

Domestic Public Debt and Economic Growth in Nigeria: Effect of Political Regimes

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Abstract: The study examined the relationship between domestic public debt and economic growth in Nigeria between 1981 to 2019. In this period Nigeria was under military rule and civilian rule. The study was able to examine the relationship between domestic debt and economic growth in Nigeria based on type of regime. The ARDL estimation technique was used in the study. The study was hinged on the endogenous and neoclassical growth theories. The results show that a positive relationship exists between domestic public debt and economic growth in Nigeria under the military and negative relationship on domestic public debt and growth during democratic rule in the short and long run. Also, the results revealed that domestic debt has a long run insignificant positive impact on growth, budget deficit has a positive relationship with growth although not significant. The results also show that prime lending rate has significant positive long run effect on growth. The effect of inflation on economic growth is negative in the long run and not significant. The results showed there was evidence of unidirectional causality from population growth to economic growth. There was evidence of unidirectional causality from economic growth to prime lending rate and gross fixed capital formation growth. It can be concluded based on the findings of this study that the political regime could have an impact on economic growth and public debt. The study recommends borrowing should be done prudently to make public debt sustainable.

Keywords: Domestic Public Debt, Economic Growth, Political Regimes, Nigeria

1. Introduction

1.1. Background Information

Public finance is for guaranteeing economic growth and improving the wellbeing of a country's citizens. If revenues are insufficient to finance public spending, the government will have to borrow [7]. Nigeria like most countries relies on domestic public debt to fund expenditures. Public debt has become a major issue in Nigeria despite its huge revenue from oil [29]. Public debt incurred by the Nigerian government shows that the bursts and booms in the domestic business cycle are in tandem with public borrowing [12]. Domestic debt is borrowing within the country and in the local currency. It is the amount of money that the government owes locally. This comprises of treasury bills, bonds, contractor debts as well as ways and means of financing [1]. Domestic debt involves a complex evaluation

of the costs and benefits [1]. According to [27] domestic debt are made of two major categories i.e. bank and non-bank borrowings. Bank borrowing is borrowing from the Central Bank through ways and means. While Non-bank borrowing is borrowing directly from the general public through sale of government securities. The impact of domestic versus external debt is a fundamental consideration when the government decides on optimal financing source [11].

The Nigerian Government started domestic borrowing in 1958 when the colonial government brought financial reforms into existence for the first time [11]. The reform brought into the first time borrowing from the domestic market. It was during this reform that the Central Bank of Nigeria (CBN) was established as well as sale of securities which are used to finance fiscal shortfalls. As the Nigerian domestic financial markets deepened coupled with attractive yield, this has made foreign portfolio investors to have significant holdings in government securities [17]. External borrowing comes with substantial

exchange rate risks. Therefore, Nigeria's ability to borrow from the local market has reduced the reliance on external borrowing. Domestic debt started building up after external debt relieve and debt cancellation in 2006.

As at December 2019 Nigeria's domestic debt was 16,023,885,379,753.00 naira. The domestic debt represents 68% of the total public debt. This comprises of Bonds 11,830,260,673,592.00 (73.83%) Treasury bills, 2,720,436,493,000.00 (16.98 %). Other kinds of domestic securities are the Savings Bond, Promissory Notes, Sukuk and the Green Bond. The Debt Management Office (DMO) does monthly sales for the Bond, bimonthly sales of Treasury bills and quarterly sales for Savings Bonds. Other securities sale does not follow a specific calendar.

Table 1. Federal Government Domestic Debt Stock By Instrument as at 31st December 2019.

