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Burden of Government Debt on Economic Development and Debt Overhang Proposition: Analysis of Empirical Evidences

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Abstract:

The study examined empirical works on burden of government debt on economic development and debt overhang proposition: analyses of empirical evidences. It was discovered that many studies predominantly found out significant negative relationship (Ajayi & Edewusi, 2020; Matandare &Tito, 2018; Ehikioya et al., 2020; Rafindadi & Musa, 2019; Amaefule, 2018; Ay'unku & Markjackson , 2020; Yusuf & Said, 2018; Elom-Obed, 2017; Pegkas, 2018; Moussa & Shawawreh, 2017; Obisesan et al., 2019; Marafa, 2017; Idris &Ahmad, 2017; Charles & Abimbola, 2018; Akhanolu, 2018) between government debt burden and economic development while very scanty and few studies revealed a positive significant relationship (Lucky & Godday, 2017; Eke & Akujuobi, 2021;Akhanolu, 2018; Iacobo & Ialile, 2017) and non-significant relationship (Ofurum & Fubara, 2022); Mensah, 2018; Ay'unku & Markjackson, 2020) between the public debt and economic development. Several of the empirical study are not premised on debt overhang theory that goes to a great extent to explain the consequences of external debt on countries exceeding certain threshold of external debt stock with attendant consequences associated with external debt as discouraging private investors due to high tax rates in order to raise fund to compensate for the debt (Cohen, 1993). The study discovered other factors namely government expenditure, inflation rate, interest rate, and exchange rate that have effect on economic development. The empirical studies examined recommended as follows: that borrowed funds, particularly foreign debt, should be reduced. That corruption, especially on borrowed monies, be avoided at all costs and that the government should limit foreign borrowing since it

has a detrimental influence on the economy. That public debt not tied to investment does not contribute to economic growth of the studied country; that the government should increase efforts to increase domestic revenue sources to finance its growth plans as external debt accumulation weighs down economic growth; that strengthening the economy is critical as the government should develop new sectors to generate revenue to support economic development; that the government and policymakers stop the accumulation of external debt stock over time; that external debts should only be used for social or political purposes.

Keywords: *Debt overhang proposition, economic development and government debt burden*

JEL Classification Codes: E12, F34, F63, H63

BURDEN OF GOVERNMENT DEBT ON ECONOMIC DEVELOPMENT AND DEBT OVERHANG PROPOSITION: ANAYLSIS OF EMPIRICAL EVIDENCES

1.0 Introduction

The issue of public debt proliferation, which many developing countries worldwide have experienced, has attracted global attention. In Nigeria, this experience, caused by falling oil prices, exchange rate volatility, rising interest rates, and other factors, has negatively impacted the country's economy Marafa (2017). Studies have found that having a high level of public debt has a detrimental influence on the growth of the most developing economy. Budget deficits show that government spending is high compared to receipts, and this gap has been rising in many developing nations. It is crucial to remember that public debt is bad when it becomes chronic and burdensome for governments to repay; however, countries cannot escape it once in a while because it can achieve critical macroeconomic goals of improving citizens' standard of living (Ajayi and Edewusi 2020). As a result, governmental debt has been described as a necessary evil. This means that borrowing is beneficial until it causes the economy to suffer.

1.1 The debt overhang theory

The debt overhang theory postulates a negative link between public debt and economic performance (Amaefule, 2018). Proponents of this theory presume that as a country's external debt grows beyond its ability to repay, investment is discouraged by the prospect of higher future taxes. Accordingly, the uncertainty associated with high debt, low likelihood of debt relief, and high chances of default [in that regard] reduce investors' incentives and economic growth; as a result, high debt service may crowd out private investment (Cohen, 1993). The debt overhang hypothesis states that debt has a negative impact on economic development due to the disincentive and illiquidity effects. Debt-overhang The Debt Overhang theory was propounded by Howard in 1972. Debt overhang occurs when a nation's debt is more than its debt repayment ability. Eme and Olugboyega (2012) explains debt overhang as one whereby the expected repayment amount of debt exceeds the actual amount at which it was contracted. Eduardo (2009) also defined debt overhang as one where the debtor nation benefits very little from the returns on additional investment due to huge debt service obligations. The "debt overhang effect" comes into play when accumulated debt stock discourages investors from investing in the private sector for fear of heavy tax placed on them by government. This is known as tax disincentive. Bamidele and Joseph (2013) relates the concept of debt overhang to Nigeria's debt situation. He stated that the debt service burden has prevented rapid growth and development and has worsened the social

