Developing Economy Journal
Vol.1, Issue:04;April-2022
ISSN (1573-1405);
p –ISSN (0920-5691)
Impact factor: 3.38

Economic Development Implications of the International Financial Institutions Loans: A Focus on Employment Generation in Nigeria.

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Abstract: Employment generation has remained central to the policy goal of economic development in Nigeria. In view of this, an empirical investigation into the link between international financial institutions loans and employment rate was carried out in this study. Specifically, the effects of loans from the International Finance Corporation (IFC), International Development Association (IDA), Paris Club and African Development Bank on employment rate were examined. The data for the variables were obtained from the United Nations Development Programme Human Development Report, National Bureau of Statistics, World Development Indicators and International Debt Statistics. The empirical investigation followed an ex post facto research design with the application of descriptive statistics, unit root and cointegration tests as well as error correction model and Granger causality tests as the data analysis techniques. The unit root test results revealed that all the variables are stationary at first difference, which justifies the test for cointegration using the Johansen method. It was found from the cointegration test results that long run relationship exists among the variables in the model. The parsimonious ECM revealed that IDA and African Development Bank loans have a significant positive effect on employment rate. This highlights the substantial role played these funding sources in generating employment in Nigeria. On the contrary, International Finance Corporation and Paris Club do not have any significant effect on employment rate. Owing to the findings, it is recommended that loans available to Nigeria from the international development association should be channeled to investments in critical infrastructure and agriculture development to generate employment and achieve economic development.

Keywords: *Employment generation, institutions loans, International Finance Corporation, IDA, Paris Club and African Development Bank*

1. INTRODUCTION

The need to avert the negative effects of unemployment has made the tackling of unemployment problems to feature very notably in the development objectives of many developing countries including Nigeria. However, a good number of these countries' economies with dearth of capital would seek for external funding in the form of foreign loans from international financial institutions for investment in critical infrastructure. These institutions give loans on hard and soft conditions depending upon the credit rating of the country (Benedict, Rina & Toan, 2003). This is expected to improve the level of production of goods and services and by extension increase employment generation. Hence, it seems obvious to many policymakers that there must be a straight forward connection between productivity and employment generation. The accumulation of external debt is a common phenomenon of the developing countries where domestic savings is low,

current account payments deficits are high, and imports of capital are needed to augment domestic resources to accelerate economic growth and poverty reduction. This becomes effective as long as borrowed funds are properly utilized for productive investment and do not suffer from macroeconomic instability and policies that distort economic incentives (Amakom, 2003).

The unemployment rate in Nigeria has also been fluctuating not following a consistent trend with public debt. Loans from international financial institutions is believed to be a means of bridging domestic savings gap especially in times of falling government revenues from internal sources. It is particularly so in the face of fluctuating prices of primary commodity exports and hence declining foreign exchange earnings. A foreign loan is also seen as a means of assisting developing countries increase its rate of real investment in addition to promoting economic growth. International financial institutions loans therefore, act as a source of capital formation and by implication a means of generating employment opportunities through increase in investment levels and employment generation.

Although, Nigeria enjoys considerable access to loans from International Financial Institutions for annual budget implementation, the conditionality associated with these loans have remained a source of worry to policy makers and other key stakeholders in the economy. The condition associated with the loans often conflicts with the fiscal targets- either capital investment or recurrent expenditure targets, thus constraining the broad objective of budget implantation and international institutions loans. Aside from the conditions that International Financial Institution provide as a pre-requisite for loans, the systemic corruption that seems to engulf the public sector has posed a major challenge to successful implementation of budgets in Nigeria as public service is considered as a goldmine. This has resulted to the diversion of borrowed funds into personal accounts with key components of the budget relegated to the background. (Sanusi, 2017). A review of the loan inclination of Nigeria against the backdrop of her infrastructural and human development and the general standard of living of the Nigerian people leave great worry as to what really has the government achieved with the huge foreign loans inclination over the years. It is against this backdrop that this study set out to investigate how the implementations of the international financial institution loans contribute to employment generation in Nigeria.

