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Management of Federal Government Fiscal Deficit as a correlate to Internal Debt and Managing Domestic Debts in Nigeria: An Empirical Evidence

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Abstract
The chief aim of the study is to examine the Management of Federal Government Fiscal Deficit as a correlate to Internal Debt and Managing Domestic Debts in Nigeria. A model was formulated. The co-integration technique was used for the empirical analysis. The technique is made up of Ordinary Least Square (OLS) regression, and the Unit Root Test (URT). The results of the study confirmed that budget deficit is the main determinant of domestic debt in Nigeria, that inflation rate has a divergent significant impact on domestic debt in Nigeria, that government consumption spending has only a long run impact on domestic debt in Nigeria, that interest rate on government debt instruments has a long run and not a short run effect on domestic debt accumulation in Nigeria. It is therefore recommended that government must endeavour to implement the fiscal responsibility Act of limiting the level or domestic debt to 3 percent of GDP, as this action, it is hoped will serve to discipline the government in carrying out its fiscal responsibility. In addition, current effort at mobilizing resources through the capital market by issuing bonds should be intensified so that government can achieve the twin objectives of financing her programmes while at the same time helping to achieve sustainable level of domestic debt. Besides, the time perspective of government spending and interest rate on debt instruments should be a stronger factor in the negotiation of domestic debt in Nigeria. There is also the need to obtain loans that are channelled in such a way as to increase the productive capacity of the economy, in order to enhance easy repayment and promote economic development.

Keywords: Fiscal Deficit, Internal Debt, Domestic Debt Management, Federal Government Finance, Nigeria

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1.0 Introduction

Government like business firms do experience shortfall in revenue expectation in a given period. When actual revenue performance falls short of the projected revenue, it becomes necessary to borrow internally or externally or both inorder to finance projects of economic and social importance. These projects fall under the expenditures of the government within a given period. In theory, borrowing can serve as a handmaiden of economic growth and development. In practical terms, borrowing becomes questionable, when there is no visible evidence to justify itsessence. A developing nation such as Nigeria that has ambitious development programme will tend to confront asituation in which domestic private investment is greater than domestic private savings, and government expenditures exceed government revenue. The Nigerian economy over the years has been characterized by poor infrastructures, poor power supply, poor investment and high-level endemic corruption. There is a need for government to borrow tofast track the needed economic growth and development. In broad terms, all kinds of obligations of government areincluded in the public debt. Such obligations include short-term funded debts, and floating debts, Others include debts owed contractors. These debts could be external or internal, gross or net, marketable or non-marketable, short-term,medium term, or long term interest bearing or non-interest bearing, and project or jumbo loan.

A major problem of macro-economic management in most developing nations including Nigeria has been the persistence of debt overhang. The debt overhang episode was not sudden but had evolved through yeas of inefficientdebt management coupled with fraudulent practices. The inefficient debt resource mobilization loomed large amongstthe causative factors resulting to debt crisis that has raged in the developing nations in general and Nigeria in particular. Despite the debt management strategies put in place by Nigerian authority, since 1983, to deal with the debt problemthe Nigerian economy has been bedevilled with strains and stress arising largely from debt-burden and debt overhang. Before now concern for the overwhelming foreign debts profile over-shadowed the attention needed for domestic debt management. However, in 2006, concerned efforts made by Obasanjo's domestic regime paid of. This led to Nigeria exit from the External Clubs of creditors (Paris and London Club). After this exit, emphasis shifted to the management of the huge domestic debt has the domestic debt. It is obvious that Nigerian government had accumulated a substantlevel of domestic debt over the years due to the poor domestic debt management approaches. It must be of note that a substantial level of domestic debt has the potential for destabilizing economic management. Borrowed funds become problematic where they had not been productively utilized. The resultant debt crisis led toanumberof macroeconomic problems which include economic and monetary instability, and high inflation. There is a potential risk that domestic debt burden may rise to a level well beyond the ability of the government: this will undermine credit worthiness, and adversely affect the financial sector ofthe economy.

1.1 Statement of the Problem

A critical review of the domestic debt profile in Nigeria showed that government at all levels borrowed internally tofinance budget deficits. Not only that, they also owed contractors huge arrears which are yet to be settled. The contractors borrowed funds from the retail banks to execute various government projects. And the borrowed funds attract interest. Unfortunately, the debt owed contractors by the government is not securitized. While the interest continues to mount coupled with the rise in inflation, the value of the funds of the contractor is systematically eroded. The inability of the Federal Government to manage domestic debt effectively is apparently killing the financial sectorand entrepreneurship. Despite the numerous strategies adopted so far, over the years by the Federal Government of Nigeria, its domestic debt profile still remains unacceptably high to the tune of NI,753,259,000,000 - One

trillion, seven hundred and fifty-three billion and two hundred and fifty-nine million naira in 2006, (CBN Annual report and Statement of Account, 2006). However, as at 2010 it rose geometrically to N4,5S 182000,000 and further to N5,655, 840,000,000 (Five trillion, six hundred and twenty-two billion, eight hundred and forty million) in 2011, andfurther to N6,537,536,305,000 in 2012 (DMO Report, 2012). So far, the various strategies adopted by the Federal Government for domestic debt management appeared sub-optimal. The above realization inspired the need for thestudy. Specifically, this study seeks to answer the following research questions:

(i) Does interest rate has effect on domestic debt management?
(ii) Does budget deficit has impact on domestic debt management?
(iii) Does inflation have any relationship with domestic debt?

