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## DOMESTIC PUBLIC DEBT AND PUBLIC EXPENDITURE IN NIGERIA: ANY POSITIVE CORRELATION ON ECONOMIC GROWTH (1980 – 2016)

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### **Abstract**

*The study investigated the relationship between domestic public debts, capital expenditure and recurrent expenditure on economic growth in Nigeria using data spanning (1980 – 2016). Secondary data were collected from the CBN statistical bulletin and National Bureau of Statistics. Recurrent Expenditure (RECUX) and Capital Expenditure (CAPEX) were used as proxies for Public Expenditure and Gross Domestic Product (GDP) represents Economic Growth. The study made use of ordinary least square of multiple regressions. The adopted Augmented Dickey – Fuller (ADF) unit root test shows that, at level, non of the variables was achieved at first difference. The Johansen co-integration test results shows evidence of long run relationship of the variables. The study reveals that domestic public debt and recurrent expenditure have negative and insignificant effect on economic growth in Nigeria, while capital expenditure has a positive and significant effect on economic growth in Nigeria. The study recommends that government should only obtain public loans whose interest rates are very low in order to reverse the devastating effect of domestic public borrowing in its economy especially in the long run. Government should commit more of its funds to capital projects especially infrastructural development in order to boost its economic growth among others.*

Keywords: Domestic Debt, Capital Expenditure, Public Expenditure , Recurrent Expenditure, Economic Growth.

### **1. INTRODUCTION**

All over the world, countries incur debts, either from the international community or internally. This is necessary in order to boost domestic investment and hence accelerate economic growth and development. Anyanwu and Erhijakpor (2004),

Borrowing does not negate any economic principle, so far its expenditure are channeled into regenerative investments that will guarantee and facilitate the repayment structure, debt liquidation and value addition in terms of supporting the standard of living of the citizens, Ogwuma, Ikenna and Odili (2015).

Domestic public debts are usually contracted through debt instruments such as Treasury Bills, Bonds, Treasury Certificates, Federal Development Stocks and Ways and Means Advances, provided by the Central Bank of Nigeria, Nzotta, (2004).

When public debt is owed to individuals, organizations and institutions within the country, with the view of providing public goods, through public expenditure, such debts are referred to as domestic debts, Nnamocha, (2002).

Government spending cuts across all sectors of the economy. Government expenditure involves expenditure on education, defense, health, water supply, electricity, roads, telecommunication, General administration among others.

As opined by Adenikinju (2005), public infrastructural provision has been a key drive for government borrowing and spending, as its investment would accelerate the economic growth and development of the country.

Public expenditure as stated by Lacy (1989) and reiterated by Agbonkhese and Asekome (2014) are mainly grouped into recurrent and capital expenditure. Recurrent expenditure of the government involves expenditure on government purchase of current goods and services (labour, consumables, wages and salaries etc) while the capital expenditure of the government captures expenditure on roads, Schools, Hospitals, Rails maintenance, Sea ports, Airports and other capital intensive expenditure of the government.

Appropriate use of debts could lead to improved socio-economic growth and thus better standards of living. In other to make debt effective, there is need for far reaching reforms in the management of the public sector. Babu, Kiprop, Kalio and Gisove (2015),

However in most cases, resources from debt have not been used as effectively, for instance, projects financed by international loans have due to lack of adequate or realistic planning, failed to generate sufficient resources to service the debt borrowed. Therefore, socio-economic development is compromised since the government spends huge sums on loan repayments, hence reducing money it spends on education, health other social amenities, which mainly target the poor, who comprise the majority of the population. KENDREN (2009).

This in effect will induce more of the government expenditure to be channeled into domestic and to some extent foreign loan services than providing the needed and appealing infrastructure deficit in Nigeria.

## **1.2 Statement of the Problem**

Nigeria as a developing country is being exposed to rigor of all forms of economic fluctuations, distortions, which have affected her economic stability. These anomalies in the country's economic system affect negatively on the savings of the households, government, corporate organizations and also discourage investment and reduce government revenues.

