

Chapter 3

Autoregressive Distributed Lag Approach to External Credit and Economic Growth in Nigeria

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ABSTRACT

The need for increasing external credit flows to boost economic activity has exposed Nigeria to the negative effects of external structural changes. Therefore, an important question of concern in this study is, how does the Nigerian economy grow when there is a decline in external credit? This study attempted to answer this question by comparing the flow of external credit to economic activities. This is a distinction from previous studies that had compared stock of external credit to economic activities. Using annual data covering 36 years for the period 1980-2016, the study adopted the neoclassical growth model and estimated the model using the Autoregressive Distributed Lag (ARDL) approach. The study argued that, to the extent that expenditure is credit financed, GDP should be a function of credit flow, which is new borrowing.

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INTRODUCTION

The deep domestic economic crises that have ravaged the African economies since the early 1970s created considerable challenges for policymakers and economists. At each turn of events, efforts are being made to design and implement appropriate policy responses to these economic disequilibria. For instance, in the 1970s, the Nigerian economy expanded as a result of an increase in revenue of crude oil, and between 1981 and 1985, at the wake of the falling oil income, the economy declined, giving way to a rapid deterioration of Nigerians' standard of living. The subsequent periods were not too different as the economic implications of the preceding period dragged into the following periods. The various macroeconomic indicators point to the grave economic situations. Particularly, there were sharp fluctuations in the economic activities, chronic fiscal deficit, remarkable fluctuations in the inflation rate, high unemployment rate, consistent growing in size and composition of government spending, and slow growth of the domestic output.

Likewise, given that domestic savings in Nigeria is inadequate to address savings-investment gap, in order to bring about the needed investment for required steady growth, there is the need for increasing external credit flows to boost economic activity, while a decline of it may adversely impact the economic activity. An important question of concern in this study is the following: how does the economy grow when there is adverse external credit shock? This study attempted to answer this question by comparing the different flows of external credit to economic activities in Nigeria. This is a distinction from previous studies that compared stock of external credit to economic activities (see Ogun & Akinlo, 2010; Oluitan, 2012; Emecheta & Ibe, 2014; Fapetu & Obalade, 2015). The study argued that, to the extent that expenditure is credit financed, GDP should be a function of credit flow. The implication is that economic growth should be related to changes in the flow of credit rather than stock of credit. This is not to invalidate the argument that stock of credit is important for output because it determines the level of potential growth in an economy. However, focusing on credit stock misses the developments in the credit flow, which is more useful for understanding the business cycle.

In addition, credit growth in emerging economies is often associated with financial deepening, which is beneficial to long-term economic growth, but it is also related to boom-bust circles and financial crises (Kalema, 2013). As a result, the recent and rapid increase in credit growth witnessed in the last decade in Nigeria is easily traceable to some of the following factors: financial deepening, macroeconomic stability, real income gains, increase in capital inflows, developed monetary policy instruments, and economic growth. These factors explain the strong expansion of credit in Nigeria. While part of this credit expansion is traceable to the process of credit boom in the economy, the resulting evidence can be seen in the vulnerabilities

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