Instrument	Amount in Naira	Proportion (%)
FGN Bonds	11,830,260,673,592.00	73.83
Nigerian Treasury Bills	2,720,436,493,000.00	16.98
Nigerian Treasury Bonds	100,988,000,000.00	0.63
FGN Savings Bonds	12,292,207,000.00	0.08
FGN Sukuk	362,557,000,000.00	2.26
Green Bond	25,690,000,000.00	0.16
Promissory Notes	971,661,006,161.00	6.06
Total	16,023,885,379,753.00	100.00

Source: DMO

1.2. Statement of Problem

There have been theoretical debates on domestic debt and economic growth which have attracted several empirical studies. Most of the previous studies adopted quantitative approach using time series data and focusing on 'main effect' variables. Many studies ignored qualitative factors like type of political regime in the investigation of domestic debt and economic growth. If the period of study covers different political regimes events like type of political regimes impact provides a more robust approach in the domestic debt and economic growth literature. Noticing this gap in the literature, this study combined quantitative and qualitative variables (political regime) to investigate the relationship between domestic debt and economic growth in Nigeria.

2. Literature Review

2.1. Theoretical Framework

2.1.1. The Neo-Classical Theory

The theory predicts that the budget deficit will lead to an increase of current expenditure that will result to a rise in interest rates [20]. The theory posit that public debt has a negative impact on the economy growth because it crowds out private sector investment which hampers capital formation in an economy [10]. The theory postulates that a rise in government borrowings would lead to a rise in the value of the domestic currency in a country. This results in an increase in imports and reduction in exports which translates to a negative effect on the current account balance of a country.

Under this theory public debt is expected to have a negative effect on growth, because fiscal deficit leads to a decline in government savings. If the growth in private savings is not adequate to make up for a reduction in government savings the impact is that the overall saving rate will decline [25]. This will lead to a rise in the interest rate, and this will lead to a decline in economic growth. The Neo-Classical theory argued that budget deficit is harmful to economic growth and countries should ensure they achieve balanced budget all the time [20].

2.1.2. Endogenous Growth Model

The model posits that economic growth is influenced by factors within the economy and not factors outside the economy [16]. The theory was propounded because of the shot falls of the neoclassical growth model which posits that external exogenous factors are responsible for economic growth [17]. In the endogenous growth model investment in human capital and labour are significant contributors to long run economic growth. According to [16] the theory was established to refute the neoclassical exogenous growth models, as it made predictions about economic growth without factoring in technological change. As stated by Murched, [21], the endogenous growth theory amongst others demonstrates that human capital is a very important input in the economic production process.

2.2. Empirical Review

Evidence provided by Anyanwu and Erhijakpor, [5] on how local debt impacts economic growth. The study spans a 24-year period, the result revealed that local debt has a significantly negative effect on economic growth due to the huge cost of servicing local debt. Also [8] investigated the relationship between local debt and economic growth in Nigeria using quarterly data between 1994 and 2008. The study affirms the finding of [5] that local debt has negative effect on economic growth in Nigeria.

Similarly [29] examined the relationship between domestic debt and some macroeconomic variables using ECM model. The results showed that debt have a positive long run relationship with growth. In a different approach [22] studied the relationship between local debt and the poverty of Nigeria (1986-2012) employing OLS and VAR techniques. The study confirmed a positive nexus exists between poverty and local debt in Nigeria.

In a study [13] used chow test analysis provided evidence on the impact of budget deficit in the two political regimes. The outcome showed that budget deficit had a significant positive impact during the military era.

Another study by [6], using an ARDL estimation technique and using data from 1981 to 2013 confirmed that there is no long run relationship between domestic debt and economic growth in Nigeria. While Edame, [13] found evidence to support the fact that domestic debt as a positive impact on the economy in Nigeria for the period 1985-2014 using VAR method of analysis Similarly [19] provided evidence on relationship between domestic debt and economic growth in Nigeria. The study used data spanning 1987-2014. They concluded the

existence of a positive relationship between domestic debt and economic growth in Nigeria. Also, Titus et al. [28], established those domestic borrowings has a significant short and long-run positive effect on growth in Nigeria from 1980 to 2015.

Also, Aero and Ogundipe, [3] studied public debt and economic growth in Nigeria, this study was unique because it took into consideration military and civilian administrations. The period for study was period of 1983-2015. The result of the comparisons showed public debt was better managed during the military rule than during democratic rule. A study by [18] affirmed the findings of Charles, [8] and Anyanwu and Erhijakpor, [5] that domestic debt has an adverse effect on the economy in the period from 1981 to 2013.