Given the attendant pressure on the side of the government in accelerating the provision of social and infrastructural amenities such as roads, power, communication, education, health and to ensure internal and external guarantee of security in country. Nigeria, in recent time has periodically embarked on domestic public borrowing, in order to increase the provision of the needed amenities for her citizens. Despite all these borrowings and huge expenditure as published in national dailies in the country, the standard of living of the larger population of the country is still being rated below average.

Also, Nigeria had had huge receipt from production and sales of crude oil before now. It has been a public notion that, given continuous rising expenditure of the government, the Nigerian economy is yet to have a meaningful economic growth and development; this is typical where per capital income of the larger citizens continue to be less than US 1 per day.

### **1.3 Objective of the Study**

The broad objective of this study is to examine domestic public debt and public expenditure and its positive correlation on economic growth of Nigerian from 1980 – 2016.

Specific objective are to:

- (i) To examine the effect of domestic public debt on economic growth of Nigeria.
- (ii) To examine the effect of public expenditure on economic growth.
- (iii) To ascertain a causal relationship between domestic public debt, public expenditure and economic growth of Nigeria.
- (iv) To investigate a long – run and significant relationship between domestic public debt, public expenditure and economic growth of Nigeria.

## **2.0 REVIEW OF RELATED LITERATURE**

### **2.1 SYNOPSIS OF NIGERIA'S DOMESTIC PUBLIC DEBT AND PUBLIC EXPENDITURE**

#### **2.1.1 DOMESTIC PUBLIC DEBT**

Domestic debt in Nigeria had its origin in 1946 when the first National Development Stock valued at ₦600,000 was floated by the colonial government. The first Treasury Bill of ₦8 million and Treasury certificate valued at ₦20 million were issued in 1960 and 1968 respectively. Nzotta (2004).

Since then, the volume of government domestic debt has risen from ₦1,040 million in 1970 up to ₦ 343.674 billion in 1996. The domestic debt outstanding as at December 31<sup>st</sup> 2004 amounted to ₦ 1,370.82 billion compared ₦ 1,329.72 billion as at December 31<sup>st</sup> 2003. This figure represents an increase of ₦ 40.63 billion or 3.1 percent over the previous year's figure. The increase of ₦ 40.63 billion in the domestic debt stock was made up of new issues of Treasury Bills valued at ₦ 46.52 billion, which was partly offset by repayment of Treasury Bonds and FGN Development stocks valued ₦ 5.6 billion and ₦ 0.22 billion respectively. Debt management office – DMO (2004).

A cursory look at the 2015 federal government of Nigeria domestic public debt stock as at end of December 2015 stood at ₦ 8,837.0 billion representing an increase of 11.8 percent over the level in 2014. The development reflected the substantial increase in FGN Bonds to bridge the FGN financing gap and facilitate the domestic bond market operations. CBN Annual Report (2015).

The holding structure of the outstanding domestic debts stock changed in favour of the non-bank public, which increased by 26.6 percent above the level in 2014 to ₦ 4,573.5 billion, (51.1% of the total). At ₦ 4,323.5 billion (48.9% of the total). The share of the banking system declined by 0.4 per cent relative to the level in 2014. A disaggregate of the banking system holding indicated that ₦ 3,284.0 billion, or 76. 0 per cent was held by the bank and discount house (DH) while ₦

1,039.5 billion or 24.0 per cent, was held by the CBN and the sinking fund. CBN Annual Report (2015).

Analysis of the maturity structure of domestic debt showed that instrument of 5 – 10 years accounted for ₦ 3,276.0 billion or 37.1 per cent, followed by instrument with tenors of one (1) year or less, which amounted to ₦ 2,772.9 billion or 31.4 per cent tenor 3-5 years were ₦ 2,532.2 billion or 28.7 per cent and tenor of over ten (10) years valued at ₦ 256.0 billion or 2.8 per cent CBN Annual Report, (2015).

After Nigeria's exit from Paris and London club of creditors in 2006, Nigeria's external debt was about \$3 billion and with a domestic debt of about ₦1 trillion. As at June 30, 2017, Nigeria's Domestic Debt had risen to ₦14 Trn about (\$45 Billion) (National Bureau of Statistics, 2017).

