Ilaro Journal of Humanities and Management (IJOHAM), 2023
Published Online October 2023 (https://fpihumanitiesjournal.federalpolyilaro.edu.ng/)
Volume 3, 2023 Edition
ISSN: 2682- 6577

Foreign Loans and the Growth of Nigeria Economy

ADEBAMIWI, Oluwole Daniel
Department of Banking and finance, Federal Polytechnic Ilaro, Ogun State, Nigeria
Email[1]: daniel.adebamiwi@federalpolyilaro.edu.ng

ABUBAKAR, Ibrahim
Department of Accountancy, Federal Polytechnic Ilaro, Ogun State, Nigeria
Email[2]: Ibrahim.abubakar@federalpolyilaro.edu.ng

Abstract: *This study investigates the impact of foreign loans on Nigeria's economic growth. The study's data was obtained from the Statistical Bulletin of the Central Bank of Nigeria. The variables utilized are Gross Domestic Product (GDP), which measures Nigeria's economic growth, as the dependent variable, The independent variables are inflation rate, foreign debt and exchange rate, which are used to assess the foreign loan. The study's time frame is from 1995 to 2021, and data are evaluated using a multiple regression model and an Econometric approach. The regression model showed that while exchange rate has a little impact on the Nigerian economy, foreign loans and inflation rates has a negative and play a non-significant role in explaining the country's economic expansion. Therefore, the study concludes that the country's currency depreciation, which has to be properly managed, is to blame for the terrible economic state. The government should therefore decrease the amount of foreign loans obtained from various sources and foreign loans should be used for the intended purpose for which it was obtained.*

Keywords: External debt, foreign loan, economic growth, government, GDP

Introduction

No government is an island unto itself; to function more effectively and productively, it would require supports, help, or financial aids. Specifically, a big source of that is borrowing from abroad or external debt. The lack of appropriate internal financial resources, especially in developing countries, which results in the requirement for foreign assistance, is what drives external debt.

In light of this, it is impossible to exaggerate foreign loans impact on a country's economic development process. The labor force, consumption level, asset value, and trade volume all have to consistently and quantitatively increase for there to be economic growth. Per capita productivity or revenue is another term for it. It denotes an extended period of time during which a country's real gross domestic output increased steadily.
Nations all across the world are reliant on one another for financial, political, social, economic, and security reasons. Countries frequently depend on one another to live as a result of this mutual dependence. It is important to remember that these variables largely make developing countries more vulnerable. Every government borrows money to accomplish one or two macroeconomic goals, such as boosting investment or consumption, but those in emerging countries borrow money at a higher rate. In order to battle poverty, unemployment, ensure enough social amenities, and alleviate the pain caused by macroeconomic instability policies, incentives, or substantial adverse shocks, the economy borrows money to stimulate economic growth and achieve development (Soludo, 2003; Shehu and Aliyu 2014). As a result, growth is likely to accelerate and allow debt to be repaid on schedule. If the circle is maintained, which is required for alleviating poverty, growth will eventually have a positive impact on per capital income. Even ideas sustained on more tenable the possibility that countries wouldn't be able to borrow at whim because of the potential to have their commitments rejected, the forecasts have shown to be accurate.

Sulaiman & Azeez (2012) foreign loan is a significant contributor to assistance for developing countries. However, relationship that exist between domestic savings, foreign investment, and economic growth affects the borrowing nations' ability to increase their capacity output with the aid of foreign funds, which in turn affects the borrowing nations' ability to borrow at a given rate. In particular when it comes to funding economic development initiatives like constructing railroads, power plants, highways, and other big capital projects, the

borrowing nation must be able to make wise financial decisions with the borrowed funds. If handled well, external debt can be productive and profitable, with a return percentage that exceeds the cost of debt payment (Ijirshar *et al.,* 2016).

The purpose of foreign loans is to accelerate economic expansion, but this has not happened in Nigeria as expected due to the high rates of unemployment among the working population, high rates of poverty, a lack of infrastructure, high rates of inflation, unstable price stability, and other issues, the country nevertheless experiences significant levels of instability and insurgency despite the resources that are available. Foreign or external loans is acquired to support budget deficits and accelerate the economy, it should lead to national economic expansion. However, if external debt is not manageable, it poses a greater risk to economic success because it is extremely expensive to service and puts countries in the position of having an account deficit, which can result in a buildup of debt.

The study's goal is to investigate how foreign loans have affected Nigeria's economy's growth, with a focus on evaluating the effects of foreign debt, the relationship between inflation, exchange rates on Nigeria's economic growth. The following questions were developed in order to accomplish the study's goal on the basis of the research. What is the impact of Nigeria's foreign debt, how does inflation rate correlate with exchange rates, and how much does that influence economic growth? As a result, the analysis includes foreign loans, which will be used to describe external debt equally.