issues. Nigeria's expected debt service is seen to be increasing function of her Output and as such resources that are to be used for developing the economy are indirectly taxed away by foreign creditors in form of debt service payments. This has further increased uncertainty in the Nigerian economy which discourages foreign investors and also reduces the level of private investment in the economy. The tax disincentive here implies that because of the high debt and as such huge debt service payments, it is assumed that any future income accrued to potential investors would be taxed heavily by government so as to reduce the amount of debt service and this scares off the investors thereby leading to disinvestment in the overall economy and as such a fall in the rate of growth. In addition, Atique and Malik (2012) stated that external debt accumulation can promote investment up to a certain point where debt overhang sets it and the willingness of investors to provide capital starts to deteriorate. This study is therefore anchored on the Debt Overhang theory. This is based on the premise that the theory goes to a great extent to explain the consequences of external debt on a nation as it described as one of the consequences associated with external debt as discouraging private investors due to high tax rates in order to raise fund to compensate for the debt.

Countries' debt management strategies that should specify usage of external borrowings to capital projects. (Expenditure based fiscal adjustment). The revenue base might bit hand on purchasing power capable of triggering inflation. Udeh et al. (2016) posits that excessive external debt stock increases external service cost and generates debt overhang problem to the economy and becomes burden on domestic production. In similar perspective, Tejvan (2016) suggests that the easiest guide to access when external debt becomes a problem is to look at the level of external debt to GDP. This he said bothers on two things; whether a country can satisfactorily meet debt interest payments from exports earnings? Lucca (2019) in global finance opined that great external debt results great responsibility. Adding that when countries resort to borrowing to maintain financial liquidity and stimulate growth, financial risk triggers the more. Debt is like any other trap, IMF and the World Bank had continually warned that high levels of external debt pose greater or increase financial stability risks than internal debt because repayments are made in foreign currency that are more exposed to exchange rate shocks. Udeh et al. (2016) had confirmed that there exists a positive relationship in the short run but negative relationship between external debt and economy as well as exchange rate in the long run, in their study of external debt and economic growth, the Nigerian experience. Cordelia at al. (2020) in their work "A mismatch between external debt finances and consumption cost in Nigeria had proved that external debt does not improve consumption cost but rather aids the rising cost of living in the country as they suggests that government should channel borrowed funds into the real sectors. (Ehikioya el al., 2020) examined the dynamic relationship between public external debt and economic growth in 43 African Countries. A curse or blessing? Using time series data from the periods 2001 — 2018. It revealed that there exist convergences to equilibrium in the long run and external debt would start to have a deteriorating impact on economic growth in Africa, their suggestions support the main objective of this work. In the same vein, the work of Obisesan et al. (2019) in their study, effect of external debt on economic growth in Nigeria also fall in line with the objective of this work as their work revealed a negative effect of external debt on the Nigerian economy. Lutfi and Zharku (2018) in his study, productive use of public debt in Kosovo, and the study confirmed that public debt not tied to investment does not contribute to economic growth of the studied country. He however, identified that the unproductive use of

public debt was attributable to lack of legal framework or fiscal rules in Kosovo, as the bulk of the borrowed funds are used to finance budget deficits.

2.0 Analyses of empirical evidences

2.1 Statistically significant positive relationship between government debt burden and economic development

Lucky and Godday (2017) used simple and multiple regression models to investigate the relationship between the structure of the Nigerian public debt and the growth performance of the Nigerian economy from 1990 to 2015. The variables utilised in the analysis are GDP, domestic debt, external debt, and total debt. The finding revealed that total public debt positively and substantially influences Nigeria's GDP. Similarly, the findings of the multiple regression analysis indicated that foreign debt has a negative impact on Nigerian economic growth. As a result, the research suggested that Nigeria pursue internal policies in contrast to its foreign indebtedness.

Eke and Akujuobi (2021) conducted empirical research on the influence of public debt on economic growth in Nigeria from 1981 to 2018. using a co—integration technique. The study discovered a substantial short-run link between Nigeria's public debt and economic growth.