Also Yusuf, [30] examined the impact of public debt on economic growth and compared its impact during the military regime with the civilian regime. The Chow Test of structural change was adopted to compare the regimes. The study confirmed that public debts were better managed military regime than during civilian rule.

A study by Akapansung and Gidiigbi, [4] provided convincing support for the existence of stable short-run and long-run relationships between public domestic debt and economic growth in Nigeria as well as identifying structural breaks. The study found strong evidence of five structural breaks based on economic and political events identified during the period from 1981 to 2018.

3. Research Methodology

3.1. Methods of Data Collection

This study used secondary data. Data was collected from various secondary sources. The data was collected from the Central Bank of Nigeria, Debt Management Office and World Bank. A comprehensive database on debt and economic growth data in Nigeria were accessed from these sources.

3.2. Research Design

The study adopted an Ex post facto design method. This is an after the fact research design method. In this type of research design, the investigation starts after the fact has occurred without interference from the researcher (Saunders, et al, 2009).

3.3. Method of Data Analysis

The study used the Auto Regressive Distributed Lag (ARDL) model which is a multiple regression model. The ARDL approach uses time series data and takes into account the short and long run relationship simultaneously [27]. It provides an error correction mechanism (ECM). The model requires every variable to be integrated at level or at order 1 [27].

3.4. Model Specification

The selected variables are based a variety of theoretical and empirical studies and their connection with economic growth. Dummy variables were used in models to capture different types political regimes and era in Nigeria. A value of 1 was assigned

for the period of democratic rule. The civilian or democratic rule was from 1981 to 1983 and 1999 to 2019. The value of 0 was assigned for the military rule period from 1984 to 1998.

$$GDPG = \beta_0 + \beta_1(DDS) + \beta_2(BGD) + \beta_3(PNT) + \beta_4(CPS) + \beta_5(GFCR) + \beta_6(POPG) + \beta_7 D1 + \beta_8 D2 + e_i \quad (1)$$

Where:

GDPG = Real GDP growth rate as the dependent variables.

β_0 = Intercept/Regression Constant

β_1 to β_6 is the coefficient of the independent variables.

D1 to D2 coefficient of the dummy variables

DMD = Total domestic debt stock.

BGD = Budget Deficit

PNT = Prime lending rate

CPS = Consumer price index

GFCR = Gross fixed capital formation growth proxy for investment

POPG = population growth as a proxy for Labour

D1 = Military Regime

D2 = Civilian Regime

E_i = random error term

4. Presentation of Result and Discussions

4.1. Descriptive Statistics

The descriptive statistics is used to illustrate the fundamental feature of the data. The descriptive statistics also help to show large data set in a summary. The mean value stands for the average value. The standard deviation measures the variables dispersion from the mean. It indicates variability and volatility in the variables.

Table 2. Descriptive Statistics.

Variable	Count	Mean	Std. Dev.	of Mean
RGDP	39	3.149929	5.467388	0.875483
BGD	39	-629.0929	1159.244	185.6275
DDS	39	2874.909	4124.126	660.3886
PNT	39	17.50542	4.586427	0.734416
CPS	39	4291.743	5998.845	960.5840
GFCR	39	-0.347851	13.77555	2.205853
POP	39	2.581738	0.066914	0.010715
All	273	937.2069	3254.638	196.9797

Source: Eviews 10 Output.

4.2. Test for Stationarity (Unit Root Test)

Table 3. Augmented Dickey-Fuller Test Result.

Variable	t-Statistic	Prob.*	Status
GDPG	-3.972177	0.0041	I(0)
LOG(DDS)	-4.566508	0.0008	I(1)
LOG(BGD2)	-10.26711	0.0000	I(1)
LOG(PNT)	-5.263133	0.0114	I(0)
CPS	-3.726973	0.0033	I(1)
GFCR	-4.657815	0.0006	I(0)
POP	-4.956091	0.0004	I(0)

Where I(0) means stationarity at level and I(1) means stationarity at first difference.

Source: Authors computation

In a time series model the basis is the unit root test, this results determines the stationarity of the variable.