2. LITERATURE REVIEW

2.1 Neoclassical Theory

According to the neoclassical growth theory, debt has a direct effect on economic growth. This is because the amount borrowed, if used optimally, is anticipated to increase investment. As long as countries use the borrowed funds for productive investment and do not suffer from macroeconomic instability, policies that distort economic incentives or sizable adverse shocks, growth should increase and allow for timely debt repayment (Butt, 2009). On the other hand, the indirect effect of debts is its effect on investment. The transmission mechanism through which debts affect growth is its reduction on the resources available for investment by debt servicing. Also, public debt can act as an implicit tax on the resources generated by a country and create a burden on future generations which come in the form of a reduced flow of income from a lower stock of private capital. This in turn, may lead to an increase in long-term interest rates, a crowding out of private investments necessary for productivity growth, and a reduction in capital accumulation (Benedict et al, 2003).

Therefore, this study is anchored on the Neoclassical Theory.

2.2 Empirical Literature

Afolabi *et al.* (2017) investigated the long and short term association between foreign institutional loans and economic growth in Nigeria. The study covered a period from 1980 to 2014 and applied error correction model and granger causality test in order to empirically establish the relationship existing among the variables. Thus, the findings showed that foreign loans had a negative relationship with economic growth in Nigeria. The suggestion is that foreign loans should be judiciously used for the provision of infrastructures and projects that will result in economic development and growth and by extension increase employment generations. Onakoya and Ogunade (2017) used OLS technique to find evidence on the implication of foreign loans to Nigeria's economic growth. The study covered a period from 1981 to 2014 and found that external debt did not granger cause economic growth at 5% level of significance. This finding implied that external borrowing in Nigeria is not used for developmental projects which is the major driver for foreign loans.

Ndubuisi (2017) extended the study on the impact of foreign loans on the economic growth of Nigeria from 1985 to 2015 using the ordinary least squares method and some other statistical tools. The control variables employed were the exchange rate and external reserve while the major independent variable includes foreign loan stock and external debt servicing. The study also employed the GDP as the dependent variable. Thus, the findings revealed that debt service payment had an insignificant negative impact on economic growth while the external debt stock had a significant positive impact on the economic growth of Nigeria and by extension on employment generation. The control variable which includes external reserve and exchange rate had significant impacts on GDP. Thus, the study recommended the use of foreign institutions loans debt for infrastructural development.

Mbah *et al.* (2016) employed an error correction model and ARDL bound testing approach to assess the impact of institutional loans on economic growth in Nigeria from 1970 to 2013. The study found a long-run relationship among the variable and further established that external debt had a significant negative impact on the economic growth of Nigeria. The study recommended prudent and export induced borrowing. In the study of Udeh et al.(2016), GDP was a function of the external debt stock, external debt service and a control variable being the exchange rate. The study covered a period from 1980 to 2013 and made use of error correction model, ordinary least squares method and so found that exchange rate had a positive relationship with GDP while the external debt stock and external debt service payment exerted a negative impact on GDP

Ajayi and Oke (2012) investigated the effect of foreign institutional loans on economic growth and development of Nigeria using ordinary least squares regression and secondary data for 27 years. The results showed that the external debt burden had an unfavorable effect on the national income and per capita income of Nigeria. The study further revealed that the enormous size of Nigeria's external debt led to the devaluation of the nation's currency, poor educational system, frequent industrial strike, growth of worker's retrenchment as well as disturbing economic stagnation. Sulaiman and Azeez (2012) studied the effect of foreign institutional loans on the economic growth of Nigeria using ordinary least

squares (OLS) technique and other relevant statistical tools to analyze the data obtained from Central Bank of Nigeria Statistical Bulletin and Debt Management Office from 1970 to 2010. The study found evidence that foreign institutional loan had positively contributed to Nigeria's economic growth. Although this finding is contradictory when compared with physical realities, however, the authors recommended that external debt should be acquired purely for economic growth purposes and not for political reasons.