Furthermore, the NBS (2017) report also indicated that while Debt Management Office (DMO) had borrowed ₦7.5 Trillion (or 68.5% of total debts) from the domestic market on behalf of the Federal Government to fund FGN fiscal deficit, the Central Bank of Nigeria (CBN) had in turn borrowed ₦3.2 Trillion or 29.64% of total domestic debt by offering to pay juicy interest rates on the Treasury Bills it sells to remove perceived excess money supply from the financial system and thereby breach the smoldering inflationary embers with its devastating consequences on masses' welfare.

#### **2.1.1.1 DOMESTIC PUBLIC DEBT MANAGEMENT**

The management of the domestic debt stock of the country introduces some complexities which are quite revealing. As noted by Anao and Alile (1986), an efficient debt management policy requires that the borrower (government) accepts borrowing terms which give it a measure of flexibility that could enable it to redeem existing obligations and refinance at cheaper rates, whenever the loans market becomes more favourable. Thus, the issue of debt instruments and the refinancing at relatively cheap costs have become the central focus of domestic debt management.

#### **2.1.1.2 ELEMENTS OF AN EFFECTIVE DOMESTIC DEBT MANAGEMENT**

To a large extent, there is a compelling need for an effective domestic debt management strategy in Nigeria. Odozi (1994) articulated a comprehensive framework and strategy for an effective domestic debt in Nigeria as:

- i. Evolve a less inflationary method of financing fiscal deficits. This recognizes the fact that the financing of fiscal deficits results in a domestic debt structure which is dominated by the CBN and the banks and this has inflationary implications.
- ii. Achievement of fiscal viability involving concerted revenue mobilization efforts and enhanced expenditure efficiency, budgetary control and fiscal discipline.
- iii. Evolve constitutional borrowing limit for the Federal and State Governments. The public sector (Federal, State and Local Governments) should be compelled to borrow from capital market to finance most of their capital projects, especially with the presence of borrowing limits.
- iv. Evolve a comprehensive and reliable data for domestic debt which would provide such details as types, ownership, maturity, distribution and size of debt.

- v. Evolve and sustain market-based approach for managing the domestic debt problem. This demands sustaining a realistic interest rate regime that would make open market operations very viable and increase investors interest in holding securitized debts.
- vi. Evolve optimal domestic debt strategy, which would include reduction of debt service burden, minimizing allocative inefficiencies and achieving macro-economic stability.

### **2.1.2 PUBLIC EXPENDITURE**

Government expenditure includes all expenditure on goods and services, transfers and capital expenditure by the Nigerian government. However, it excludes inter governmental transfers. This limits government expenditure then to government expenditure on goods and services and transfer to the non-government sector of the economy. It is the totality of the final sector expenditure for whatever purposes.

The size, structure and growth of government expenditure have increased tremendously and become increasingly complex. Not only has recent political developments engendered expenditure growth, the challenge of raising additional and identifying alternative sources of revenue to meet the ever increasing needs of governance have made it more imperative to take a more focused look at government activities, especially its expenditure, Agbonkese and Asikome, (2014).

The importance of the need for investment in infrastructure and other public goods as a way of increasing urban and rural productivity and national economic growth and development has become an important subject of renewed attention in almost less developing countries, Edame, (2014).

Public Expenditure are grouped into capital and recurrent expenditure, Modebe, Regina, Onwumere and Imo (2012).

Capital expenditure captures expenditure of government on the provision of capital goods and services such as railways, roads, dams, airports and other capital intensive projects, while recurrent expenditures are expenditures incurred on wages and salaries of public workers, general administration of the state and to a greater extent, expenses on the provision of internal security.

Musgrave (2004) asserts that, given low per capita income of developing countries, this will translate to low demand for public service as funds and other income will be used for primary needs such as food, shelter, clothing, etc.

### **2.1.3 EMPIRICAL REVIEW**

Obademi (2012), examined the impact of public debt on economic growth using Nigeria as a case study. An analysis of long-run relationship and impact of debt from the perspective of the value impact and proportional impact was done. An augmented Cobb Douglas Model was used. A dynamic version of the functional relationship was estimated using cointegration technique to capture the long-run impact of the debt variables on economic growth. The result showed that the joint impact of debt on economic growth is negative and quite significant in the long-run, though, in the short run the impact of borrowed funds and coefficient of budget deficit is positive.