1.2 Aims and Objectives of the Study

The aim of the study is to examine the Management of Federal Government Fiscal Deficit as a correlate to Internal Debt and Managing Domestic Debts in Nigeria.

The specific objectives are to:
(i) Determine ifinterest rate has effect on domestic debt management.
(ii) Determine ifbudget deficit has impact on domestic debt management.
(iii) Determine inflation have any relationship with domestic debt.

1.3 Hypotheses

The following hypotheses were tested in the course of the study.

(i) There is no significant relationship between real Interest rate and domestic debt in Nigeria.
(ii) There is no significant relationship between budget deficit and domestic debt in Nigeria.
(iii) There is no significant relationship between inflation rate and domestic debt in Nigeria.

1.4 Justification of the Study

The study is significant because it will assist Federal Government of Nigeria and other nations having similar problemsto effectively and efficiently manage the avalanche domestic debt.

2.0 Review of Related Literature

2.1 Concept of Domestic Debt

Oshadami (2006) defined domestic government debt as debt instruments issued by the Federal Government and dominated in local currency. In principle state and Local governments can also issue debt instruments, but limited in their ability to issue such. Debt instruments consist of treasury certificates, federal government development stocks, and treasury bonds. Out of these, treasury bills, treasury certificates and development stocks are marketable and negotiable while treasury bonds, ways and means advantages are not marketable but held solely by the Central Bank of Nigeria (Odozi, 1996). The Central Bank of Nigeria (CBN) as banker and financial adviser to the Federal Government was charged with the responsibility for managing the domestic public debt before the creation of Debt Management Office which now handles such function.

2.1.1 The Concept of Domestic Debt Management

Domestic debt management involves advising the federal government as to the timing and size of new debt Instruments, advertising for public subscription to new issues, collecting proceeds of issues for and on behalf of Federal Government, payment of interest, redeeming matured stocks and sensitizing the government on the implication n of the size of debts and budget deficit, (CBN Brief, 1988). According to Obadan (2001), debt management refers to those government initiatives aimed at influencing the size and structure of nation's debt or the conditions (terms) under which borrowing take place whether the debt is changing or not. In the case of management of Nigeria'sdomestic debt, for example, it involves three elements, One, is the acquisition of the debt through the Central Bank'sadvice as to the timing of floatation of debt instrument and terms ofthe issue. Two, is the re-structuring of domestic debtentailing the Central Bank accommodation of government's financial short-falls through the provision of overdraftfacilities and conversion ofsuch facilities into short-term debt instruments.

2.2 Components and Structure of Nigeria's Domestic Debt

According to DMO (2012) the components of Nigerian Domestic Debt include mainly Treasury bills, treasury bonds,development stock, treasury certificates, promissory notes and bonds. Public domestic debt usually mean debtinstruments issued by the central government. However, in companies with relatively developed financial sectors, there can be private sector domestic debt as companies can use bonds or loan to finance or to fund their activities. Nigeria Treasury bills is made up of 91,182 and 365 days range. **FGN Bonds** (2-years, 3-years, 5-years, 7-years and 10 yearsrange)

2.2.1 Nigeria's Domestic Debt Profile

In retrospect, in the early 60's to exactly 1988. the total federal government domestic debt summed up to N47,031,000,000 (forty-seven billion and thirty-one million naira). The debt instruments that dominated this periodwere development stock, treasury bills, treasury certificate. In 1989, the first Treasury bond was introduced to the debt portfolio. It is remarkable to note that, the introduction of more debt instruments to the federal government debtportfolio led to the relaxation of treasury certificates from the debt portfolio. In 2003, added to the debt portfolio was federal government bonds of different categories which include **FGN Bonds** of 2-year, 3-years, 5-year, 7-year and 10-year maturity duration. In precision, over the five year period of 2001 -2005, Nigeria domestic debt stock rose from ₦,016,980,000,000 to ₦1,525,910,000,000 as at the end of 2005. This represents an increase of 50.0 percent over theperiod or an average annual increase of 12.5 percent. The stock of domestic debt rose by 0.7 percent from ₦1,525,910,000,000 to ₦1,536,009,000,000 by June 2006. The observed increase in the domestic debt stock wasaccounted for by new issues of Nigerian Treasury Bills (NTBS) and FGN Bonds during the period under review tofinance budget deficits as well as lengthen the maturity structure of the debt portfolio (DMO, 2006). Between 2005 and 2006 alone, it increases by 15 percent representing an increase of ₦619,755.80 billion (4,744,635.74 minus 4,124,879,94), CBN annual data (2010). The observed increases in the domestic debt stock were mainly accounted forby new issues of FGN Bonds to finance budget deficits, lengthen also the maturity of the debt portfolio and further, todevelop the domestic debt markets (DMO, 2007).