Adedoyin et al. (2016) also covered a period from 1981 to 2014 using auto-regressive distributed lag (ARDL) which showed the existence of a significant relationship between foreign institutional loans and economic growth both in the long and short run, but no causality was found among the variables. This study suggested among others that debt limit should be set and maintained to avoid debt overhang. Ijirshar et al. (2016) used a combination of descriptive statistics and econometric tools to examine the relationship between external debt and economic growth in Nigeria from 1981 to 2014. The result of the study indicated that external debt stock had a significant positive impact on economic growth both in the short and long run. On the contrary, external debt service negatively and significantly impacted on the economic growth of Nigeria.

Mbanasor and Okere (2012) examine whether foreign borrowed fund is a tool for or threat to the growth in the Nigerian economy. In carrying out these studies, data were sourced from the CBN statistical bulletin and analysed using OLS estimating tools. Findings reveal that external borrowed fund is positively related to economic growth, hence government should ensure proper debt management so as to stimulate future growth. Shehu usman and Aliyu, (2013) investigated the contribution of foreign borrowed fund on the growth of the Nigeria economy. The study covered between 1970 and 2010 while data were obtained from the CBN statistical bulletin. GDP was used as proxy for growth while five other variables were proxies for debt indicators. Three different estimating tools was used in the process of analysis and finding reveals that foreign borrowed fund has a direct flow toward economic growth in Nigeria.

Kasidi and Said (2013) investigated the impact of external debt an economic of growth in Tanzania using time series of 1990-2010. The study 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. Atique and Malik (2012) examined the impact of domestic and external debt on the economic growth of Pakistan separately over a period of 1980-2010 using ordinary Least Square approach (OLS) to co-integration. The result showed significant inverse relationship in both, that is, inverse relationship between domestic debt and economic growth, and external debt and economic growth.

3. METHODOLOGY

3.1 Research Design

An ex post research design was followed in this study given that for each of the variables used for the investigation are already in existence.

3.2 Model Specification

This study employed a dynamic model with the selected key International Financial Institutions loans such as Paris club loan, International Development Association loan, International finance cooperation loan and Loan from African development bank as the explanatory variables

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while employment rate is the dependent variable. The specification of the model in its functional form is as follows:

EMP = (IFCL, PCL, IDA, ADB)
(3.1)

EMP = Employment rate, IFCL = International financial corporation loan, PCL = Paris Club Loans, IDA = loans from International Development Association and ADB = African Development Bank Loan.

The formal specification of the ECM with the underlying notations for each of the variables is as follows:

$$\Delta InEMP = \alpha_0 + \sum_{i=1}^{a} m_1 \Delta InEG_{t-i} + \sum_{i=1}^{a} m_2 \Delta InIFCL_{t-i} + \sum_{i=1}^{a} m_3 \Delta InPCL_{t-i} + \sum_{i=1}^{a} m_4 \Delta InIDA_{t-i}$$

$$+ \sum_{i=1}^{a} m_5 \Delta InIML_{t-i} +$$

$$\sum_{i=1}^{a} m_6 \Delta InADB_{t-i} + \delta ECM_{t-1} + \mu_t \qquad (3.2)$$

Where: α_0 = constant parameter

$m_1 – m_6$ = short-run dynamic coefficients of the lagged explanatory variables

a = optimal lag length

Δ = first difference operator

δ = ECM parameter which captures the speed of adjustment μ_{1t} *and* u_{5t} = Stochastic term (error term)

3.2 Data Collection Procedure and Sources

The data sets for the underlying variables spanned from 1981 to 2020 and cover various aspects of budget implementations in Nigeria economy with a focus on the sources of foreign institutional loans and HDI. Specifically, the data were obtained from the World Development Indicators (WDI) and UNDP Human Development Report.