The implication of public debt on economic development in Nigeria was studied by (Akhanolu, 2018). Secondary data from 1982 to 2017 was obtained using the quantitative research approach. The study showed that internal debt favours economic growth, whereas external debt has an inverse association with economic growth, according to the findings. The study concluded that borrowed funds, particularly foreign debt, should be reduced based on the results.

Iacobo and Ialile (2017) used Two-Stage Least Squares [2-SLS] to examine the impact of government debt on GDP in 16 Latin American economies from 1960 to 2015, including Bolivia, Argentina, Chile, Brazil, Costa Rica, Colombia, Dominican Republic, Mexico, Honduras, Panama, Nicaragua, Peru, Paraguay, Venezuela, and Uruguay. The variables included in the study are the starting level of GDP per capita, the GDP per capita growth rate, gross government debt as a proportion of GDP, investment rate proxied by gross fixed capital formation as a share of GDP, and population growth rate. The findings suggest that debt benefits GDP growth, but this impact diminishes to near nothing beyond public debt—to—GDP ratios of 64 per cent to 71 per cent. Above this threshold, increasing debt has a stimulating effect on growth.

2.2 Statistically significant negative relationship between government debt burden and economic development

Ajayi and Edewusi (2020) explored the role of Nigeria's national debt on economic growth. The research specifically identified the influence of domestic debt on Nigerian economic growth, assessed the impact of external debt on Nigerian economic growth, and examined the link between public debt and Nigerian economic growth. The study's findings indicated that external debt has a negative long—run and short-run influence on Nigerian economic development, but domestic debt has a positive long—run and short-run effect on Nigerian economic growth.

Matandare and Tito (2018) examined Zimbabwe's governmental debt and economic development. The World Development Indicators database was used to collect secondary time series data covering 36years (1986—2016). The study's data were examined inferentially and established a negative relationship between external debt and economic development in Zimbabwe. The research also revealed that the exchange rate and inflation negatively affect economic development in Zimbabwe. Based on the findings. the authors proposed that the government should increase efforts to increase domestic revenue sources to finance its growth plans. as external debt accumulation weighs down economic growth. They also recommended that strengthening the economy is critical as the government should develop new sectors to generate revenue to support economic development.

Ehikioya et al. (2020) examined the dynamic relationships between foreign debt and economic development in 43 African nations from 2001to 2018. They utilised the Johansen Cointegration test and the system Generalised Method of Moments (GMM). The research explains how the impact of foreign debt might be overstated owing to its misapplication. The findings support a 1ong—run equilibrium link between foreign debt and African economic growth. The result shows that. above a certain capacity. the short-run converges to equilibrium in the long run. and foreign debt begins to influence African economic growth negatively.

The influence of government debt management techniques on Nigeria's debt profile was experimentally examined by (Rafindadi and Musa 2019). The study examined the impact of debt refinancing (DRF). as well as the effects of debt forgiveness (DF) and debt conversion (DCV) schemes on Nigeria's public debt profile. The study used an econometric research technique. with secondary time series data from the Central Bank of Nigeria yearly statistics bulletin, Debt Management Office records, and the World Development Index spanning 37 years (1981—2016). Inferential analysis was used to examine the data collected in the study. The study revealed that debt refinancing negatively influenced Nigeria's total debt profile. Furthermore, the study discovered that debt forgiveness has a substantial negative influence on the country's debt profile, but debt conversion has a considerable positive impact on the debt profile of Nigeria. Following these findings, the research recommended that the government enhance debt refinancing to lower the country's debt profile, pursue debt forgiveness, and provide additional debt conversion instruments to cut Nigeria's national debt substantially.

Amaefule (2018) investigated the impact of public debt on Nigeria's economic performance. Economic performance was assessed using GDP, public capital investment (PCI),and the human development index (HDI), whilst public debt was measured using external debt, domestic debt, and total debt payments. The study period was between 1991 and 2016, and data were obtained from the Central Bank of Nigeria bulletin, Debt Management Office reports, and World Bank publications. The ordinary least square regression model was used for the analysis. The result revealed that external debt negatively influences GDP and PCI, but there is no indication of a significant effect on HDI. Domestic debt had a substantial positive influence on all economic development indices, but total debt servicing had no statistical evidence of relevance on any economic development indicators. The conclusion implies that the extensive foreign debt records and related debt servicing costs are not justified; the government has not used the revenues from such loans wisely.