In 2007, the domestic debt stock rose to ₦2,541,733.690,000 (two trillion, five hundred and forty-one billion, seven hundredand thirty-three million, six hundred and ninety thousand naira) CBN annual data (2010) while in 2008, it was ₦2,320,310,000,000 (Two trillion, three hundred and twenty billion and three hundred and ten million naira). In 2011, it hit ₦5,662,840,000,000 (Five trillion, six hundred and sixty-two billion, eight hundred and forty

million naira compared to ₦4.551,82,000,000 end of 2010 reflecting an increase of 23.52 percent of this amount. FGN Bondsamounted to ₦3,541.2 billion of 62.98 percent, the NTBs was 1,727.91 billion or 30.73 percent while treasury bondsaccounted for the balance of N353.73 billion or 6.29 percent. The increase over the years is attributed to the funding ofthe budget deficit and refinancing of the maturing debt obligations, as well as issuances of bonds for special projectsincluding the funding of Nigerian cotton and Textile Garment Development Scheme, the Commercial Agriculture Credit Scheme, Airports and Outer Northern (Kubwa Road) and Express ways in Abuja (DMO, 2012).

2.3 Reasons for Domestic Borrowing

One of the key issues to consider in analyzing government debt is the reason for borrowing. This is important because not only influences the stock and terms of the domestic debt, but it can also affect the scope for debt relief and/or restructuring. In general, there are three main reasons for government domestic debt:

The first is for **budget deficit financing**. If the government is unable to meet its expenditure commitments from domestically raised revenue, such as taxes and duties, and externally sourced grants and borrowings, then it may seek to borrow domestically.

The second is for **implementing monetary policy.** The government can implement monetary policy by altering the supply of money in the economy. It does this by buying or selling Treasury bills, that is, by *open market operations* (sometimes referred to as OMO). Government sales of Treasury bills reduce the money supply and mop up liquidity aspeople andinstitutions buy Treasury bills and hence hold less money: whereas government purchases of Treasury bills pump money into the economy as people sell Treasury bills and hold more cash.

The third is for **developing the financial sector.** To develop and deepen the financial sector markets, there needs to bea steady supply and range offinancial instruments to be traded. At the beginning of this process the government usually offers short-term Treasury bills which provide a secure return and boost investor confidence in government debtinstruments. Thereafter, financial market deepening can be achieved by offering longer-dated instruments withdifferent interest t rate structures, i.e. fixed and floating rates.

2.4 Sources of Domestic Debts and Deficit Financing in Developing Nations

The domestic debt of a nation is made up of debt instruments publicly issued through the monetary authority of the nation, in most cases the Central Bank. They consist of direct government borrowing, overdrafts from deposit moneybanks, as well as outstanding contractual obligations of the country, such as debt owed to contractors, hoteliers, or suppliers by government institutions. Domestic debt represents the gross liability of government. These include the federal, state and local government transfer obligations to citizens and corporate firms within the country. It alsoincludes arrears owed pensioners. However, the major sources of debt are through deficit financing. In economic literature, three main methods of deficit financing are always identified. These are:

(i) Finance through money creation (inflationary financing);
(ii) Finance through sales of government securities (non-inflationary domestic financing); and
(iii) Finance through external borrowing (non-inflationary external financing).

Money creation is different from sales of government securities and external borrowing, in that it does not lead to anyincrease in the stock of debt and therefore analogous to the

conventional taxation, hence it is often referred to asinflation tax. In contrast, finance through sales of government securities, and through external borrowing can lead todebt accumulation and carry interest rate charges. The net contribution of such financing to long term deficit financingis less than the gross contribution; and heavy use of these strategies may lead to a rise in inflation tax revenues. It maynot be completely true to say, that these forms of debts are non-inflationary. It must be noted that the excessive use ofmoney creation can lead to a high inflation rate, and have negative effects on the economy. Generally, it is oftenassumed that domestic sales of government securities are organized on voluntary basis, where demand and supplyfreely determine interest rates and prices. This is contrary to what exists in most developing countries. The reason isthat most of the existing markets in these countries are embryonic and most of them maintain very strong administrative control on interest rates, which they often do for reasons that can be linked to the large deficit theymaintain. Consequently, they do not allow the free movement of rates which would be necessary incentive to voluntarily sell the large volumes of debt issues required (Hansen and Neàl, 1984).

Financing through sales of government securities involves a variety of compulsory mechanism, through which government places their debt. Such mechanisms invariably involve interest rate below market levels, the increases indebt, which also affect them can be regarded as a mixture of taxation and debt accumulation. Identified below are fiveimportant subdivision of this approach that are of interest.

(i) Reserve Requirement of Banks and Other Financial Institutions:
This is a straight forward financing mechanism as far as government is concerned. The interest rates paid on required serve are normally set at zero, orwell below 'market' rates. Therefore, the tax element involved is large. It is therefore a method which can be highly distortionary in that, for a given profit target in the banks, the banks have to maintain ahigher margin between deposit and lending rates than would otherwise be necessary. In short, the consequence of a high reserve requirement is financial system, which Implies above all that the tax base on which the reserve requirement can be levied is progressively reduced.

(ii) Required Purchase of Government Bonds by Banks at controlled Interest Rates:
This has analogous consequences on the required reserve with the one exception that the interest rate period on bonds is normally greater than zero, although lower than the market rate. The implication therefore is that the tax element of this approach and its distortionary consequences will be less than the previous case. Fakiyesi (1997), opined 'that the important point about controlling interest rates is that if the government also uses inflationary methods of finance, the real burden of government debt is reduced as inflation takes its course without the need for any compensation to the d^{e}positors in the form ofhigher nominal interest rates. Further, he argued that the distortion can be very large in a highlyinflationary situation and any suggestions that it is a sound basis on which to stimulate the development of capital markets, and hence the economy is fallacious.

