

Boosting Economic Growth in Nigeria through Domestic and International Finance

Attamah Nicholas and Okolo Chimaobi Valentine

Department of Economics Enugu State University of Science and Technology
numanick@esut.edu.ng; chimaobi.okolo@gmail.com; valentine.okolo@esut.edu.ng

Abstract

The paper evaluated the effectiveness of domestic and foreign finance in boosting economic growth in Nigeria. Specific objectives were to examine the impact of domestic finance on the economic growth of Nigeria, to assess the effect of international finance on the Nigerian economic growth and finally to determine the causal relationship between domestic finance, international finance and economic growth in Nigeria. Error correction model was adopted for the study. Furthermore, an autoregressive error correction model was employed to explain the autonomous growth in the real gross domestic product in Nigeria. Findings of the study showed that both domestic finance and international sourcing of finance have not significantly boosted economic growth in Nigeria. Rather, federal government domestic outstanding debt and federal government external outstanding debt have both shown counterproductive contributions (negative contribution) to economic growth. Only the variables of domestic finance had causal relationship with the real gross domestic product in Nigeria. Government should reduce the size of fiscal deficit, which directly influences the size of debt service and seek long term finance for the annual budget. Credit to the private sector should be boosted by reducing monetary policy rate, which transmits to the reduced bank lending rate, since it positively contributed to economic growth of Nigeria.

Keywords: Autonomous growth, autoregressive error correction model, domestic finance, economic growth, international finance.

Introduction

The incessant fluctuation of economic growth over the years and the current recession of the Nigerian economy, regardless of the expansionary policies (deficit financing) planned by the government of Nigeria questions the potency of international financing, especially as it applies to the economy at large [1]. While the government of Nigeria borrows funds from international countries and organizations to fund the deficit in the budget for the purpose of boosting investment, output, employment, and the living standard of the people, there are also domestic credit flows to private investors and the government, which are geared towards business expansion and profitability as well as the achievement of the afore mentioned objectives [2,3,4]. These efforts have yielded little or no effects towards achieving the policy objectives of the government. For instance, from 1981 to 1984, the federal government domestic outstanding debt rose from N11.19bn to N25.67bn, representing a growth rate of 129.40%. in the same period, the Federal government external outstanding debt rose from N2.33bn to N14.81bn, representing a growth rate of 535.62%, while the real gross domestic product in the same period dropped from N15,258bn to N13,779.26bn (a negative growth of 9.69%). This was also the case between 1990 and 1991, while from 1992 to 2015, federal government domestic and external outstanding debts grew by 4,865.72% and 287.96 respectively as the real gross domestic product grew by only 251.80% in the same period, signifying that the growth in government's domestic and external debts did not translate to the expected growth of the Nigerian economy [5,6,7].

Deepening of the financial sector, which increases the funds mobilized in the economy for investment, and increased access to credit has shown to have positive contribution to investment and economic growth. However, the cost of domestic credit (interest rate) has been on the rise, discouraging domestic investors from accessing credit from banks. The lending rate of deposit money banks in Nigeria continued to rise from 22.42 in 2011, 23.79 in 2012, 24.69 in 2013, 25.74 in 2014 and 26.71 in 2015. Furthermore, the dynamics of international finance, global price of risk and the exchange rate appreciation, among others, are factors that negatively influence the level of credit that can be accessed from international sources. These credits could be from the money market (credit from banks) or capital market (domestic investors in the bond and stock market) for domestic financing sources and from international financial institutions and from foreign investors in the capital and bond market [8,9,10].

The inflationary pressure had been on a persistent increase from 2011 to date, resulting from rising exchange rate and expansionary fiscal operations embarked upon by the government with the attendant injection of liquidity into the economy, among other things. The pressure on the balance of payments of the nation can all be said to be a function of fiscal deficit and deficit financing embarked upon by the government from time to time [11, 12, 13]. With the consequential effect on both the real sector as well as other sectors of the economy, the reason therefore arise for the need to examine the implications of domestic and international financing on the growth of the Nigerian economy.