Literature Review

Debt (loan), whether internal or external can be categorized as dead weight and productive debt. Any time a loan is taken out to enable a country to buy assets of any type, such as factories, refineries, or energy, it is referred to as productive debt. On the other hand, debts accumulated to pay for a war and ongoing expenses are considered dead weight debts. When nation accepts a loan from another nation, it can import goods and services up to the loan amount without having to export anything in exchange, the difficulty of producing products and services without receiving any imports in return will fall on the same nation when capital and interest must be returned. However, for these two categories of debt, the borrower's savings must be sufficient so as to pay the interest and principle payments in the future (debt servicing). In order to offer returns greater than the cost of debt servicing, investments in debt financing must be lucrative and effectively managed (Ajayi and Oke, 2012).

Anyafo (2020) asserts that when the government borrows money from other nations, the situation changes because more resources are introduced into the economy for investment. The debt overhang idea doesn't seem to fit with this position. For instance, the claim is that since borrowing from outside sources makes resources available, such additions would make it possible to achieve faster growth, higher domestic income, and economic progress. It's possible to say that Anyafo (2020) argument above adheres to the principles of the so-called IMF School's non-evil ideology of foreign borrowing. This school holds that external borrowing is a crucial component of any country's economic development since no country, developed or developing, can advance to its full potential without some sort of outside funding.

Currently, foreign loan is among the key components of domestic capital. The dual-gap hypothesis has drawn particular attention to the necessity of including external debt in a growth model since it addresses both the savings and foreign exchange gaps. To ensure that savings and foreign exchange gaps underscore the significance of external borrowings by demonstrating the lack of and inadequacy of available resources to support the anticipated rate of economic expansion. Consequently, the significance of foreign loans in economic development has been recognized, despite the fact that it depends on the two gaps of either import-export or savings-investment. To narrow the gaps and bring the predicted marginal capital production into line with the marginal cost of capital, the amount borrowed abroad will increase.

The main objective of external debt is to assist domestic financial resources for a country's development and other needs. A country frequently accumulates external debt when it lacks the domestic savings and foreign money necessary to achieve its growth and other national goals (Abu *et al.*, 2015).

If foreign loans are not effectively used for, such as generating income and encouraging productive undertakings, the potential of a debtor country to repay the loan is greatly reduced. The use of external debt can take many different forms, including project aid,

technical assistance, humanitarian aid, and emergency aid. Foreign debt or external debt which can also incur the state at which a country improve or influence its economic capacity or enlargement in order to achieve the desired growth, should take note that when it borrows loan, it is expected of that country to ensure its debt servicing is paid back in order not to disrupt the functionality of the impact on economic growth and, if debt payment is done wisely, it presents the borrowing country to creditor nations and other lending institutions as a creditworthy nation. In other words, the economy expands as more borrowed money comes in.

Theoretically, The Dependency Theory, which holds that dependence on developed countries (DCs) by less developed countries is a major factor in the former's economic downfall, theoretically supports the study (LDCs). According to the thesis, rich nations use foreign currency to force an undesirable developmental pattern on poor countries. The idea continued by asserting that a major outflow of cash is brought on by a country's heavy reliance on foreign capital for things like interest payments, royalties, and debt servicing. These all lessen the wealth of LDCs. According to the argument, foreign capital indicates dependence and is exploited by rich countries to exploit underdeveloped nations. Additionally, the Keynesian idea of increasing government intervention acting as a catalyst for long-term growth was deemed to be the most appropriate one.

Also, Debt Overhang theory which occurs when a nation's amount of loan exceeds its financial capacity to adhere to the conditions of the debt agreement which include arrangements for debt servicing and repayment. This theory is based on the idea that projected debt payments would increase as a function of the country's expansion rate if the quantity of debt exceeds the capability of repayment with some degree of imminent possibility (Adedoyin *et al*., 2016).

Empirically, Onakoya and Ogunade (2017) used OLS to find proof of the foreign debt of Nigeria's economy's growth. The study, which covered the years 1981 to 2014, found no proof at the 5% level of significance of an external debt-induced slowdown in economic development. Findings indicated that external borrowing is not used to finance Nigerian development projects, which are the main justification for foreign loans.

Monogbe (2016) employing co-integration methods, the granger causality test, and the ordinary least squares approach, examine the long-term impacts of Nigeria's external debt on its economic performance from the period 1981 to 2014. It unravels a strong positive nexus between foreign loans and sustained economical growth.

Materials and Methods

The study employed a causal research methodology; causal analysis is primarily concerned with assessing cause and effect relationships among variables. It is based on the notion that if two variables are statistically significantly related, then there may be a relationship between them. For this study, secondary data was used and was derived from the Central Bank of Nigeria (CBN) statistical bulletin for the years 1995–2021. Gross domestic product is taken into account as a dependent variable in this study, whereas foreign debt, inflation, and exchange rates are taken into account as explanatory variables.

The functional relationship can be expressed below:

$GDP = F(FD, INFL, EXR)$ …………………………………… Equ1

In econometric term

$GDP = B_0+B_1FD+B_2INFL+B_3EXR+u$ ………………………... Equ2

$GDP = \beta_0 + \beta_1FD + \beta_2INFL+ \beta_3EXR + \mu$ …………………… Equ3

GDP = Gross Domestic Product
FD = Foreign Debt
INFL = Inflation rate
EXCR = Exchange rate
u = error term
β_0 = intercept of the regression
β_1- β_3 are the coefficient of variables to be estimated.