(iii) Required Purchases of Government Bonds by Banks at Market Interest Rates:
This approach does not involve any tax element or have distortionary consequences associated with the approaches. However, with rate of inflation generally high in developing nations, it has not been possible for governments, to acceptthe extremely high nominal interest rates on bonds as required by this approach. In addition, if expectations. of higher future inflation are well established, this method may well-

require highly positive real interest rates in excess ofeconomic growth rates and return on public spending projects. Thus, in a high deficit, high inflationary environment, this approach to deficit financing can be a formula for an unstable and explosive growth of the government's financing gap.

(iv) Credit Rationing, in the Presence of Controlled Interest Rates:
Where credit is rationed, banks are not allowed to determine deposit interest rates in order unbalance deposit and credit growth. And unspent surplus offunds in the banks is an inevitable consequence. Government is able to utilize this fortheir own financing purposes through a variety of measures including the issues of special securities carrying below market interest rate. Those in the private sector who benefit from the credit rationing will in effect share the taxrevenue associated with artificially low interest rates with the government. Its distortionary effect is analogous to the previous methods.

(v) Arrears of Government Payments:
Most African nations spenta greater part of the 1980s in a state of severe liquidity constraint if not insolvency. Nigeria, Ghana and Uganda are classical examples. In this situation, failure to pay outstanding obligations, either to theemployees or suppliers of goods and services appeared on the basis of casual evidence to have become an important source of government financing. Fakiyesi (1997) posited that borrowing from suppliers or arrears is obviously anextremely unsatisfactory basis of financing as far as the lender is concerned and since it 1s unlikely to involve any interest payment on outstanding balances, the tax element forms a large part of the total. However, its distortionary effects do not discourage the holding of monetary and other financial assets, and so, 1s against the growth of the financial sector. It must be worthy of note that it would be distortionary when government uses it as a source of financing as this is almost certain to lead to a general collapse of respect for the law of contract and to a pervasive failure of private economic agents to make the payment required to them. In particular, since most contractors are also taxpayers, the rate of tax revenue may suffer in a very direct manner. In Nigeria, this has led to banks failures and collapse of individual economic activities.

2.5 Justification for Domestic Debt and Implications for Economic Management

Domestic debt is preferable to external debt considering the debt burden. The cost of servicing external debt in Dollars, Pounds or Euro is of higher burden relative to GDP than that of internal debt. In addition, domestic debt is an internal debt and as such money flows within the country. For external debt, there is net out flow from the economy because thedebt is in foreign currency. Owualah (2001) contended that one of the reasons for the recourse to deficit financing by many developing countries is the desire to accelerate economic development at independence; this led most of them toembark on a number of development projects. In the face of low-level domestic savings and low-income levels generally to generate high tax revenue, many of them experienced serious shortfalls in their revenue drive and the desired level of investment. Borrowing therefore becomes inevitable if the savings-investment gap was to be filled.

Itis also argued that the absence of a domestic money market at political independence in many developing nationsgave added impetus to issuances of government short-term debt instruments as the starting blocks for their nascent domestic money markets. Moreover, especially in Nigeria's case, the production and consumption pattern spawned bythe oil boom era could not be sustained when the boom subsided as a result of large gaps in government

finances. The situation there fore meant that to maintain the tempo of development activities initiated in the boom era, borrowingofsome sort had to be undertaken. Deficit financing via the issuance of short debt instruments as a tool ofmonetary policyhas been pursued in some developing countries as part of the control measures for excess liquidity in their banking systems. Consequently, in the face of such levels of liquidity, the Central Bank on behalf of the central governments hashad to issue short-term debt instrument to mop up the excess. Against the backdrop of the foregoing reasons, government borrowing from domestic sources ought to be a more attractive option than from external sources. More-so, since it does not entail the same servicing costs, foreign exchange outflows. That domestic debt has equally become a problem deserving attention as external debt stems mainly from the fact that a substantial level of domestic debts hasthe potential for destabilizing economic management.

The monetization of deficit often leads to inflation. It serves as an impediment to the development of the market for the debt instruments. This occurs to the extent that such deficit financing creates undue pressure on monetary expansion.This would seem to be the case in situation where governments are unduly insulated from the fiscal discipline usuallyimposed by borrowing from the financial market. This was common during the military regime. Market development isalso hampered when low interest rate on government securities encourages a large accumulation of domestic debt. Asthe case in Nigeria, this may exacerbate the debt problem, with a large size of accumulated domestic debt before deregulation of interest rates, Nigeria incurred a higher domestic debt service e payment after deregulation. In addition, large fiscal deficit may also exacerbate the financial system; excess liquidity creates a new problem of sterilization of such liquidity for the Central Bank. This is time especially where there is insufficient portfolio of government securities to mop up the liquidity through Open Market Operation (OMO), and. if the returns on the securities are not sufficientlyattractive.

According to the Syndicate Groups (2001), domestic debt in the early years after independence was 'used for thepurposes of domesticating and promoting the nation's money market mobilizing domestic savings to finance socio-economic development programmes through the provision of basic infrastructure such as roads, water supply, electricity, health care and educational facilities; and facilitating monetary management. The domestic debt was in noway problematic up to 1980, following favourable developments in the international oil market which provided thegovernment with substantial foreign exchange and revenue for the financing of its programmes. However, governmentrevenue came, under severe pressure from 1981 following the collapse of the international oil market. Government revenue from oil declined sharply in the face of rising expenditure, resulting in fiscal deficit in most of the 1980s up to1994. The size of the internal debt has been on the upward trend since 1959.

