highlight the relatively weaker direct role of foreign borrowing in driving economic performance. The first lag of GDP (LNGDP(-1)) retains a strong positive coefficient (1.248857, t-statistic of 7.87422), signifying the critical role of historical economic performance. The second lag (LNGDP(-2)) displays a smaller negative impact, consistent with Models 1 and 2. However, the lags of foreign debt (LNFD(-1) and LNFD(-2)) are not statistically significant, with coefficients close to zero. This finding indicates that foreign debt does not exert a substantial immediate influence on GDP, though it may play an indirect role in facilitating development projects or augmenting fiscal capacity.

The goodness-of-fit for Model 3, while still high, is slightly lower than the other models (R-squared of 0.998791), which may reflect the less direct impact of foreign debt compared to domestic borrowing. This aligns with the broader economic understanding that while foreign debt can provide needed resources, its effectiveness is contingent on factors such as the efficiency of fund utilization and external economic

conditions.

Comparative Effects

Below is a tabular representation of key statistics from the three models. Following the table, a detailed analysis explores whether Nigeria's economy is better off relying on domestic debt, foreign debt, or a combination of both.

Table 7: Comparative Summary of Effects

Statistic	Model 1 (GDP = f(DD, FD))	Model 2 (GDP = f(DD))	Model 3 (GDP = f(FD))
R-squared	0.999013	0.998845	0.998791
Adjusted R-squared	0.998839	0.998717	0.998657
F-statistic	5736.961	7784.277	7435.227
Durbin-Watson statistic	2.386408	2.270657	2.087633
Coefficient of DD (-1)	0.275174	0.278935	N/A
Coefficient of FD (-1)	0.008798	N/A	0.029439
Prob(F-statistic)	0.000000	0.000000	0.000000
Akaike Information Criterion (AIC)	-6.511995	-5.767459	-4.048986

The comparative statistics highlight significant insights about the relationships between Nigeria's GDP, domestic debt (DD), and foreign debt (FD): All three models demonstrate a very high R-squared value, indicating that the chosen variables effectively explain variations in GDP. The inclusion of both DD and FD (Model 1) provides the highest R-squared and adjusted R-squared, suggesting that a mixture of domestic and foreign debt better accounts for Nigeria's GDP movements than relying solely on either debt source. However, the individual models (Model 2 and Model 3) are also strong, indicating that both domestic and foreign debt individually have a substantial impact on economic performance.

In Model 1, the coefficient for lagged domestic debt (LNDD(-1)) is positive and statistically significant (0.275174, $p < 0.05$), indicating that domestic debt positively contributes to GDP in the short term. In contrast, the lagged coefficient for foreign debt (LNFD(-1)) is small and statistically insignificant (0.008798, $p > 0.05$). This pattern persists in Model 2, where the domestic debt coefficient (0.278935) remains statistically significant, reinforcing the conclusion that domestic borrowing has a direct and meaningful effect on GDP. In Model 3, the coefficient for foreign debt (0.029439) is positive but statistically insignificant, showing a much weaker relationship with economic performance.

The Durbin-Watson statistic across all models indicates no severe autocorrelation issues, enhancing the reliability of the findings. However, Model 1, which combines both debt types, shows the most balanced Durbin-Watson statistic (2.386), suggesting the robustness of results when domestic and foreign debts are analyzed together.

From the results, Nigeria appears to benefit more from domestic debt than foreign debt in driving GDP growth. Domestic debt is statistically significant in all models where it is included, while foreign debt's contribution is weaker and less consistent.

Discussion of Findings

The findings shows that domestic debt contributes more significantly to Nigeria's GDP growth compared to foreign debt align with economic theories and the current fiscal realities in the country. This observation can be dissected by examining the theoretical underpinnings, historical trends, and practical implications of Nigeria's debt strategy.

Economic theories on public debt and growth provide a lens through which to interpret Nigeria's debt dynamics. The Debt Overhang Theory posits that excessive debt, especially external debt, can discourage investment by creating uncertainty about future taxation and economic policy (Krugman, 1988). External debt carries the additional burden of currency risks, making it more vulnerable to exchange rate volatility. Domestic debt, on the other hand, is less sensitive to such risks, and its servicing is usually more predictable since it is denominated in local currency. In Nigeria's case, the empirical results confirm that domestic debt has a more robust and statistically significant relationship with GDP growth. This outcome aligns with the Keynesian Theory, which emphasizes that government borrowing, particularly domestically, can stimulate demand and catalyze economic growth when directed towards productive investments. However, the Ricardian Equivalence Hypothesis suggests that excessive domestic borrowing may lead to higher interest rates, crowding out private investment. Thus, the results should be interpreted with caution.