Ay'unku and Markjackson (2020) studied the impact of external debt on Nigeria’s foreign reserves portfolios and concludes thus; that external debt exerts a negative and statistically significant impact on the nation’s reserves’ portfolios. Yusuf and Said (2018) investigated Tanzania's governmental debt and economic development. Secondary time series data spanning forty-five years were gathered for this study which used a quantitative research technique. The data collected in the study were analysed using cointegration and the Vector Error Correction Mechanism (VECM) Approach. Over the research period, the VECM estimate revealed a negative connection between public debt and economic development in Tanzania. Furthermore, the granger causality test found no causal link between government debt and economic development. Based on these findings. The study recommended that the government and policymakers stop the accumulation of external debt stock over time. They also recommended that external debts should only be used for social or political purposes.

Elom-Obed (2017) conducted an empirical study of the link between public debt and economic development in Nigeria between 1980 and 2015. The study used the Vector Error Correction Model (VECM) to analyse econometric data. Real gross domestic product [RGDP], foreign debt, domestic debt, and domestic private savings are among the indicators examined in the study. The study's findings revealed that external debt had a considerable negative influence on economic growth during the study period.

Pegkas (2018) experimentally studied the relationship between public debt and economic development factors such as private and public consumption investment, trade openness. And population growth in Greece using unit root tests and the autoregressive distributed lag (ARDL) model. The unit root tests revealed that the variables had mixed integration of 1(0) and 1(1).The ARDL model results indicated a long-run link between trade openness and economic growth, whereas government debt and population increase negatively influenced growth. The study also looks at the topic of the break effects between government debt and economic growth. The findings revealed that the relationship between debt and growth is dependent on debt relief. Particularly at debt levels before 2000. The influence on economic growth gradually decreased, and the growth consequences became negative.

Moussa and Shawawreh (2017) investigated the influence of debt on Jordan's economic development. The research specifically examined the impact of external debt on the gross domestic product, the impact of domestic debt on the gross domestic product, the impact of debt payment on the gross domestic product, and the influence of public debt on the gross domestic product. The study used secondary time series data spanning fifteen years, and a quantitative research technique was employed [2000-2015]. The least-squares and regression models were used to evaluate the study's data. The study's findings indicated that overall governmental debt, particularly external debt, had a detrimental influence on economic growth. Following these findings, the research proposed that governments should rely on existing domestic resources rather than foreign debt. In the same vein, the work of Obisesan et al. (2019) in their study, effect of external debt on economic growth in Nigeria also fall in line with the objective of this work as their work revealed a negative effect of external debt on the Nigerian economy

Marafa (2017) looked at Nigeria's governmental debt and economic growth. The study looked into the extent to which foreign debt influences national output in Nigeria and whether domestic debt impacts national output in Nigeria. It also looked into the degree of causality between the explanatory variables and national output in Nigeria. The research adopted a quantitative approach in its investigation, and the study data were time—series data from the Central Bank of Nigeria spanning 45 years (1970-2015). Results from the study suggest that foreign debt has harmed economic growth over the study period. It also revealed that domestic debt [DMD] had a negative impact on economic growth during the study period. Based on the findings, the research recommended that the government minimise external debt and that the funds received be used solely for objectives that would have a beneficial impact, as well as that the government limit domestic borrowing and guarantee that the funds already borrowed are appropriately utilised.

Idris and Ahmad (2017) looked at the relationship between public debt and economic growth in Sub-Saharan Africa. The autoregressive distributed lag model was used in this investigation. In the study, secondary time series data spanning 35 years was gathered. The research revealed that domestic debt had a detrimental impact on economic growth using econometrics estimate techniques. From the study's findings, the study recommends that fiscal policymakers and other related policymakers pay close attention to the productive use of any internally borrowed funds to ensure that resources are allocated to specific growth—oriented programs. They also recommended that adequate loan—repayment capacities are in place.

Charles and Abimbola (2018) investigated the impact of external debt on Nigerian economic development. The dependent variable was the gross domestic product, used as a proxy for economic growth. In contrast, the independent variables were external debt stock, external debt service payments, domestic debt, foreign reserve, and exchange rate. External debt stock and external debt service payments were utilised to calculate Nigeria's external debt burden. As a suitable approach for co—integration, the article used ARDL bound testing. According to the findings, domestic debt lag 1, D[LDDS [-1]] has a negative but substantial influence on economic growth.