4.3. ARDL Estimation

Auto Regressive Distributed Lag was estimated. The result is shown on Table 4.

Table 4. ARDL Model Estimation.

Selected Model: ARDL (1, 0, 0, 1, 0, 0, 1, 1)				
Variable	Coefficient	Std. Error	t-Statistic	Prob.*
GDPG(-1)	-0.127889	0.192769	-0.663431	0.5129
LOG(DDS)	-0.425005	1.059388	-0.401179	0.6916
LOG(BGD2)	0.196443	0.344388	0.570410	0.5733
LOG(PNT)	5.804378	3.563590	1.628801	0.1154
CPS	-0.000202	0.000346	-0.584743	0.5638
GFCR	0.044132	0.049453	0.892419	0.3804
POP	124.2305	32.32378	3.843315	0.0007
CDUMMY	-1.081921	3.189690	-0.339193	0.7372
MDUMMY	1.081921	3.189690	0.339193	0.7372
C	-93.99344	42.59441	-2.206708	0.0364
R-squared	0.666141	Mean dependent var		3.578293
Adjusted R-squared	0.524894	S.D. dependent var		4.832236
S.E. of regression	3.330762	Akaike info criterion		5.496369
Sum squared resid	288.4434	Schwarz criterion		6.013501
Log likelihood	-92.43100	Hannan-Quinn criter.		5.680360
F-statistic	4.716116	Durbin-Watson stat		2.024190
Prob (F-statistic)	0.000559			

*Note: p-values and any subsequent tests do not account for model selection

Source: Eviews 10 output

Since the variables are integrated of different order, the bounds test will be used to measure the relationship that exists amongst the variables.

Table 5. Bounds Test for Cointegration.

Test Statistic	Value	Null Hypothesis: No levels relationship		
		Signif.	I(0)	I(1)
F-Bounds Test				
			Asymptotic: n=1000	
F-statistic	4.754359	10%	2.03	3.13
k	7	5%	2.32	3.5
		2.5%	2.6	3.84
		1%	2.96	4.26
Actual Sample Size				
	38		Finite Sample: n=40	
		10%	2.26	3.534
		5%	2.676	4.13
		1%	3.644	5.464
Finite Sample: n=35				
		10%	2.3	3.606
		5%	2.753	4.209
		1%	3.841	5.686
t-Bounds Test				
t-statistic	-5.850999	10%	-2.57	-4.23
		5%	-2.86	-4.57
		2.5%	-3.13	-4.85
		1%	-3.43	-5.19

* p-value incompatible with t-Bounds distribution.

Source: Eviews 10 output

Table 6. Bounds Test Decision Rule.

Model	F-Statistic	Signif.	I(0)	I(1)	Decision
ARDL (1, 0, 0, 1, 0, 0, 1, 1)	4.754359	5%	2.32	3.5	Estimate ECM Long Run Model
Model	t-Statistic	Signif.	I(0)	I(1)	Decision
ARDL (1, 0, 0, 1, 0, 0, 1, 1)	-5.850999	5%	-2.86	-4.57	Estimate ECM Long Run Model

Source: Authors Computation

Table 7. ECM Result.

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-0.372979	1.086066	-0.343422	0.7338
D(LNDDS)	3.468390	4.533397	0.765075	0.4504
D(LNBGD2)	-0.195971	0.245190	-0.799263	0.4306
D(LNPNT)	6.882625	2.852296	2.413012	0.0224
D(CPS)	-0.000477	0.000671	-0.710401	0.4831
D(GFCR)	0.013667	0.032837	0.416203	0.6803
D(POP)	-25.38097	24.51252	-1.035429	0.3090
D(MDUMMY)	2.484095	2.709181	-0.916917	0.3667
D(CDUMMY)	-2.484095	2.709181	-0.916917	0.3667
ECM	-0.903693	0.183293	4.930331	0.0000
R-squared	0.561543	Mean dependent var		0.403587
Adjusted R-squared	0.440589	S.D. dependent var		4.775618
S.E. of regression	3.571866	Akaike info criterion		5.587447
Sum squared resid	369.9887	Schwarz criterion		5.975297
Log likelihood	-97.16150	Hannan-Quinn criter.		5.725441
F-statistic	4.642621	Durbin-Watson stat		1.932012
Prob(F-statistic)	0.000990			

Source: Eviews 10 output

4.4. Diagnostic Test

4.4.1. Test for Serial Correlation

Table 8. Test for Serial Correlation.