Obadan (2003), also submitted that Nigeria's experience in internal debt management and monetary policy shows anupward swing in the size of the internal debt generally with the bulk of it financed by the banking sector. More importantly, the debts' have largely been incurred through budgetary excesses especially between 1986 and 1994. Thus, the overall fiscal deficits as a percentage of GDP rose from 2.3% in 1985 to 15.4% in 1993. He also posited that heavy reliance on Central Bank financing has had adverse implications for macro-economic stability and the effectiveness of monetary policy in Nigeria, witha positive correlation being observed between the growth of fiscal deficit, money supply, domestic debt and inflation rate. A major point worth noting is that most of the debts were notacquired from a conscious and a planned interplay of budgetary provisions, but rather, they were mostly results ofbudgetary excesses. For example, fiscal operations, before the Structural Adjustment Programmes in 1986,expenditure profile of the government was particularly high between

1986 and 1994. The ratio of Total Domestic Debtto Nigeria's GDP rose from 9.4% to 15.4% in the years 2006 and 2010 respectively. The range is still below the 40 percent international threshold (DMO, 2012).

Generally, the debt indebtedness of a country becomes a problem when the burden of servicing the debt imposesintolerable constraints on the economy and on the development efforts of the authorities. In such circumstances, the bulk of the foreign exchange earnings are earmarked for servicing of the debt and, at times and more still, drawing onnew loans may be needed to service existing debt. In such a situation, only a small proportion of total foreign exchange earnings is available for financing of economic and social project. Luckily, from above data, Nigeria's debt hascurrently been sustainable because it is below the international threshold of 40 percent of the country's GDP, which must not be surpassed. This is partly, due to the forgiveness received in the 2006 from the Paris club and the London club. Unfortunately, the relief has not been put into positive use to assist the economy. In fact, the $41 billion debt as at2011 was higher than the nation's budget ofN4.9 trillion (about S32 billion) as at the same year. Worse still, the minister of Finance, Mrs Okonjo Iweala is currently bidding for another $7.9 billion from the World Bank. This would enslavethe economy more. The Nigerian economy has not fared well to date due to the following among others.

(1) Corruption on the part of Nigerian Leaders.
(2) Too many political appointees with exorbitant allowances.
(3) Low savings propensity.
(4) Unrealistic exchange rate.
(5) Poor External Debt Management Policies.
(6) Reliance on mono-product (crude oil).
(7) Financing long term projects with short/medium term loans.
(8) Diversion of the proceeds of Loan into other/personal uses.

2.6 Key Economic Variables Influencing Domestic Government Debt in Nigeria

Rapu (2003) citing CBN Annual Report of various years submitted that inflation rate, GDP growth rate, GDP/Expenditures, Public expenditures/GDP, Fiscal deficit/GDP, Saving /GDP, Retained revenue/ GDP, Primary surplus/GDP and Real interest rate as key economic variables influencing Government internal debts in Nigeria.

2.7 Various Strategies Adopted So Far in Nigeria's Domestic Debt Management

Debt management is thus a delicate skill which requires careful analysis of future prospects; since it is an attempt todelicately balance the desire to keep interest charges as low as possible while at the same time raising the necessary funds. One of the major tasks of debt management policy is therefore to regulate maturity in sucha way as to achievede desired level of liquidity in the economy. Before the year 2000 the Central Bank of Nigeria had the mandate of managing the Federal Governments domestic debt, under section 35 of the CBN ordinance of 1958. The CBN was saddled with the functions ofdebt management namely:

(a) advising the government on the best time to float debt instrument or terms ofissue,
(b) advertising forpublic subscription to the issue,
(c) Collecting the proceeds on behalf of the government,
(d) supervising certificates and Warrants and maintaining proper books of accounts in respect of receipt and disbursements,
(e) payments of interest and principal as at when due and
(f) managing the sinking funds set up to facilitate the redemption.

The CBN, issued securities both in the primary and secondary market in respect of Federal Government debts. In the primary market, the CBN plays the role of issuing house and underwriter for government securities. At the Secondary market, the bank operates as registrar and market maker by making securities available for trading and offering re-discounting facilities for the market. The CBN assumed the underwriting responsibility for government securities frominception by making available the full value of the loan irrespective of full subscription or not. The unsubscribed portion is made available by the CBN in the secondary market for banks wishing to invest in securities of shorter tenors rather than the original issue. The sinking funds approach of debt management is for long term securities, such as Development Stocks, and lately treasury bonds, with tenor of5 years and above. By this approach, contributions are made by the Federal Governmentinto specially created funds for redemption of debt at maturity. The CBN invests such funds in securities and onredemption date, not more than 25% of the face value is available, which enable the government to repay the entire loan without feeling, the impact as a single repayment. Another method of management is the role over syndrome. By this approach, the CBN provides the necessary funds for repayment even when the federal government is not in a position to repay the loan. The reason for this is to ensure and sustain public confidence in government debt instruments. New issues are arranged for short term instruments, such as treasury bill and treasury certificates, to coincide with the date of maturity so that the proceeds of the new issues are utilized to repay the old issues which are maturing.