Godfrey and Cyrus (2013) investigated the effect of domestic debt on economic growth in Kenya. They made use of advanced economic technique and quarterly time series data spanning 2000 to 2010. Jacque Bera (JB) and Augmented Dicky-Fuller (ADF) were used to investigate the properties of macroeconomic time series in the aspect of normality and unit root respectively.

Their result showed that domestic debt expansion in Kenya within the period under study has a positive and significant effect on economic growth.

Babu, Kiprop, Kalio and Gisore (2015) explored the effect of domestic debt, as a share of Gross Domestic Product (GDP) on economic growth in the East African Community (EAC) over the period of 1990 – 2010. The study was based on Solow Growth Model. Levin-Lin Chu Test and Hausman specification test with the result that shows that domestic debt has a positive significant effect on per capita GDP growth rate in the EAC.

Saifuddin (2016) examined how public debt in Bangladesh may influence its growth between 1974 – 2014. The study was carried out with the aid of investment and growth model, Augmented Dick-Fulher test, a TSLS regression, with the result that public debt is positively related investment and economic growth.

Aregbeyen (2007) investigated the impact of public expenditure on economic growth. The study concluded that a positive and significant relationship exists between capital expenditure and economic growth but a negative relationship between recurrent expenditure and economic growth.

Loto (2011) studied the effects of government expenditure on security, health, education, transport, communication and agriculture on the economy using error correction test. He opined that expenditure on agriculture negatively impacts on the economy. Education was both negative and non-significant to the economy.

Musgrave (2004) asserts that, given low per capita income of developing countries, this will translate to low demand for public services as funds and other income will be used for primary needs such as food, shelter, clothing, etc.

### **3.0 METHODOLOGY**

In this study, an analysis of long-run correlation of domestic public debt, public expenditure and its impact on economic growth was carried out with a view to establishing the real effect of the variables under study. The study made use of secondary time series data extracted from various issues of the Central Bank of Nigeria (CBN) Debt Management Office (DMO) and National Bureau of Statistics (NBS) from 1980 – 2016. The estimation technique include: Augmented Dicky-Fuller (ADF) Unit Root Test, Johansen Cointegration Test and Granger Causality Test.

#### **3.1 DESCRIPTION OF RESEARCH VARIABLES**

The variables used for this analysis are classified into two groups, dependent and independent variables.

##### **3.1.1 Dependent Variable**

Economic growth made up of the variable for this study. The variable here is proxied as Gross Domestic Product (GDP). The GDP explains in monetary terms the value of all products and services within a country, during a particular year period.

##### **3.1.2 Independent Variables**

Public expenditure, (proxied by recurrent expenditure and capital expenditure) and domestic debt constituting independent variables used for this research.

### **3.2 MODEL SPECIFICATION**

The purpose of the study is to examine if there is any positive correlation of domestic public debt and public expenditure on economic growth of Nigeria using multiple regression model spanning from 1980 – 2016. Considering the functional notations of this work, to capture the effect of

domestic public debt and public expenditure on the economic growth of Nigeria were specified and modeled as follows:

$$GDP = f(\text{Domed}, \text{Capex}, \text{Recux}, \dots) \dots \dots \dots (1)$$

$$GDP = \beta_0 + \beta_1 \text{Domed} + \beta_2 \text{Capex} + \beta_3 \text{Recux} + \mu \dots \dots \dots (2)$$

Where:

GDP = Gross Domestic Product (Proxy for Economic Growth)

Domed = Domestic Debt

Capex = Capital Expenditure

Recux = Recurrent Expenditure

$\beta_1$ ,  $\beta_2$ , and  $\beta_3$  are the slope coefficient of Domed, Capex, and Recux respectively and are parameters of the explanatory variables.