Literature Review

[14], examined the determinants of, and interactions between, capital inflows, financial development, and domestic investment in developing countries during 2001 to 2007, a period of surging global liquidity and low interest rates and concluded that private capital inflows and domestic credit exert a positive effect on investment. They also argued that neither greater domestic credit nor greater institutional quality increases the extent to which capital inflows translate into domestic investment. [15], argued that multiple forms of domestic financial development were important determinants of R&D intensity but only foreign direct investment was significant among alternative measures of international financial development. The study found the strongest effects for private bond-market capitalization, while FDI, private credit by banks, and stock-market capitalization had similar effects in terms of magnitude. [16], asserted government should therefore consolidate on past financial sector reforms to improve domestic saving mobilization to reduce the dependence of Nigeria on foreign savings to finance domestic investment. [17], explained that the negative impact of deficit financing on economic growth can be adduced to the prevailing socio-cultural mal-adaptation coupled with perennial corrupt practices in the economy. he recommended that government should reduce wastage in public spending, ensure greater budgetary discipline and adopt a financial structural transformation.

[5,8] found that declining bank credit to the private sector will not necessarily constrain the economic recovery after output has bottomed out following a financial crisis. They opined that lack of association between deleveraging and the speed of recovery does not seem to arise due to limited data. Their findings revealed that increasing competitiveness, via exchange rate depreciations, is statistically and economically significantly associated with faster recoveries [7]. [9], examined the relationship between fiscal deficit and economic growth within the Nigerian context, using data over the period, 1970 - 2006 and indicated firstly, that fiscal deficit affects economic growth negatively, with an adjustment lag in the system; secondly, that a one percent increase in fiscal deficit is capable of diminishing economic growth by about 0.023 percent; and thirdly, that there is a strong negative association between government consumption expenditure and economic growth. Furthermore, [11] revealed that a percentage increase in fiscal deficit expands the national output by 10.05%, while a 10% increase in government capital expenditure in Nigeria increases the growth rate of the economy by 6.22%. However, findings of the study showed that recurrent expenditure had no significant impact on economic growth [8]. Studying the implications of deficit financing on economic growth in Nigeria using OLS regression analysis, [9] argued that government deficit financing through external source of deficit financing and non-banking public source of deficit financing maintains economic stability while government deficit financing through banking system source of deficit financing reduces economic growth thereby causing instability in the economy. Agreeing with [12] revealed that there is significant impact of the external debt and debt service on GDP growth. Whereas total external debt stock has a positive effect of about 0.36939, debt service payment has a negative effect of about 28.517 [10]. Similar findings by [16] were followed by recommendation that government

should ensure economic and political stability and external debt should be acquired largely for economic reasons rather than social or political reasons. A similar research was done by [15] with the same result.

Results of [7] showed a negative relationship between debt stocks of internal and external; and gross domestic product, meaning that an increase in debt stock will lead to a reduction on the growth rate of Nigerian economy. Similarly, [15] examined the correlation between debt servicing and economic growth in Nigeria, finding that debt payment to Nigerian creditors has significantly impacted on the GDP and GFCF. However, contrary to [12] on external debt impact on the economic growth of Nigeria, [8], argued that there is significant inverse between domestic debt and economic growth, and external debt and economic growth. [11] showed that negative impact of high debt on growth operates through a strong negative effect on physical capital accumulation and on total factor productive growth, while [5], argued, in a similar study, that a positive relationship between FDI and economic growth, and inverse relationship existed between external debt and economic growth.

Where a few literatures examined international and domestic financing on macroeconomic indicators, the study scope were cross country examinations, which excluded Nigeria and also were not extended to 2015. This study therefore, seek to examine domestic and capital inflows to Nigeria and other factors that influenced them, such as cost of domestic credit, global price of risk, among others.