The management of domestic debt also involves the performance ofa registrar function by the CBN. The CBN opens a register for all issues of domestic debt instruments where particulars like amounts of holding and interest payments are recorded. The same applies to transfer of ownership. Such details assist the CBN on the interest payment and dates to determine the rightful beneficiary. Also of importance, is the stock control and adjustment of debt management pragmatic effort undertaken by CBN whereby the statutory limits are reviewed upwards or disregarded as the need arise. At the liberalization of interest rate along with the Structural Adjustment Programme (SAP), debt service burdenbecame an issue in the management of Federal government total domestic debt stock. In order to mitigate the impact ofthe expected upward movement in debt burden N20 Bilion treasury bills were converted into treasury bonds at 5%.

In 1993, debt management in the economy received the major boost as a result of the commencement of OM0, as anindirect approach to monetary control. This led to the introduction of the stripping system 'that is the conversion of the CBN take-up from the primary issues to shorter dated OMO bills. This innovation had led to the deepening of the market as well as stability in rate. In consequence, the shorter dated OMO bills have become so popular and their rate has emerged as a reference point in the system for determining call money rates specifically between banks and discounthouses. The implication is that if an instrument takes in to account the mutuality preference of the market and there is reasonable degree of liquidity for it, government would be able to raise funds at reasonable rates of interest. For more flexibility of the market, the repurchase agreement (Repos) between the central Bank and the Discount housesequally a new innovation. Practically, it has been used essentially as an overnight market, though the tenor of two to five days is common. The discount houses have found Repos a more appropriate instrument for liquidity management was suspended by the CBN in January 1995 while the reverses were offered as sole securities with the commitment to buy back at an agreed price and date. This creates opportunity for the discount houses to invest their surplus funds.

Repos was later reintroduced in 1996; in a related development, as at 1996, treasury certificates were phased out as the stock of outstanding treasury certificates were converted to treasury bonds (long term debt instrument). Despite thestrategies put in place. Nigeria's experience in internal debt management indicates an upward swing in the size of the internal debt generally with the bulk of it financed by the banking sector. Neglecting the interventional role of the public sector and the capital market made the debt management approaches adopted so far ineffective. Moreover, other reasons that could be adduced for the gross ineffective domestic debt management was lack of focus and proper attention. Prior now, emphasis and attention were mainly on external debts, it was after the exit of federal government from the clubs of creditors (External) that it became incumbent on government that internal debt management, is highly desirable to ameliorate the huge internal debt burden that was grossly characterized by imprudence and fiscal indiscipline. Another problem was that of government indebtedness to banks and contractors. In recent years, there hasbeen a proliferation of government agencies with little regard to their sustainability. Their undue dependence on federal statutory allocations and lack of ability to raise funds has led to their distress, especially state owned - banks. The process has swelled the rank of involuntary domestic debt issuers and holders in the country. More so, there is the problem of strong, credible, and firm data base for the domestic debts while the s statistics of securitized domestic debtsmanaged by CBN is adequate and reliable, there is a dearth of reliable statistics on debts owed to banks and local contractors which adversely affect the management of domestic debts with proper accountability. Absence of data and adequate information on such securitized debt portends implication for fiscal objectives, discipline in government and effective public sector finance.

Furthermore, when compared with other investment outlets the instruments used in managing domestic debts wereunattractive because of the low rates of interest and administered rates. Moreover, with the introduction of OMO, the relative position of the CBN as at then declined as a major holder. A situation where CBN held majority of government securities was detrimental to macroeconomic policy and financial discipline. Besides, the market base as was then constituted was narrow and shallow. This was due to lack of deregulation policy, which could have encouraged the government to source for short term and long-term funding. These and others reasons make for the sub-optimality of domestic debt management in Nigeria.

Iwualah, (2001) opined that deficit financing per se or domestic debt for that matter, need not be counter productive ifkept at reasonable or prudent level, if financed largely by the private banking system and non-bank public and if thefinancial resources generated in the process are channelled into productive investments. Imprudent domestic borrowing drives up interest rate and crowds out private borrowing. According to him, some of the steps that could be taken toreduce the burden of debt service and or facilitate it include the rolling over of maturing obligations, by issuing newones to retire them. Conversion of short dated instruments to longer-term ones with fixed interest rates and the creation of sinking fund to facilitate the redemption of due obligations. He affirmed that deficit financing - a major source of domestic debt ifnot effectively managed has the potency of being inflationary and destabilizing to the macro-economy.It can also increase the cost that a responsible government may have to bear.

2.8 Recent Nigeria 's Domestic Debt Management Strategy

To further broaden and deepen the domestic bond market through:

- The introduction of a variety of government securities;

- The use of appropriate technology to aid effective and efficient issuance and trading; the improvement of the regulatory framework; and,
- The facilitation of the issuance of corporate bonds by the private sector for the development of the real sectorof the economy.

The DMO Act empowers the DMO in collaboration with the CBN and OAGF to determine, among others, the floatation of Federal Government long-term securities to raise funds in the Capital Market; the type of securities that may be created, issued or floated to achieve the domestic debt management objectives of the Federal Government; the payment of interest; the maintenance of a register of holders; the redemption of securities at maturity; and the creation and management of sinking funds to provide for redemption of securities at maturity. The Minister of Finance shall specify by directions published in the Federal Gazette, the mode of raising the loans, the sum of money to be raised by that loan and other particulars. Sovereign public issues usually contain the following information:

i) Issuer; ii) The Issue; iii) Units of Sale; iv) Purpose; v)Tenor; vi) Sinking Fund; vii) Coupon; viii) Status; ix) Security; x) Payment terms;xi) Opening date; xii) Closing date.