3.4 Methods of Data Analysis

The error correction mechanism (ECM) was adopted as the model estimation technique to explore the dynamic relationship between employment rate and foreign institutional loans as well estimate the speed of adjustment. In addition, it was also applied in estimating the coefficients of each of the differenced lagged dependent and explanatory variables. Notably, the ECM provides the empirical standpoint for gaining deeper insight into the speed at which each of the models returns to equilibrium after being influenced by an economic shock. In addition, the Augmented Dickey Fuller (ADF) by Dickey and Fuller (1981) approach to unit root was used to test for stationarity in each of the variables. The general expression of the unit root in an algebraic form is displayed as:

$$\Delta(X_t = m_0 + m_1(Y_{t-1}) + \sum_{i=1}^{q} \beta_i \Delta(X_{t-i}) + E_t \qquad (3.3)$$

Where: X_t = variable being tested for unit root, m_1 and β_i = parameter estimates, q = maximum order of lag, Δ= notation for first difference and E_t = Error term

The Johansen and Juselius (1990) cointegration procedure, a multivariate-based methodology for differenced

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ISSN (1573-1405);
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integrated variables was also employed in this study. The model for the cointegration test is specified as:

$$F_{trace}(r) = -N \sum_{i=r+1}^{n} \log\left(1-\hat{\lambda}_i\right) \quad (3.4)$$

$$F_{\max}(r, r+1) = -N \log\left(1-\hat{\lambda} r+1\right) \quad (3.5)$$

Where: $F_{trace}(r)$ and $F_{\max}(r, r+1)$ denote Trace and Max-Eigen statistics respectively, $\hat{\lambda}$ = coefficients of the characteristic roots, N = sample size, r = cointegrating vectors and n = lag length.

4. RESULTS AND DISCUSSION

4.1 Descriptive Statistics

The descriptive statistics of each of the variables ranging from the mean distribution of the variables, standard deviation to normal distribution are presented in Table 1.

Table 1: Summary of the descriptive statistics

	EMP	IFCL	PCL	IDA	ADB
Mean	14.89	0.003	12.59	2.951	0.004
Median	14.29	0.000	9.109	1.967	0.0007
Maximum	25.00	0.051	35.69	11.907	0.043
Minimum	10.32	-0.030	0.000	0.580	0.00014
Std. Dev.	3.73	0.017	13.39	2.771	0.0082
Jarque-Bera	1.58	11.039	4.863	23.51	264.01
Probability	0.45	0.004	0.0879	0.000	0.000
Observations	39	39	39	39	39

Source: Researcher's computation using E-views 10

The descriptive statistics showed that the mean value of the employment rate stood at 14.89 per cent while loans from the International Finance Corporation, Paris Club, IDA and African Development Bank averaged 0.003, 12.59, 2.95 and 0.004 per cent of GDP respectively during the study period. This indicates that Nigeria has substantially borrowed from the Paris Club compared to other bilateral and multilateral sources. As observed from the standard deviations, the observations for all the employment rate and IDA loans clustered around their respective mean values while the other variables do not. In addition, the probability values of the Jarque-Bera statistics for employment rate and Paris Club loans indicate that they are normally distributed at 5 per cent level. However, the other variables for the investigation were not normally distributed given that the probability values of their respective Jarque-Bera statistics are above 0.05.

4.2 Pairwise Correlation Coefficients

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As an integral aspect of the pre-estimation tests, the correlation between each pair of the explanatory variables was examined and the results are reported in Table 2.

Table 2: Summary of the correlation matrix

	HDI	POV	EMP	IFCL	IDA	PCL	ADB
HDI	1						
POV	0.248	1					
EMP	0.594	-0.175	1				
IFCL	-0.018	0.088	0.007	1			
IDA	-0.381	-0.0359	-0.513	-0.095	1		
PCL	-0.655	-0.1190	-0.450	0.081	0.578	1	
ADB	0.093	0.220	0.057	0.070	-0.323	-0.241	1

Source: Researcher's computation using E-views 10

As observed from Table 2, the correlation coefficients between a pair of the explanatory variables ranged from a minimum value of -0.323 to a maximum value 0.578. This implies that there is no evidence of perfect or near perfect correlation between each of the explanatory variables. In other words, the correlation coefficients between each pair of the explanatory variables do not pose any threat of multicollinearity. For this reason, the explanatory variables were regressed together in each of the models.

4.3 Unit Root Test

The ADF method of unit root test was applied in this study to determine if the variables are stationary or not and the order of integration of integration of each of the variables. The results of the tests are presented in Table 3.