#### 4.0 DATA PRESENTATION AND ANALYSYS

##### 4.1 Data Analysis

**Table 4.1: Unit Root Test Result**

ADF Unit Root test

Variables	ADF Level	ADF 1 <sup>st</sup> Difference	0.05 Critical Value Level	0.05 Critical Value 1 <sup>st</sup> Difference	Order of Integration
D(LOGRGDP)	0.258995	-3.076209	-2.948404	-2.948404	I(1)
D(LOGDPD)	-1.695472	-5.746963	-2.945842	-2.948404	I(1)
D(LOGCAPEX)	-1.219901	-5.892479	-2.945842	-2.948404	I(1)
D(LOGRECEX)	-1.271692	-7.966932	-2.948404	-2.948404	I(1)

**Source: Author’s computation using E-views 9.0 software**

This study adopted the augmented Dickey-Fully (ADF) unit root test. From the result in table 4.1, it is evident that at level, none of the variables was stationary as their ADF values were less than the critical values at five percent level of significance. The ADF values for RGDP (0.258995), DPD (1.695472), CAPEX (1.219901) and RECEX (1.271692) in absolute terms were less than their critical values (2.948404), (2.945842), (2.945842) and (2.948404) respectively. Based on this outcome, there was a need to difference the non-stationary time series one more time to see whether we will obtain overall stationarity. At first difference, all the variables became stationary as their ADF values 3.076209, 5.746963, 5.892479 and 7.966932 became greater than their critical value 2.948404 in absolute term. Because all the variables were integrated of the same order (i.e. I(1)), cointegration analysis was justified.

**Table 4.2: Cointegration Test Result**

Hypothesized No. of CE(s)	Trace Statistic	0.05 Critical Value	Max-Eigen Statistic	0.05 Critical Value
None	48.87997*	47.85613	31.74210**	27.58434
At Most 1	17.13787	29.79707	9.779282	21.13162
At Most 2	7.358592	15.49471	4.797591	14.26460
At Most 3	2.561001	3.841466	2.561001	3.841466

Trace Statistic indicates 1 cointegrating equation at 5% level of significance

Max-Eigen statistic indicates 1 cointegrating equation at 5% level of significance

\*(\*\*) indicate significance

***Source: Author's computation using E-views 9.0 software***

The study adopted Johansen cointegration test which relies two test statistics in determining the existence or otherwise of long run equilibrium relationship namely the Trace statistic and Max-Eigen statistic. Based on the Johansen cointegration test result in table 4.2, the Trace statistic indicates that there exists one cointegrating equation at five percent level of significance. From the result, the Trace statistic (48.87997) exceeds the critical value (47.85613). This is an indication that the variables of the model are related in the long run and as such suitable for carrying out regression analysis. More so, when we apply the cointegration test based on Max-Eigen statistic, the result indicates the existence of one cointegrating equation at five percent level of significance. From the result, the Max-Eigen statistic (31.74210) also exceeds the critical values (27.58434) at five percent level of significance. This is also an indication that there is existence of long run relationship among the variables of model.



Table 4.3: Parsimonious Result

Dependent Variable: D(LOGRGDP)

Method: Least Squares

Date: 12/08/17 Time: 08:15

Sample (adjusted): 1983 2016

Included observations: 34 after adjustments

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.021081	0.003819	5.520094	0.0000
D(LOGDPD)	-0.007189	0.005725	-1.255661	0.2193
D(LOGCAPEX(-2))	0.024267	0.011596	2.092705	0.0404
D(LOGRECEX(-1))	-0.012820	0.027164	-0.471948	0.6405
ECM(-1)	-0.163216	0.061562	-2.651237	0.0129
R-squared	0.672563	Mean dependent var	0.019306	
Adjusted R-squared	0.572227	S.D. dependent var	0.018383	
S.E. of regression	0.016725	Akaike info criterion	-5.208797	
Sum squared resid	0.008112	Schwarz criterion	-4.984332	
Log likelihood	93.54954	Hannan-Quinn criter.	-5.132248	
F-statistic	4.716499	Durbin-Watson stat	1.809214	
Prob(F-statistic)	0.039071			

**Source: Author's computation using E-views 9.0**

From the result, one percent increase domestic public debt leads to 0.01percent decrease in real gross domestic product (proxy for economic growth) in Nigeria. The probability value of domestic public debt (0.2193) is greater than the test significant level (i.e.  $P > 0.05$ ). Thus, we conclude that domestic public debt does not have significant impact on economic growth in Nigeria especially in the long run. This finding corroborates (Anyanwu and Erhijakpor, 2004) which argued that domestic public debt undermines economic growth in Nigeria. Perhaps, this outcome can be attributed to the fact that domestic public debt often comes with high interest rates which crowds-out private investment and erodes whatever gains that would have been through such borrowing.