Sub-national Governments and their agencies may from time to time source for funds in the capital market to finance a specific project in the course of governance. Sections 222 to 273 of Part XV of ISA 2007 govern such borrowing.

Section 223 of ISA enables any such borrower to do so either:
i. By the issue of securities in the form ofRegistered Bonds; or
ii. By the issue ofsecurities in the form of Promissory Notes.

However, as a check on possible excesses, a limit on amount of loans outstanding at any particular time including the proposed loans shall not exceed 50% of the actual revenue of the body concerned for the preceding 12 months Sub-national Governments and their agencies that want to issue bonds in the capital market are required by SEC to do so by way of prospectus inviting the general public to treat. The prospectus is expected to contain, among others, 5 years audited accounts of the State or the Local Government. The funds to be raised are to be tied to a specific project. The latest account may be such that accounts for operations over the past 1 year may not be available already audited to assist informed judgment. Such a situation might conceal the actual latest performance of the issuer. Accounts. Though audited, but which are more than nine months old are regarded as stale for the purpose of a public issue. In such cases compulsory preparation and auditing of accounts within 9 months of an issue to guide the investing public on the latest operational status of the issuer is demanded.

The Attorney General is also required to sign the offer documents stating that the statements contained therein are thetrue position of the affairs of the State. As a measure of ensuring due repayment of the loan, an Irrevocable Letter ofAuthority to the Accountant General of the Federation to deduct the relevant sum at source from the statutory allocation due to the issuer, in the event of default by the issuer, must be sent by the issuer in order to meet its payment obligations arising from the loan. Section 251 ISA 2007 stipulates that a sinking fund be established to guarantee the liquidation of the loan as and when due. Instalments due and not paid could therefore be deducted at source under the arrangement, and paid to the sinking fund.

The main objectives of the domestic debt strategy include:

a) Raising finance in the domestic market to cover the government's borrowing needs;

b) Funding the nation's debt in a non-inflationary manner, without recourse to monetary financing;
c) Minimizing the cost ofgovernment's debt over the long term, while taking risk into account;
d) Promoting the development of the domestic capital market;
e) Developing mechanisms for accessing the International Capital Market, including for Naira denominated debts;
f) Developing mechanisms for Sub-national and Agency Bond Markets;
g) Developing various innovative instruments such as derivatives and mortgage-backed securities to meet thevarious needs of the market; and,
h) Ensuring proper coordination between debt management and monetary policy.

After building and analysing four different strategies, the Debt Strategy which has been adopted is one that has the following strengths:

It will significantly reduce the rate of growth ofpublic debt in general, and domestic debt in particular and ensure debt sustainability;

It will reduce the amount spent on debt service by achieving an optimal mix between the relatively more expensivedomestic debt and less expensive external debt - at present, the difference between the domestic and external average cost ofborrowing is about 8%% per annum;

It encourages direct budgetary provisions for the repayment of part of maturing FGN Bond obligations instead of refinancing them and also supports the creating of a sinking fund;

It will achieve an optimal mix between domestic and external borrowing and arrive at a more balanced public debt portfolio- preferably, in the ratio of 60:40 for domestic and external debt, respectively - whilst allowing adequateliquidity in the domestic bond market to ensure a vibrant fixed-income securities market as an essential component of a robust capital market;

Within the limited and prudent amount to be borrowed, it will reduce the issuance of short-term domestic debt instruments in favour of long-term instruments to hedge against refinancing and other market risks;

It will help attain appropriate mix in terms of currency composition, interest rate structure, and concessional versus commercial borrowing;

It will. stabilize and deepen the domestic debt market to attract more foreign investment inflows; and,

It favours the creating of more borrowing space for the private sector to access long-term funds to grow the real sectoras well as incentivizes them to play a more prominent role in the development of commercially viable critical infrastructure projects for economic growth and development, in line with the policy posture of the Transformation Agenda.

2.9 Relationship between Domestic Debt and other Related Economic Variables

Under this section the researcher draw the relationship between the assumed key variables (inflation rate, real interest rate, and budget deficit) and domestic debt as specified in the hypotheses of the study. Inflation is the persistent and continuous rise in the general or average price level of commodities. As the general price level rises in an economy, thevalue of money or purchasing power of money decreases. Inflation is a key macroeconomic indicator of a country, providing an important insight into the state of the economy. A low and stable inflation rate uplifts the poor and vulnerable citizens and gives a nurturing environment

for economic growth. Domestic debt is a fundamental tool used by the governments in both developed and less developed countries to finance internal and external gaps. Proper and efficient utilization of the resources in the form of debt may enhance productive capacity and economic growth throughdevelopment related projects. However, if the debt is not effectively utilized and managed, it creates problems for the economy. The relationship between domestic debt and inflation is direct and evident. Government can acquire domestic debt from different sources i.e. the central bank, commercial banks and non-bank financial institutions.