Table 3: Unit root tests results based on ADF method

Variable	Levels test results		First difference test results		Order of integration
	t- statistic	5 % Critical value	t- statistic	5 % Critical value	
EMP	-1.531	-2.94	-6.029	-2.94	I(1)
IFCL	-0.911	-2.94	-7.511	-2.94	I(1)
IDA	-1.521	-2.94	-5.299	-2.94	I(1)
PCL	-1.442	-2.94	-4.837	-2.94	I(1)
ADB	-1.695	-2.94	-4.558	-2.94	I(1)

Developing Economy Journal
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ISSN (1573-1405);
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Source: Researcher's computation using E-views 10

The results of the ADF unit root test reported in Table 3 revealed that all the variables are not stationary at levels given that the computed t-statistics are less than the corresponding 5 per cent critical values. Thus, the null hypothesis of unit root cannot be rejected. The evidence of non-stationarity in the variables necessitated the differencing and they are found to be stationary at first difference. This implies that they attain stability by first differencing. In other words, all the variables are integrated of order one [I(1)], which is consistent with the findings of Sulaiman and Azeez (2012), Akram (2016) and Bamidele and Joseph (2013). With evidence of first difference stationarity in all the variables, the Johansen method was considered appropriate for the cointegration test to determine if the linear combination of the non-stationary variables will lead to long run relationship among them.

4.4 Cointegration Test Results

The cointegration test for the variables was conducted at 5 per cent level using the Johansen method. The results are presented in Table 4.

Table 4: Johansen cointegration test results

Series: EMP IFCL IDA ADB PCL				
Trace test results				
Hypothesized		Trace	0.05	
No. of CE(s)	Eigenvalue	Statistic	Critical Value	Prob.**
None *	0.821106	125.2200	69.81889	0.0000
At most 1 *	0.650733	66.70731	47.85613	0.0003
At most 2 *	0.437152	30.94210	29.79707	0.0368
At most 3	0.238598	11.40078	15.49471	0.1880
At most 4	0.060797	2.132601	3.841466	0.1442
Maximum Eigenvalue test results				
Hypothesized		Max-Eigen	0.05	
No. of CE(s)	Eigenvalue	Statistic	Critical Value	Prob.**
None *	0.821106	58.51268	33.87687	0.0000
At most 1 *	0.650733	35.76520	27.58434	0.0036
At most 2	0.437152	19.54133	21.13162	0.0822
At most 3	0.238598	9.268176	14.26460	0.2645
At most 4	0.060797	2.132601	3.841466	0.1442

Source: Researcher's computation using E-views 10

*** denotes rejection of the hypothesis at the 0.05 level**

In furtherance of the pre-estimation tests, cointegration test for the employment model was equally conducted at 5 per cent level. The trace test results revealed that three

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ISSN (1573-1405);
p –ISSN (0920-5691)
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cointegrating equations exist in the model. This indicates that at least three variables can adjust to the long run equilibrium position. In addition, the maximum eigenvalue test results showed evidence of two cointegrating equations in the model. In other words, at least two variables can adjust to the long run position. Overall, the results provide the empirical condition for rejecting the null hypothesis of no cointegrating, which implies that employment rate has long run relationship with the selected institutional loans. This finding is consistent with the results of Iwuoha (2020); Cahyadin & Ratwianingsih (2020) and Saad, & Ahmad (2020) among others.

4.5 Model Estimation

The evidence of cointegration in the model necessitated the choice of the ECM in accordance with the proposition of Engle and Granger (1987). The results are presented in Table 5.