Methodology

Following, the Keynesian theory of increasing government activity as a catalyst to economic growth. The study adopted expo facto research design, using the ordinary least square regression technique for the analyses. Two models were designed for the study in line with the objectives. The first model had the real gross domestic product as the dependent variable, while credit to private sector, retained earnings (modeled as one year lag real gross domestic product), government domestic outstanding debt, bank lending rate and Treasury bill rate are the independent variables. Consequently, the real gross domestic product remained the dependent variable for the second model, while retained earnings (modeled as one year lag real gross domestic product), federal government external outstanding debt, Exchange rate and Treasury bill rate [11].

In line with [6], who looked at deficit financing and economic growth in Nigeria using Vector Autoregression and domestic financial sector development and economic growth in Nigeria respectively, an autoregressive function was introduced in the models (specifically to give explanation to autonomous growth of the real gross domestic product). The study hypothesizes that:

- Domestic finance does not significantly impact on the economic growth in Nigeria.
- International finance does not significantly affect the Nigerian economic growth.

The models therefore are

$$1. \quad \text{RGDP} = f(\text{CPS}_t, \text{FGDOD}_t, \text{TBR}_t, \text{LR}_t) \quad (1)$$

Therefore,

$$\text{RGDP}_t = \beta_0 + \beta_1 \text{CPS}_t + \beta_2 \text{FGDOD}_t + \beta_3 \text{TBR}_t + \beta_5 \text{LR}_t + \mu_t \quad (2)$$

Where,

RGDP = Real gross domestic product

CPS = Credit to private sector

FGDOD = Federal government domestic outstanding debt

TBR = Treasury bill rate

LR = Bank lending rate

t = time

μ = error term

$$2. \quad \text{RGDP} = f(\text{FGEOD}_t, \text{TBR}_t, \text{GRIR}_t) \quad (3)$$

Therefore,

$$\text{RGDP}_t = \beta_0 + \beta_1 \text{FGEOD}_t + \beta_2 \text{TBR}_t + \beta_3 \text{GRIR}_t + \mu_t \quad (4)$$

Where,

RGDP = Real gross domestic product

FGEOD = Federal government external outstanding debt

TBR = Treasury bill rate

GRIR = Global real interest rate

t = time

μ = error term

Data was sourced from the central bank of Nigeria (CBN) statistical bulletin and the World Bank (IBRD) site. All variables except global cost of fund were sourced from the statistical bulletin. The global cost of fund was sourced from the World Bank website.

Discussion
Results of Preliminary Tests
Unit root test

Augmented Dickey-Fuller (ADF) Test

Variable	ADF Test Statistics	5% Critical Value	Order of Integration
LNRGDP	-3.602984	-3.552973	I[1]
LNCPS	-3.733083	-3.552973	I[1]
LNLR	-5.966544	-3.557759	I[1]
LNTBR	-5.888619	-3.552973	I[1]
LNGRIR	-6.824347	-3.557759	I[1]
LNFGDOD	-4.451551	-3.552973	I[1]
LNFGEOD	-4.571274	-3.552973	I[1]

Source: author's computation using e-view 9.5 software

The Augmented Dickey Fuller test for unit root, which was conducted at 5% level of significance shows that the log of all variables (log of real domestic product, log of credit to private sector, log of commercial bank lending rate, log of treasury bill rate, log of global real interest rate, log of federal government domestic outstanding debt, log of federal government external outstanding debt and log of one year lag of real gross domestic product) used in the model were stationary at first difference,

implying that they all had unit root problem at level form and therefore cannot be used for regression analyses. Furthermore, the variables were stationary at the same order of integration.