Nigeria's preference for domestic debt is evident in its debt portfolio. As of mid-2023, domestic debt accounted for approximately 66% of the country's

total public debt, while foreign debt represented the remaining 34% (Debt Management Office, 2023). The growing emphasis on domestic borrowing reflects concerns over the risks associated with foreign debt, such as currency mismatches and rising debt service obligations.

For example, the depreciation of the naira against the U.S. dollar in recent years has exacerbated Nigeria's external debt servicing costs. In 2023, external debt servicing consumed a significant proportion of federal revenue, leaving less fiscal space for domestic development (IMF, 2023). This aligns with the findings that foreign debt contributes less significantly to GDP growth, as the benefits of foreign borrowing are often outweighed by its costs.

The statistical significance of domestic debt in all models highlights its effectiveness in driving Nigeria's GDP growth. Several factors contribute to this outcome: Domestic debt is denominated in naira, insulating it from exchange rate fluctuations. This stability allows the government to focus on utilizing funds effectively without the immediate pressure of rising costs. Nigeria's financial sector has developed sufficiently to absorb significant government borrowing. Instruments like Treasury bills and bonds provide the government with a steady source of funding while offering risk-free returns to investors. Funds borrowed domestically are often recycled within the economy, supporting local industries, banks, and other financial institutions. This multiplier effect amplifies domestic economic activity and bolsters GDP growth (Ojiambo & Nwokolo, 2021).

5. Conclusion and Recommendation

The study's findings reveal significant insights into Nigeria's debt dynamics and their implications for economic growth. By comparing the impacts of domestic and foreign debt on GDP, the analysis highlights the relative strengths and weaknesses of both debt types in the Nigerian context.

Domestic debt has consistently shown a statistically significant and positive relationship with GDP growth in Nigeria. This suggests that domestic borrowing, when managed effectively, serves as a critical instrument for stimulating economic activity. The advantages of domestic debt include reduced currency risk, ease of access to local financial markets, and the recycling of borrowed funds within the domestic economy. These factors enhance its effectiveness in driving short- and medium-term economic growth. Additionally, domestic debt has proven to be less volatile than foreign debt in terms of its impact on GDP. This stability makes it a preferred option for financing government expenditures aimed at fostering economic development.

Foreign debt, by contrast, demonstrates a weaker and less consistent contribution to GDP growth. This finding is largely attributable to Nigeria's susceptibility to external shocks, including exchange rate fluctuations, rising global interest rates, and the high cost of servicing external loans. Furthermore, Nigeria's historical reliance on foreign borrowing has been marred by challenges such as inefficient allocation of funds and the mismanagement of loan proceeds, leading to suboptimal returns on investments in economic growth. The country's dependence on oil revenues to finance external debt obligations exacerbates these challenges, as oil price volatility often undermines the government's capacity to service foreign debt. Consequently, the benefits of foreign borrowing are frequently offset by its associated risks and costs, limiting its contribution to sustainable economic development.

The findings align with key economic theories such as the Debt Overhang Hypothesis, which warns against the negative effects of excessive borrowing on economic growth, particularly when debt servicing becomes unsustainable. Nigeria's experience with foreign debt underscores this risk, as high debt servicing costs often crowd out essential investments in infrastructure, education, and health. Conversely, the positive impact of domestic debt supports the Keynesian view that government borrowing, when used for productive purposes, can act as a catalyst for economic growth. However, it also cautions against potential drawbacks, such as higher domestic interest rates and the crowding out of private sector investment, which could arise from excessive reliance on domestic borrowing.

7Recommendations

The findings suggest that Nigeria's policymakers should adopt a balanced approach to debt management, emphasizing the strengths of domestic borrowing while carefully addressing the risks associated with foreign debt. Key policy recommendations include:

i. Domestic debt should be channeled toward productive investments with measurable

economic returns, such as infrastructure, education, and healthcare projects.

ii. External loans should only be taken for projects with clear, high-impact economic benefits, such as those related to energy, transportation, or technology.

iii. The country must focus on enhancing revenue generation through improved tax collection and reduced leakages is essential to reduce over-reliance on debt.

iv. There should be active policies in stabilizing the naira which is critical for minimizing the cost of servicing existing foreign debt and attracting foreign direct investment. By prioritizing domestic borrowing and leveraging foreign debt strategically, Nigeria can enhance its economic resilience and achieve more inclusive and sustainable growth. Addressing structural issues such as revenue mobilization, fiscal discipline, and diversification of the economy will further strengthen the country's capacity to manage its debt effectively while driving economic development.

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Conflicts of Interest

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