Table 5: Parsimonious ECM

Dependent Variable: D(EMP)				
Method: Least Squares				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
D(EMP(-1))	0.530043	0.146926	3.607553	0.0020
D(IFCL)	-7.025750	12.54014	-0.560261	0.5822
D(IFCL(-1))	-32.93440	16.53065	-1.992323	0.0617
D(IDA)	1.470558	0.330388	4.451002	0.0003
D(IDA(-1))	0.638225	0.301427	2.117343	0.0484
D(IDA(-2))	0.679343	0.228284	2.975866	0.0081
D(PCL)	-0.069291	0.043344	-1.598627	0.1273
D(PCL(-2))	0.040285	0.043434	0.927498	0.3659
D(ADB)	-40.81066	33.02944	-1.235584	0.2325
D(ADB(-1))	102.5895	45.30291	2.264523	0.0361
ECM(-1)	-0.395678	0.134206	-2.948284	0.0086
C	-0.110837	0.265347	-0.417706	0.6811
R-squared	0.792822	Mean dependent var		0.005588
Adjusted R-squared	0.620174	S.D. dependent var		2.463873
S.E. of regression	1.518484	Akaike info criterion		3.978490
Sum squared resid	41.50430	Schwarz criterion		4.696777
Log likelihood	-51.63433	Hannan-Quinn criter.		4.223447
F-statistic	4.592133	Durbin-Watson stat		2.189351
Prob(F-statistic)	0.001420			

Source: Researcher's computation using E-views

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Vol.1, Issue:04;April-2022
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As observed from the results, employment rate lagged for one period has a significant positive effect its current value. This implies that employment generation in the previous period can relied upon in forecasting future changes in the employment rate. The findings further revealed that IDA loans impacted positively on employment rate. This is in tandem with the findings of Haiss & Steiner (2020) and Mensi *et.al.* (2020), but disagreed with the results of Eke & Akujuobi (2021). It further highlights the substantial role played by the World Bank Group in providing concessional loans and grants to boost economic growth and stimulate productive employment. It is also evident from the results that loans from the African Development Bank contributed positively to employment rate. This finding is very impressive as it corroborates with the results of Nyadera, Asal & Agwanda (2021). The implication of this finding is that funding available to the government and private sector from the Bank promotes the process of employment generation in Nigeria. On the contrary, International Finance Corporation and Paris Club do not have any significant effect on employment rate. This finding could be attributed to the challenges that undermine the effectiveness of foreign institutional loans which cut across systemic corruption, poor institution and governance, high debt servicing obligations among others

Table 6: Post-estimation diagnostics test results

Test type	Test statistic	Probability	Decision
Breusch-Godfrey Serial Correlation LM Test H_0: No serial correlation in the residuals	1.197	0.5496	Accept H_0
Normality Test H_0: Residuals are normally distributed	2.687	0.2609	Accept H_0
White's Heteroscedasticity Test H_0: No heteroscedasticity in the residuals	15.769	0.7405	Accept H_0
Ramsey RESET Test H_0: No misspecification in the model	0.417	0.6663	Accept H_0

Source: Researcher's computation using E-views

The outcomes of the post-estimation tests showed that the residuals are serially independent and normally distributed at 5 per cent level. This is based on the fact the associated probability values of the Breusch-Godfrey serial correlation LM test and normality test results are greater than 0.05. Accordingly, the null hypotheses of no serial correlation and normal distribution of the residuals were accepted. The results further showed that residuals are homoscedastic given that probability value of the White's heteroscedasticity test result is above 0.05. Thus, the null hypothesis of no evidence of heteroscedasticity in the residuals is accepted. In addition, the outcome of the Ramsey test indicates that there is no misspecification in the model. It, therefore, follows from the post-estimation test results that the employment model is very reliable for policy formulation and forecast.

5. CONCLUDING AND RECOMMENDATIONS

This study offered some insights into the empirical relationship between International Financial Institution loans and economic development in Nigeria. This followed the growing recognition of the importance of the international financial institutions loans in unlocking private investment and creating opportunities for long term growth and employment generation. Loans from the Work Bank Group, especially IFC and IDA in addition to loans from the Paris Club and African Development Bank were used as proxies for International Financial Institution loans. On the other hand, employment rate served as the proxy for economic development. The findings revealed that IDA loans contributed meaningful to promoting employment generation in Nigeria. However, contrary to expectations, Paris Club loans do not have any significant contribution to employment generation. Based on the findings, it is concluded that loans from the IDA are important for creating employment opportunities in Nigeria. Thus, it is recommended that loans available to Nigeria from the international development association should be channeled to investments in critical infrastructure and agriculture development to increase production of goods and services and by extension generate employment and achieve economic development.

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