Further, within the framework of regression analysis at level of significance of 5%, this study analyses data on variables of external debt analyzed using multiple regression with the aid of Ordinary Least Square (OLS) method as one of the main econometric tools in E-views 9

Presentation, Interpretation and Discussion of Result

Table 1: Multiple Regression Analysis

Dependent Variable: GDP
Method: Least Squares
Date: 08/29/23 Time: 09:09
Sample: 1995 2021
Included observations: 27

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-29948.49	10156.47	-2.948711	0.0072
FD	-2.623405	1.699212	-1.543895	0.1363
EXR	578.4332	65.91594	8.775317	0.0000
INF	204.0348	420.3447	0.485399	0.6320

R-squared	0.897063	Mean dependent var	56762.83
Adjusted R-squared	0.883637	S.D. dependent var	52827.29
S.E. of regression	18020.49	Akaike info criterion	22.57236
Sum squared resid	7.47E+09	Schwarz criterion	22.76434
Log likelihood	-300.7269	Hannan-Quinn criter.	22.62944
F-statistic	66.81265	Durbin-Watson stat	0.523554
Prob(F-statistic)	0.000000		

Source: Authors computation E-view 9 Outputs, 2023

Discussion of Result

The result of the table reveals the significance of the regression constant and coefficients for the model which state that based on the information obtained the regression constant (-29948.49) is statistically significant because the p-value (0.0072) is lesser than the significant value (0.05), the regression coefficient (FD= -2.623405) is not statistically significant because the p-value (0.1363) is greater than the significant value (0.05), the regression coefficient (INFR= 204.0348) is not statistically significant because the p-value (0.6320) is greater than the significant value (0.05), the regression coefficient (EXCR=578.4332) is statistically significant because the p-value (0.000) is less than the significant value (0.05). From this information, the researcher deduced that exchange rate is the most significant factor to consider in order obtaining a stable economic, which is followed by foreign debt. These two variables really need to be monitored and properly examined on the foreign loan aspect in other to get a steady economical growth.

Summary of findings

Findings indicate that foreign loan has a negative effect on the growth, and it has been claimed that, unless it is used for unproductive purposes, foreign loan is not inherently bad. Therefore, a country may borrow, but not for unwise or unproductive purposes. Intergenerational equity results from the decrease of debt for unproductive activities. Specifically, this refers to burdening a nation's next generation with debt that will not benefit them. And that with a good use of foreign loans injected in the economy, it will bring about economic growth sustainability.

Conclusion

This study examines the effects of foreign loans (including foreign debt, exchange rates, and inflation rates) on Nigeria's economic growth. According to the results of using the multiple regression approach, the factors (foreign debt and inflation rates) has a negative effect on the expansion of the Nigerian economy, but the exchange rate did not, according to the data. This result demonstrates that the foreign debt and inflation rate has an insignificant impact on the expansion of the Nigerian economy. The federal government should reduce its foreign debt because of its negative effect on the economic growth, as well inflation index should be made minimal to sustain growth and it should pay close attention to the Naira to USD conversion rate because a rise in the naira to USD indicates that the country's currency is depreciating, which could cause a number of economic crises. Foreign loans should be used for the intended purpose for which it was obtained. These recommendations were made based on the findings and conclusion.

References

Abu, S., Selvanathan, E., & Saroja, S. (2015). The impact of external debt on economic growth: Empirical evidence from highly indebted poor countries. *The University of Western Australia.*15(10), 1-33.

Adedoyin, L. I., Babalola, B. M., Otekinri, A. O., & Adeoti, J. O. (2016). External debt and economic growth: Evidence from Nigeria. *Acta Universitatis Danubius Economica.* 12(6), 179-194.

Ajayi, L. B. & Oke, M. O. (2012). Effect of external debt on economic growth and development of Nigeria. *International Journal of Business and Social Science*, 3(12), 297-304.

Ijirshar, V. U., Joseph, F., & Godoo, M. (2016). The relationship between external debts and economic growth in Nigeria. *International Journal of Economics & Management Sciences*. 6(1), 1-5. doi:10.4172/2162-6359.1000390.

Monogbe, T. G. (2016). Inter-generational effect of external debt on performance of the Nigeria Economy. *NG-Journal of Social Development* 5(2), 51-65.

Onakoya, A.B. & Ogunade, A. O. (2017). External debt and Nigerian economic growth connection: Evidence from autoregressive distributed lag approach. *Journal of Economics and Development Studies,* 5(1), 66-78. doi: 10.15640/jeds. v5n1a7.

Shehu, U. &Aliyu, M. (2014). External debt and economic growth: Evidence from Nigeria. *Journal of Economics and Sustainable Development*, 5(18), 12-13.

Sulaiman, L. A. & Azeez, B. A. (2012). The effect of external debt on economic growth of Nigeria. *Journal of Economies and Sustainable Developmen*t.www.iiste.org 3(8), 71-79.

Soludo, C. C. (2003). Debt poverty and inequality in Okonjo Iweala, Soludo, and Muntar (Eds), The Debt Trap in Nigeria, Africa World Press NJ, pp. 23-74.