**Cointegration Test
Cointegration for the first Model**

Sample (adjusted): 1983 2015 Included observations: 33 after adjustments Trend assumption: Linear deterministic trend Series: LNRGDP LNTBR LNFGDOD LNCPS LNLR 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 *	0.699914	88.39499	69.81889	0.0008
At most 1 *	0.540872	48.67332	47.85613	0.0418
At most 2	0.401201	22.98525	29.79707	0.2468
At most 3	0.166309	6.061911	15.49471	0.6882
At most 4	0.001800	0.059459	3.841466	0.8073
Trace test indicates 2 cointegrating eqn(s) at the 0.05 level * denotes rejection of the hypothesis at the 0.05 level **MacKinnon-Haug-Michelis (1999) p-values				

Source: author’s computation using e-views 9.5

Cointegration for the Second Model

Unrestricted Cointegration Rank Test (Maximum Eigenvalue)				
Hypothesized No. of CE(s)	Eigenvalue	Max-Eigen Statistic	0.05 Critical Value	Prob.**
None *	0.609539	31.03412	27.58434	0.0173
At most 1	0.266369	10.22171	21.13162	0.7236
At most 2	0.162973	5.870683	14.26460	0.6299
At most 3	0.004659	0.154107	3.841466	0.6946
Max-eigenvalue test indicates 1 cointegrating eqn(s) at the 0.05 level * denotes rejection of the hypothesis at the 0.05 level **MacKinnon-Haug-Michelis (1999) p-values				

Source: author’s computation using e-views 9.5

Johansen cointegration test was conducted at 5% significance level for the variables of the first and second model and the result showed that there were two (2) cointegrating equations in the model for domestic financing effect on economic growth in Nigeria, while the second model, focusing on the effect of international financing influence on the Nigerian economic growth had a cointegrating equation. The implication is that though the variables had short run residual disequilibrium, there is long run relationship between the variables of each model, and therefore the error correction model is best suited for the analysis, to correct the disequilibrium.

ECM Result 1

Dependent Variable: D(LNRGDP)				
Method: Least Squares				
Date: 02/11/17 Time: 10:59				
Sample (adjusted): 1982 2015				
Included observations: 34 after adjustments				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.040490	0.016261	2.490079	0.0190
D(LNFGDOD)	-0.068882	0.049037	-1.404704	0.1711
D(LNCPS)	0.072525	0.053647	1.351891	0.1872
D(LNLR)	-0.022042	0.052337	-0.421164	0.6769
D(LNTBR)	0.029341	0.035170	0.834252	0.4112
ECM	-0.206075	0.095192	-2.164837	0.0391
R-squared	0.206289	Mean dependent var		0.044393
Adjusted R-squared	0.064554	S.D. dependent var		0.042419
S.E. of regression	0.041027	Akaike info criterion		-3.390381
Sum squared resid	0.047130	Schwarz criterion		-3.121024
Log likelihood	63.63648	Hannan-Quinn criter.		-3.298523
F-statistic	1.455461	Durbin-Watson stat		1.024597
Prob(F-statistic)	0.235786			

Source: author's computation using e-views 9.5

The result of the error correction mechanism of the least square regression analysis shows that domestic financing did not significantly impact on the growth of the Nigerian economy over a period of thirty four (34) years, from 1981 to 2015. This is evidenced in the probability of the t-statistics and f-statistics being greater than 5%. Federal government domestic outstanding debt (FGDOD), which is a proxy for domestic finance to government contributed negatively to the real gross domestic product in Nigeria (0.069% decrease in RGDP for every 1% increase in FGDOD). Government continued to access increased domestic finance until the year 2005, which witness a decrease in the federal government domestic outstanding debt until 2012 and it began to rise again in 2013 to 2015. Access to finance is expected to grow the economy; however, the case is different with government domestic outstanding debt. This may be due to the extent to which debt service eats into the deficit finance supposed to be injected into the economy for growth. Although outside the scope of the study, the federal government of Nigeria (FGN) 2017 proposed debt service of 22.75% of total budget (representing 70.35% of deficit finance) plus 5.64% of total budget (representing 17.44% of deficit finance) for statutory transfers is a good example of the negative implication of government domestic outstanding debt on the economic growth of Nigeria. This leaves on 12.21% of the deficit finance for the 2017 budget actually going into the economy.

