

# AfriHeritage Policy Brief



## Nigeria's Debt Burden: Implications for Human Development

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### Executive Summary

Nigeria's total public debt stock rose continuously from NGN8.32 trillion in September 2013 to NGN22.7 trillion in March 2017. The high debt made the World Bank and the International Monetary Fund (IMF) warn the country of the economic consequences of such huge debt. Even the Nigerian DMO warned that Nigeria's high debt service to revenue ratio could trigger a debt crisis. The Minister of Finance, however, described the situation as an "emotive issue" and made a strong and persuasive case for more foreign loans to ramp up the country's stock of infrastructure.

While economists believe that borrowing is healthy for the economy and may help to maintain economic growth and development, the 172% leap within five years is worrisome. More worrisome still is the lack of evidence that the borrowed funds are being properly utilised. These situations undoubtedly may have negative implications for human development that is already in a deplorable condition in the country as the revenues that should have been used for human development will now be channelled to debt servicing and payback. It is therefore recommended that: the tax system in the country should be made effective to increase revenue

generation; a high proportion of the government debt within the 2018/2019 fiscal years should be external; the federal government should borrow only to finance capital projects that will over time, generate enough returns to pay off the debt. Also, the government should adopt alternative financing measures such as public-private partnerships, and above all, the Federal Government should comply with the Fiscal Responsibility Act requirements in borrowing.

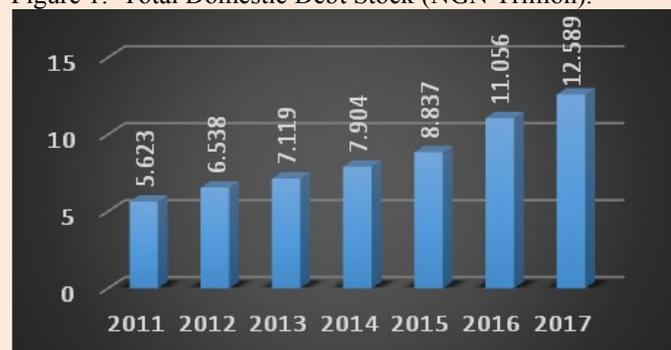
### Debt Profile of Nigeria

According to the DMO, Nigeria's debt stock profile (both domestic and foreign loan) stood at NGN22.7 trillion as at March 2017. While the stock of external debt was USD22.07 billion, the domestic debt was USD52.21, billion. Statistics from the DMO as contained in Figure 1 below show that there has been a consistent increase in the volume of domestic debt from around 5.6NGN trillion in 2011 to over 12.5NGN trillion as at December 2017, more than double fold increase within a space of six years.

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Figure 1: Total Domestic Debt Stock (NGN Trillion).



More worrisome is that of the external debt, which as shown in figure two below, had a consistent increase from USD8.82 billion as at December 31, 2013, to a whopping USD22.07 billion as at March 31, 2018.

The data in figure 2 below show that the growth rate of external debt stock in the country leapfrogged from 10.17 in 2015 to 15.72 in 2016, a 43.23% increase within one year.

Figure 2: Total External Debt (USD billion)

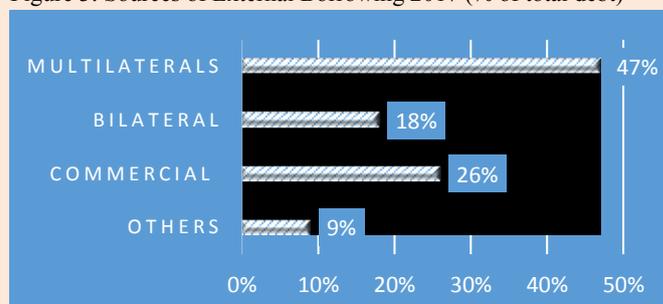


Information from the Debt Management Office shows that the sources and as well, the instruments of government debt in the country vary. Before 2016, the government borrowed internally using only three instruments which were the Nigerian treasury bills, treasury bonds and federal government bonds. In 2017 however, the government introduced three new instruments called the Federal Government of Nigeria (FGN) Savings Bond, FGN Sukuk, and the Green Bond.

The sources of external debt to the country include multilateral, bilateral, commercial and others. In 2017, multilateral borrowing accounted for 47% of

total debt, bilateral accounted for 18%, commercial accounted for 26%, and others sources accounted for 9% (See figure 3 below).

Figure 3: Sources of External Borrowing 2017 (% of total debt)



Source: <http://www.dmo.gov.ng/debt-profile>

The 2018 Fiscal Sustainability Analysis for the Federation (federal, states and FCT) as reported by the DMO through its Director General in Vanguard of July 26, 2018, show that the ratio of total public debt-to-gross domestic product remained below its threshold of 19.8% throughout 2017. They, however, warned that Nigeria's high debt service to revenue ratio, which deteriorated in 2016, could trigger a debt crisis if there are any prolonged shocks on the revenue. The report has it that for the country to remain in the proposed country-specific threshold of 25% borrowing limit, the total domestic and external borrowing for the 2018 fiscal year should not go beyond USD6.25 billion or NGN1,906.37 billion, which should be divided in the 50:50 ratio.

Also in Vanguard of April 19, 2018, an Assistant Director in IMF described the country's debt to revenue ratio, which she put at 64% as "extremely high", stating that there is a need for Nigeria to build revenue to have more space to spend for infrastructure, social safety nets etc. to avoid interest eating up most of her revenue. Nevertheless, she still aligned with the new position of the government saying that Nigeria still has room for foreign borrowings.