Akhanolu (2018) utilise the two—stage least square regression to examine the Nigerian government's debt and its influence on economic development from 1982 to 2017. External debt, as well as their burdens, were regressed against GDP. The results revealed that foreign debt negatively influences the economy, but internal debt has a favourable relationship. They also regressed GDP, total savings deposits in Nigerian deposit money institutions, and capital expenditure against internal debt. The results revealed that all variables had a strong association with internal debt. The research advised that corruption, especially on borrowed monies, be avoided at all costs and that the government should limit foreign borrowing since it has a detrimental influence on the economy.

2.3 Statistically insignificant relationship between public debt and economic growth government debt burden and economic development

Ay'unku and Markjackson (2020) studied the impact of external debt on Nigeria’s foreign reserves portfolios and concludes that both external debt and its servicing obligations has no significant impact on international reserves positions of Nigeria.

Mensah (2018) tried to explain the aggregate influence of institutional quality and foreign debt on the economic development of 36 Sub—Saharan African nations between 1996 and 2013. The GMM method was employed in the study, and it was discovered that external debt explains the patterns of economic growth in SSA. According to the study, foreign debt spent on developmental projects would have a beneficial impact on growth. However, above a certain level, foreign debt may be irrelevant and detrimental to Sub—Saharan Africa's economic growth.

Ofurum and Fubara (2022) investigated the impact of public debt on economic development in Nigeria. The objective is to empirical study the relationship between public debt and economic development in Nigeria between 1980 and 2019. Data were collected from the Central Bank of Nigeria (CBN) Statistical bulletin, and the Augmented Dickey-Fuller ADF], Autoregressive Distributed Lag (ARDL), and Granger Causality were used to test the hypotheses and analyse the data. The results indicate that foreign debt servicing does not have a significant impact on Nigerian real GDP. Foreign debt servicing has insignificant impact on real GDP. In addition, the result indicates that external debt does not significantly impact unemployment. External debt servicing has no significant effect on unemployment.

3.0 Conclusion

The study examined empirical works on burden of government debt on economic development and debt overhang proposition: anaylsis of empirical evidences. It was discovered that many studies predominantly found out significant negative relationship (Ajayi & Edewusi, 2020; Matandare &Tito, 2018; Ehikioya et al., 2020; Rafindadi & Musa, 2019; Amaefule, 2018; Ay'unku & Markjackson , 2020; Yusuf & Said, 2018; Elom-Obed, 2017; Pegkas, 2018; Moussa & Shawawreh, 2017; Obisesan et al., 2019; Marafa, 2017; Idris &Ahmad, 2017; Charles & Abimbola, 2018; Akhanolu, 2018) between government debt burden and economic development while very scanty and few studies revealed a positive significant relationship (Lucky & Godday, 2017; Eke & Akujuobi, 2021;Akhanolu, 2018; Iacobo & Ialile, 2017) and non-significant relationship (Ofurum & Fubara, 2022); Mensah, 2018; Ay'unku & Markjackson, 2020) between the public debt and economic development.

4.0 Recommendation

The empirical studies examined recommended as follows: that borrowed funds, particularly foreign debt, should be reduced based on the results: that corruption, especially on borrowed monies, be avoided at all costs and that the government should limit foreign borrowing since it has a detrimental influence on the economy. that public debt not tied to investment does not contribute to economic growth of the studied country; that the government should increase efforts to increase domestic revenue sources to finance its growth plans as external debt accumulation weighs down economic growth; that strengthening the economy is critical as the government should develop new sectors to generate revenue to support economic development; that the government and policymakers stop the accumulation of external debt stock over time; that external debts should only be used for social or political purposes; that debt benefits GDP growth, but this impact diminishes to near nothing beyond public debt—to—GDP ratios of 64 per cent to 71 per cent. Above this threshold, increasing debt has a stimulating effect on growth; that the government minimise external debt and that the funds received be used solely for

objectives that would have a beneficial impact, as well as that the government limit domestic borrowing and guarantee that the funds already borrowed are appropriately utilized; that fiscal policymakers and other related policymakers pay close attention to the productive use of any internally borrowed funds to ensure that resources are allocated to specific growth—oriented programs. They also recommended that adequate loan—repayment capacities are in place and that governments should rely on existing domestic resources rather than foreign debt.

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