On the other hand, credit to private sector contributed positively 7.25% to the growth of the real gross domestic product in Nigeria. that notwithstanding, its contribution was insignificant as the probability of t-statistics was less than t-statistics significance level of 2.5% and the f-statistics significance level of 5% (i.e. confidence interval of 97.5% and 95% respectively). Therefore, credit to private sector also did not impact significantly on the real gross domestic product in Nigeria. Commercial bank lending rate and Treasury bill rate followed the a priori expectation having negative implication and positive effect respectively on the real gross domestic product in Nigeria. Their impact on the real gross domestic product in Nigeria was however statistically insignificant. A percentage increase in the lending rate and Treasury bill rate contributed -0.022% and 0.029% to the real gross domestic product.

Noteworthy, given the insignificance of explanatory variables, real gross domestic product in Nigeria shows an autonomous statistical significance ($0.0190 < 0.025$ and 0.05), growing autonomously by 4.05%. Given this finding, an autoregressive function was introduced to further explain the autonomous growth and statistical significance of the real gross domestic product in Nigeria (see appendix 1a). It was discovered that one year lagged real gross domestic product significantly impacted on the economic growth in Nigeria (current real gross domestic product in Nigeria), correlating fairly 51.17% with current real gross domestic product (see appendix 2c) and determining 26.18% (R^2 of 0.26183791) of the current real gross domestic product. This is evidenced by the probability of t-statistics (0.0002) less than 2.5% (0.025).

Furthermore, the probability of the f-statistics of 0.235786 further indicated that the explanatory variables jointly did not significantly impact on the Nigerian economic growth. The coefficient of determination (R-Squared) revealed that the explanatory variables jointly explained only about 20.63% of the variations in the real gross domestic variables. However, given the autoregressive model, the independent variables explained about 47% of the variations in the dependent variables, out of which lagged RGDP explained 26.18%.

The error correction term indicated that the residual error that resulted in the short run disequilibrium was significantly adjusted to residual equilibrium in the long run at an adjustment speed of 20.6% (and 82% using the autoregressive ecm model). The sign further followed the a priori expectation.

Serial correlation and Heteroscedasticity Test

Breusch-Godfrey Serial Correlation LM Test:			
F-statistic	0.159899	Prob. F(2,24)	0.8531
Obs*R-squared	0.433939	Prob. Chi-Square(2)	0.8050
Heteroskedasticity Test: Breusch-Pagan-Godfrey			
F-statistic	1.779586	Prob. F(6,26)	0.1426
Obs*R-squared	9.606922	Prob. Chi-Square(6)	0.1422
Scaled explained SS	8.063616	Prob. Chi-Square(6)	0.2335

Source: author’s computation using e-views 9.5

Evidence from the Breusch-Godfrey serial correlation LM test showed that the residual of the model is free from serial correlation. The probability of the F- statistics and probability of Chi-Square of the observed R-Squared showed that they are greater than 0.05 (5%), which is the condition for satisfying that the residual of the model is not serially correlated.

Furthermore, the residual is homoscedastic, having a constant variance as required for a good regression model. This is evidenced in all the tests (F-stat, Obs *R-Squared and Scaled explained SS) as they are all greater than 5% (0.05). Therefore, we can conclude that the residual is free from heteroscedasticity.

ECM Result 2

Dependent Variable: D(LNRGDP)				
Method: Least Squares				
Date: 02/11/17 Time: 12:33				
Sample (adjusted): 1982 2015				
Included observations: 34 after adjustments				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.049374	0.007938	6.219805	0.0000
D(LNFGED)	-0.027844	0.015238	-1.827267	0.0780
D(LNGRIR)	-0.002216	0.012810	-0.173026	0.8638
D(LNTBR)	0.015852	0.025481	0.622092	0.5387
ECM	-0.005239	0.021022	-0.249232	0.8049
R-squared	0.111048	Mean dependent var		0.044393
Adjusted R-squared	-0.011566	S.D. dependent var		0.042419
S.E. of regression	0.042664	Akaike info criterion		-3.335881
Sum squared resid	0.052786	Schwarz criterion		-3.111417
Log likelihood	61.70998	Hannan-Quinn criter.		-3.259333
F-statistic	0.905670	Durbin-Watson stat		1.152385
Prob(F-statistic)	0.473597			