Reacting to these reports, the Finance Minister to the country, Kemi Adeosun, said that the current Federal Government's revenue and debt management strategy would mitigate the country's debt service risk and fast-track her development. According to her, the strategy would mobilise revenue while reducing the debt burden by lengthening the maturity profile, increase foreign exchange reserves, reduce crowding-out of the private

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sector, and create savings in debt service cost. She further argued that rather than making debt servicing a burden on Nigeria, the federal government was saving N76.375 billion per annum from US\$2.5 billion borrowing and N91.65 billion per annum from US\$3 billion refinancing of short-term domestic debt.

While borrowing is a necessity in periods of national budgetary deficits and when there are expenditure needs, there is a need to adhere to the rules and principles that guide such borrowing. The 2007 Fiscal Responsibility Act (FRA) as a policy document for borrowing in Nigeria made explicit provisions for debt and debt management, stipulating that “borrowing shall be only for capital projects and human development”, that it should be “concessional in nature, subject to legislative approval and a long period of amortisation”. The Act also stated that the nation’s debts “should be sustainable and should also have some limitations”.

Unfortunately, most of the states have exceeded the red line debt accumulation which is 50% of the state statutory revenue according to the 2007 FRA. Among the 36 states and the FCT, Lagos recorded the highest foreign and domestic debt profile, accounting for about 37% and 10.39% respectively of the country’s total sub-national foreign debt. In 18 states, the debt profiles exceeded their statutory revenue by more than 200%. In Lagos, Osun and Cross River States, in particular, debts exceeded revenues by almost 500% (Udo, 2017).

## Alternatives to Debt Borrowing in Nigeria

Debt borrowing is a major instrument by the government to finance budget especially in a developing country where low capital stock and limited investment opportunities exist. According to Nwankwo (2015) who was the former DMO Director General, Nigeria requires about USD 25 billion investment per annum over the next seven years for infrastructural development to occur. Exploring alternative financing has proved to be effective in closing the infrastructure gap and dealing with debt crisis especially in developing countries rather than accessing the loan component of foreign direct investment (FDI). The Build, Operate, and Transfer (BOT) model has been adopted successfully by countries like China, India, Ethiopia, and even in Nigeria where the Lagos-Ibadan expressway and the Lekki expressway (Lekki Toll Plaza) respectively

are successful BOT projects. The Diaspora Bond (DB) has been used successfully in India, Israel, etc. While India set up its bond for infrastructure financing and to support their balance of payments; Israel set up their DB to finance development projects in various industries including energy and transport (Mkansi, 2013; Ketkar and Ratha, 2011).

## Implications of Debt Crisis on Human Development

The cost of servicing debt in Nigeria has adverse effects on both economic and human development. For instance, as of June 2017, 34% of the nation’s total revenue was spent on debt servicing as stated by the DMO. The report from the Guardian interview with the Finance Minister also shows that the debt service to revenue ratio was 45% as at December 2017 (Nelson, 2017). The continuous increase in national debt servicing, no doubt crowds out expenditure on critical infrastructures and human development activities. Even when there is a shortfall in revenue, debts will still be serviced and paid back at the expense of capital projects that could address social development.

Furthermore, the commercial loans which are meant for private sector investments are borrowed by the government at a high-interest rate thereby excluding investors who have the potentials to invest in economic activities that would create jobs. This could worsen the already deplorable state of unemployment, inequality, health and poverty in the country.

Going through the history of government borrowing in Nigeria, evidence shows that there has been little or no regards for fiscal discipline. Political leaders were borrowing even in the periods of the oil boom, where there was surplus (Amakom and Agu, 2016). While the oil boom lasted, there were no meaningful investments in the other productive sectors that could sustain the economy during the economic downturn. The present administration had borrowed to offset accumulated salaries and pensions of workers in the states. The idea of borrowing for consumption purposes has impacted negatively on the economy and on workers whose salaries depend on loan. One resultant effect of this is that from late 2015, several states could no longer pay the salaries of their workers in full.

In conclusion, public debt is a source of revenue for most economies in the world, but over-accumulation of debt may be detrimental to the debtor nation due to the cost of

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servicing the debts, which can lead to the debt crisis. Given the current condition of the Nigerian economy, debt crisis/overhang could worsen the poverty and inequalities existing in the country that is already in a deplorable state and this call for caution and more planned strategy in debt management in Nigeria.

## Policy Recommendations

- Although the debt-to-GDP ratio in the country is within the threshold, it is clear that the debt-to-revenue in the country is getting out of hand and effort should be made by the government to diversify and strengthen its revenue base to improve the ratio and avoid the likely crises. Although total reliance on debt was understandable during the recession period, there is a need for there to be a more effective tax system in the country to increase revenue generation and improve the debt-to-revenue ratio.
- Being that the economy is just recovering from the recession, domestic borrowing by the government will crowd out local domestic investment and reduce the alternative revenue base. This brief is, therefore, suggesting that the 50:50 external to domestic debt source recommended by the IMF may not be the best for the country. Instead, we recommend that a high proportion of the government debt within the 2018/2019 fiscal years should be external.
- In line with the Suggestion by the Director-General, West African Institute for Financial and Economic Management, Dr Akpan Ekpo, we recommend that the federal government should borrow only to finance capital projects that will over time, generate enough returns to pay off the debt.
- In addition to borrowing, the government should adopt alternative financing measures such as public-private partnerships arrangement. These include the BOT, Diaspora bond, etc. By doing this, the cost and resources for servicing debt will be saved and invested in the productive economic activity.
- Above all, we recommend that the Federal Government should comply with the Fiscal Responsibility Act requirements in borrowing. This is essential because it will help in directing government loans to proper investments and also limits government from exceeding the loan ceiling.

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