Second, the study reveals that there exists a positive relationship between lagged two-year capital expenditure and economic growth (proxied by real GDP) in Nigeria. From the result, one percent increase in capital expenditure leads to 0.02 percent increase in real gross domestic product (proxy for economic growth) in Nigeria. The probability value of capital expenditure (0.0404) is less than the test significant level (i.e.  $P < 0.05$ ) and with this we conclude that capital

expenditure has significant effect on economic growth in Nigeria especially in the short run. This finding corroborates Fajingbesi and Odusola (1999) which argued that there was a positive and significant effect of capital expenditure on economic growth in Nigeria. Perhaps, this finding can be attributed to the fact that infrastructural development, which is what capital expenditure is used for, activates economic activities in all the sectors of the economy thereby increasing productivity.

Third, the study reveals that there exists a negative relationship between lagged one-year recurrent expenditure and economic growth (proxied by real GDP) in Nigeria. From the result, one percent increase in lagged one year recurrent expenditure leads to 0.01 percent increase in real gross domestic product (proxy for economic growth) in Nigeria. The probability value of recurrent expenditure (0.6405) is greater than the test significant level (i.e.  $P < 0.05$ ). Thus, we conclude that recurrent expenditure does not have significant effect on economic growth in Nigeria. This finding corroborates Nwankwo, Kalu and Chiekezie (2017) which argued that lagged two-year recurrent expenditure has negative and insignificant effect on economic growth in Nigeria. This finding can be attributed to non-yielding nature of recurrent expenditure which makes it to undermine economic growth rather than spur it.

Importantly, the coefficient of the error correction term carries the correct sign and it is statistically significant at five percent level of significance with the speed of convergence to equilibrium of 16 percent. This implies that in the short run, economic growth adjust by 16 percent of the past year's deviation from equilibrium. This is essential for maintaining long run equilibrium to reduce the existing disequilibrium over time. Thus, distortions in Nigeria's economic growth can be corrected by domestic public debt, capital expenditure and recurrent expenditure at the speed of 16 percent. This represents a very slow speed of adjustment.

The coefficient of determination (adjusted R-squared) of 0.67 shows that 67 percent of the variations in economic growth in Nigeria are due to changes in domestic public debt, capital expenditure and recurrent expenditure. The probability F-statistic (0.039071) is less the test significant level (0.05) and this indicates that the model used in the study is appropriate, reliable and significant and can be used for sound policymaking. The Durbin-Watson statistic (1.81) lies within the acceptance region and suggests that there is no presence of autocorrelation.

### **5.1 Conclusion**

The study investigated the relationship between domestic public debt, capital expenditure and recurrent expenditure on economic growth in Nigeria. Specifically, the study investigated the effect of domestic public debt, capital expenditure and recurrent expenditure on real gross domestic product in Nigeria. Thus, domestic public debt incurred by government, capital expenditure and recurrent expenditure served as the independent variable while real gross domestic product served as the dependent variable. From the empirical evidence, the study revealed that domestic public debt and recurrent expenditure have negative and insignificant effect on economic growth in Nigeria. However, the study revealed that capital expenditure has a positive and significant effect on economic growth in Nigeria. In conclusion, the study argued that economic growth in Nigeria responds positively to government capital expenditure but responds negatively to both domestic public debt and government recurrent expenditure.

### **5.2 Recommendations**

The following recommendations are made in line with the findings of the study:

- (i) Government should only obtain public loans whose interest rate are very low in order to reverse the devastating effect of domestic public borrowing on its economy especially in the long run.
- (ii) Government should commit more of its funds to capital projects especially infrastructural development in order to boost its economic growth.
- (iii) Government should fashion out ways of trimming down its recurrent spending in order to reverse its negative consequences on the economy especially in the short run.

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