Source: author's computation using e-views 9.5

The result of the error correction mechanism of the least square regression analysis showed that foreign financing did not significantly impact on the growth of the Nigerian economy over a period of thirty four (34) years, from 1981 to 2015. This is evidenced in the probability of the t-statistics and f-statistics being greater than 5%. Federal government external outstanding debt (FGEOD), which is a proxy for international finance to government contributed negatively to the real gross domestic product in Nigeria (0.019% decrease in RGDP for every 1% increase in FGEOD). Access to finance is expected to grow the economy; however, the case is different with government external outstanding debt. Similar to the case of federal government domestic finance, this may be due to the extent to which debt service eats into the deficit finance supposed to be injected into the economy for growth.

On the other hand, global real interest rate and Treasury bill rate followed the a priori expectation having negative implication and positive effect respectively on the real gross domestic product in Nigeria. Their impact on the real gross domestic product in Nigeria was however statistically insignificant. A percentage increase in the lending rate and Treasury bill rate contributed -0.0022% and 0.016% to the real gross domestic product.

Noteworthy, given the insignificance of explanatory variables, real gross domestic product in Nigeria shows an autonomous statistical significance ($0.0000 < 0.025$ and 0.05), growing autonomously by 4.94%. Given this finding, an autoregressive function was introduced to further explain the autonomous growth and statistical significance of the real gross domestic product in Nigeria. It was discovered that one year lagged real gross domestic product significantly impacted on the economic growth in Nigeria (current real gross domestic product in Nigeria), correlating positively 51.17% with current real gross domestic product and determining 26.18% (R^2 of 0.26183791) of the current real gross domestic product. This is evidenced by the probability of t-statistics (0.0002) less than 2.5% (0.025).

Furthermore, the probability of the f-statistics of 0.473597 further indicated that the explanatory variables jointly did not significantly impact on the Nigerian economic growth. The coefficient of determination (R-Squared) revealed that the explanatory variables jointly explained only about 11.10%

of the variations in the real gross domestic variables. However, given the autoregressive model, the independent variables explained about 39.90% of the variations in the dependent variables, out of which lagged RGDP explained 26.18%.

The error correction term indicated that the residual error that resulted in the short run disequilibrium was significantly adjusted to residual equilibrium in the long run at an adjustment speed of 0.5% (and 75.02% using the autoregressive ecm model). The sign further followed the a priori expectation. The sign further followed the a priori expectation.

Serial correlation and Heteroscedasticity test

Breusch-Godfrey Serial Correlation LM Test:			
F-statistic	0.288592	Prob. F(2,25)	0.7518
Obs*R-squared	0.744689	Prob. Chi-Square(2)	0.6891
Heteroskedasticity Test: Breusch-Pagan-Godfrey			
F-statistic	1.790551	Prob. F(5,27)	0.1486
Obs*R-squared	8.217475	Prob. Chi-Square(5)	0.1447
Scaled explained SS	7.273273	Prob. Chi-Square(5)	0.2011

Source: author's computation using e-views 9.5

Evidence from the Breusch-Godfrey serial correlation LM test showed that the residual of the model is free from serial correlation. The probability of the F-statistics and probability of Chi-Square of the observed R-Squared showed that they are greater than 0.05 (5%), which is the condition for satisfying that the residual of the model is not serially correlated.

Furthermore, the residual is homoscedastic, having a constant variance as required for a good regression model. This is evidenced in all the tests (F-stat, Obs *R-Squared and Scaled explained SS) as they are all greater than 5% (0.05). Therefore, we can conclude that the residual is free from heteroscedasticity.