Breusch-Godfrey Serial Correlation LM Test:			
F-statistic	0.250326	Prob. F(1,25)	0.6212
Obs*R-squared	0.376723	Prob. Chi-Square(1)	0.5394

Source: Eviews 10 Output

Hypothesis

H_0 : No Serial Correlation

H_1 : Presence of Serial Correlation

The result on Table 8 shows that null hypothesis cannot be rejected with P-value of 0.6212 which is greater than 0.05

level of significant at 95% confidence interval for rejecting the null hypothesis, which implies that the ECM is a good fit.

4.4.2. Test for Stability

Figure 1 Test for Stability (CUSUM Test).

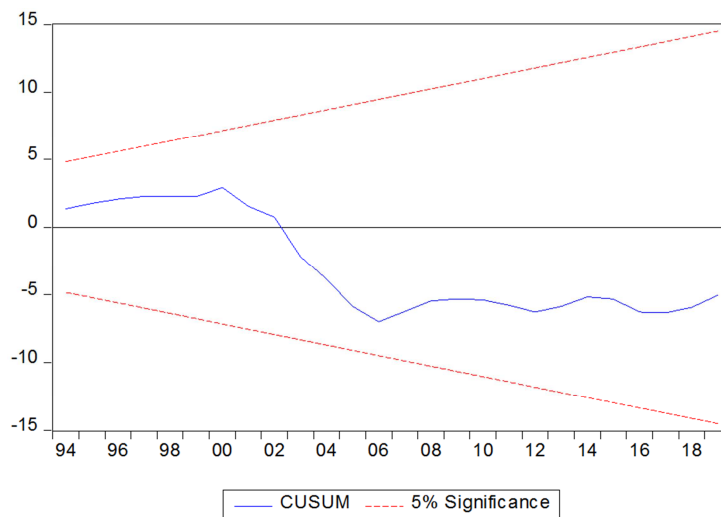


Figure 1. CUSUM Test Result.

The figure 1 show that the model is within the 5% level of significant, which implies that, the model is stable.

4.5. Causality Tests

Granger causality test was done to ascertain what independent variable can be used in the prediction of the dependent variable or vice-versa.

Table 9. Pairwise Granger Causality Tests.

Null Hypothesis:	Obs	F-Statistic	Prob.
LOG(BGD2) does not Granger Cause GDPG	37	0.57749	0.5670
GDPG does not Granger Cause LOG(BGD2)		1.19895	0.3147
LOG(DDS) does not Granger Cause GDPG	37	2.05391	0.1448
GDPG does not Granger Cause LOG(DDS)		2.04685	0.1457
LOG(PNT) does not Granger Cause GDPG	37	1.15415	0.3281
GDPG does not Granger Cause LOG(PNT)		6.38047	0.0047
CPS does not Granger Cause GDPG	37	0.57374	0.5691
GDPG does not Granger Cause CPS		0.73496	0.4874
GFCR does not Granger Cause GDPG	37	1.37002	0.2686
GDPG does not Granger Cause GFCR		6.35783	0.0047
POP does not Granger Cause GDPG	37	3.63570	0.0378
GDPG does not Granger Cause POP		2.59163	0.0905
CDUMMY does not Granger Cause GDPG	37	0.90361	0.4152
GDPG does not Granger Cause CDUMMY		2.76236	0.0782
MDUMMY does not Granger Cause GDPG	37	0.90361	0.4152
GDPG does not Granger Cause MDUMMY		2.76236	0.0782

4.6. Discussion of Findings

The ECT -0.9036 coefficients on Table 7 is the speed of adjustment. The speed of adjustment was 90.36% every year. The coefficient is less than 1, this indicates that the result is not ambiguous. The R-squared demonstrates that the model can explain 56.15 % of the relationship among the variables and 43.85% is outside the model. The F statistic of 0.0090 demonstrates the entire model is statistically significant meaning the model is of good fit.