Granger Causality test

The Granger causality test shows that the real gross domestic product significantly causes federal government domestic outstanding debt, credit to private sector and real gross domestic product in Nigeria granger causes each other, and global real interest rate granger causes federal government external outstanding debt. This implies that only credit to private sector and real gross domestic product in Nigeria has bi-directional causality. Federal government domestic outstanding debt did not granger-cause real gross domestic product in Nigeria and federal government external outstanding debt and real gross domestic product in Nigeria has neither uni-directional or bi-directional causality. Furthermore, neither commercial bank lending rate nor Treasury bill rate granger-caused credit to private sector and federal government domestic outstanding debt.

Test of Hypotheses

The first hypothesis states that domestic finance does not significantly impact on the economic growth in Nigeria. Following the results of the t-test and f-test of the explanatory variables that proxy domestic finance, the probability of the tests was greater than 5%, implying the individual and joint statistical insignificance of the relevant explanatory variables in determining economic growth in Nigeria. We therefore accept the null hypothesis and conclude that domestic finance did not significantly impact on economic growth in Nigeria for the period from 1981 to 2015.

The second hypothesis states that international finance insignificantly affects the Nigerian economic growth. Following the results of the t-test and f-test of the explanatory variables that proxy foreign finance, the probability of the tests was greater than 5%, implying the individual and joint statistical

insignificance of the relevant explanatory variables in determining economic growth in Nigeria. We also accept the null hypothesis and conclude that foreign finance did not significantly impact on economic growth in Nigeria for the period from 1981 to 2015.

Conclusion and Recommendations

It is appalling to discover that both domestic finance and international sourcing of finance have not significantly boosted economic growth in Nigeria. Rather, findings of the study revealed that federal government domestic outstanding debt and federal government external outstanding debt have both shown counterproductive contributions (negative contribution) to economic growth, against popular theory. This may be due to the fact that this finance are short term for the purpose of financing annual budget and therefore, will be serviced from the following year. This debt service therefore, decreases funds which should have been actively used to boost the economy of Nigeria. Credit to the private sector though not significant, has shown positive contribution to the growth of the Nigerian economy.

The global real interest rate showed negative (with the real gross domestic product) and significant causal relationship with federal government external outstanding debt, while the external outstanding debt and real gross domestic product in Nigeria have no causal relationship. A careful observer may begin to wonder why government seek for increasing external source of finance since it has no significant relationship with output growth, but rather negatively influence the economy. In light of this, government should consider its source of finance and the application of the funds and the level of debt it services annually, given its economic objectives.

Given the negative influence of both domestic and external finance, government should reduce the size of deficit finance it plans in the budget, considering that the finance is short term, and government will start servicing debt the following year, thereby reducing/ exporting funds that otherwise would have been plunged into the economy for growth. Therefore, the size of deficit finance directly influences the size of debt service the next few years.

Since real gross domestic product autonomously grows by 4% and previous year real gross domestic product significantly contributed 26.18% to current RGDP, government should improve in saving its earnings and reinvest it into the economy. This will reduce the size of deficit finance it seeks, which according to finding, negatively impacts of the real gross domestic product. The retained earnings may come from excess crude revenue saving and savings from non oil exports etc.

In comparison of the relative effectiveness of domestic and foreign finance, evidence from the auto regressive model showed that external outstanding debt contributed more negatively than domestic outstanding debt. Therefore, if government must finance its deficit, domestic sources should be preferred to foreign sources.

Government of Nigeria should encourage the financial institutions to increase credit to private sector by reducing monetary policy rate (MPR) and cash reserve ratio by 50%, since from the study, it has positive contribution to economic growth. Although insignificant, increasing credit to private sector by reducing MPR and cash reserve ratio will in turn reduce bank lending rate.

It may be better for government to seek for longer term finance, of a minimum of 2 years and a maximum of 3 years to fund annual budget, considering that from the study, the real RGDP, a major macroeconomic indicator responded significantly to one year lag. This will allow time for the economy to recover, grow and save to service its debt. In this way, the promising effect of deficit finance will not be countered by the size and demand of annual debt service.

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