Domestic debt during military regime is positively related to growth although not significant both in the short run (SR) and the long run (LR). This implies that the type of political regime may have an influence on economic growth. This is similar to the findings of Abiodun et al., Edame and Okoi, Yusuf, [2, 13, 30].

In the short run results show the domestic debt results to a negative change in GDP growth (0.425005) although not significant. Regarding the short run relationship between budget deficit, prime lending rate and growth, the results indicates that they both influence real GDP in a positive manner but not statistically significant. The study also shows a negative relationship between inflation and GDP in the short run. Findings show a positive relationship between population growth and economic growth. The probability value at 0.0007 (see Table 4) implies that population growth significantly impacts on Nigeria's economic growth in the short run.

The ECM results in Table 7 showed that there is long run positive relationship although not significant between domestic debt and economic growth in Nigeria. The results corroborate the findings of Akapansung and Gidiigbi, Anyanwu and Erhijakpor, Igbodika et al., Charles, Onogbosele and Ben, Yusuf, [4, 5, 19, 23, 8, 28, 30].

From the results it is observed that budget deficit has a positive relationship with growth although not significant at the 5 percent level in the long run. Furthermore, the results show that in the long run prime lending rate have positive and significant effects on growth. Inflation effect is negative but not significant. The findings also reveal that population

growth is negatively associated with GDP growth in the long run. This suggests that increase in population leads to more government expenditure and more borrowing in the long run.

The gross fixed capital formation growth has positive but insignificant relationship with growth. This supports endogenous growth theory which predicts increase in investment can lead to economic growth. There was evidence of unidirectional causality from population growth to GDP growth i.e. population granger causes economic growth. Likewise there was evidence unidirectional causality from GDP growth to prime lending rate and gross fixed capital formation growth. GDP growth granger causes prime lending rate and gross fixed capital formation growth.

5. Summary Conclusion and Recommendations

5.1. Summary

Nigeria government depends on domestic borrowing to meet up revenue shortfalls. Thus it becomes imperative to examine the relationship between economic growth and domestic debt in Nigeria in the context of the type of government. The proponent of the use of domestic debt is based on the expected positive impact on economic growth based on domestic savings mobilization. Domestic borrowing can assist in pooling up private savings to stimulate growth. The study was hinged on the neoclassical theory and endogenous growth theory. The research covered a period of 1981-2019 when Nigeria was both under military rule and civilian rule. Dummy variables were introduced and used to capture the effect of the political regimes on debt and economic growth in Nigeria. An ARDL model was used to investigate the long term relationship between economic growth and public debt. Error correction indicated a fast adjustment speed parameter of 90.36 % convergence. The ECM was negative and statistically significant and unambiguous.

5.2. Conclusion

Domestic debt has a positive but also not significant long run relationship with growth in Nigeria. This implies domestic

debt has a potential of spurring economic growth in Nigeria when domestic debt is incurred. The result reveals that civilian regime has a negative relationship but this is insignificant. This suggests that civilian regime does not manage public debt well. This is despite the fact that debt forgiveness and writes off during the democratic government. This may be because civilian governments have a high propensity to borrow to fulfill campaign promises. Also the capacity for military government to borrow both from domestic sources was lower because of the fear of debt repudiation by lenders by military governments' hence less borrowing abilities. This also suggests that the cost of running a civilian government is expensive. The process for borrowings during the military regime is less complicated. It appears the use of domestic borrowing is more likely to contribute to economic growth than processes to incur the debt.

5.3. Recommendations

Having established that domestic debt has positive relationship over the 40 year period and impact of borrowing in civilian rule is negative. The current government should direct borrowing to capital projects instead of financing recurrent expenditures like salaries and overheads. The government should pursue sound fiscal and monetary policies to create an enabling environment for economic growth. Creating such an environment serves as panacea for the continuous effective use of domestic public debt.

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