Bildirici and Ersin (2007) examine the relationship between domestic debt and inflation for those countries that have high inflation. The findings show that the cost of domestic debt increases on account of inflation. Consequently, the increasing debt to GDP ratios led these countries to borrow at higher cost and with low maturity. The study concludes that the increasing cost of borrowing is due to non-Ricardian fiscal policies. The inflationary spirals which had been experienced by many emerging countries could be explained by the cost of domestic debt. Countries experiencing inflationary periods follow interest rate policies resulting from tight money policies, which increase domestic borrowing even further; decreasing maturity and increasing budget deficits. During the process, further rises in interest payments amplify domestic debt stock.

In contrast to external debt, the interest rate on domestic debt is, at least partially, determined by the outstanding stockof debt. In particular, a high domestic debt stock presents the authorities with an incentive to devalue the real debt stockby generating inflation above the level anticipated by the private sector. Given the narrowness of the traditional tax base in low income economies, the potential value of this inflation tax" revenue may be high. Anticipating this incentive, the private sector will demand an "inflation premium" on domestic debt, driving up interest rates. The inflation tax incentive (and hence the premium required to counter it) is positively related to the stock of debt, hence reducing the stock of debt will, in addition to lowering the cost ofdebt service directly, lower the interest rate on debt.

Obi and Nurudeen (2009) make an effort to determine the effects offiscal deficits and government debt on interest ratesin Nigeria by applying a Vector Auto-regression approach for the period of 1981 to 2006. The interest rate in the modelis a function ofthe fiscal deficit and government debt. The findings of the study show that fiscal deficits and government debt have a positive impact on interest rates. The authors suggest that the government should increase the revenues and should decrease unnecessary spending. A budget deficit implies that the national debt is increasing. But since the GDPis also rising. the ratio of the national debt to GDP may or may not be increasing. That depends on whether the growth rate ofthe national debt is more than or less than the growth rate of GDP. A continually increasing ratio of debt to GDP runs the risk that the debt will get on an unsustainable path leading to national insolvency. Even if the debt ratio is not explosive in this way, a high ratio of debt to GLDP has serious adverse consequences (Feldstein 2001).

3.0 Research Methodology

Cointegration was used for data analysis having specified the model as below
FDD= f(RBD, INTR, INFR, GCON)
Therefore,
$FDD = _0 + _1RBD + _2INFR + _3INTR + _4GCON + v_t$----------*(i)*
Where:
FDD= federal government domestic debt
RBD =ratio ofbudget deficit to GDP

INFR= inflation rate
INTR= interest rate on treasury bills
GCON =ratio ofgovernment consumption expenditure to total expenditure
V_t =stochastic term
Apriori expectation:$_{1,2,3,4}$>0

3.1 Cointegration Analysis

According to Engle and Granger (1987), if two time series variables, p_t and q_t are both non-stationary in levels but stationary in first-differences, i.e., both are *I(1)*, then there could be a linear combination of p_t, and q_t, which is stationary, i.e., the linear combination of the two variables is *I(0)*. The two time series variables that satisfy this requirement are deemed to be cointegrated. The existence of cointegration implies that the two cointegrated time series variables must be drifting together at roughly the same rate (i.e. they are linked in a common long-run equilibrium). A necessary condition for cointegration is that they are integrated of the same order (Granger 1986; Engle and Granger 1987). The economic interpretation of integration is that if two or more variables are linked to form an equilibrium or long run relationship between them, even though the series themselves in the short-run deviate from equilibrium, they will move together in the long run. Indeed, a non-stationary variable might have a long run relationship with other non-stationary variables and this does not create a spurious regression if the deviation of this long run relationship isstationary. It implies that these variables are cointegrated.

The Johansen Cointegration method is used for this analysis because the study involves the use of multivariate estimations. The results from the multivariate cointegration test are presented in Table 4.4 below. As can be seen from the table, the Eigenvalue max statistic for the null hypothesis of no cointegrating vector among the variables issignificant at the 5 percent level. Thus, we reject the hypothesis of no cointegrating vector among the variables. This implies that is at least one cointegrating vector in the relationship between domestic debt and the independent variables. This implies that a long run relationship exists among these variables.

Table 4.4: The Multivariate Cointegration Result

	Likelihood	5 Percent	1 Percent	Hypothesized
Eigenvalue	Ratio	Critical Value	Critical Value	No. of CE(s)
0.750006	75.43127	68.52	76.07	None *
0.376134	33.84170	47.21	54.46	At most 1
0.249447	19.68712	29.68	35.65	At most 2
0.219513	11.07875	15.41	20.04	At most 3
0.114368	3.643625	3.76	6.65	At most 4
*(**) denotes rejection of the hypothesis at 5% (1%) significance level				

3.2 DynamicAnalysis

The dynamics of the pattern of domestic debt movements in Nigeria within the context of short term movements in itsmain determinants is captured within an Error Correction Model (ECM) in this study. The Autoregressive Distributed Lags (ARDL) approach is used for the ECM. The error correction mechanism result for the model is reported in table 4.5 below. The result has impressive diagnostic statistics, suggesting that short term changes in domestic debt may actuallybe sufficiently explained by the factors selected I the model. The goodness of fit of the model is relatively high; the R-squared value of 0.694 indicates that up to about 69 percent of the systematic short run variations in GDP at any giventime is explained by the

explanatory variables and the ECM term. In the same vein, the F-statistic value of 1 1.3 passesthe significance test at the I percent level, thus, we cannot reject the hypothesis of a significant short term relationship between domestic debt and all the independent variables combined.

Table 4.4: ECM Estimation of Determinants of Domestic Debt in Nigeria

Variables	Coefficient	T-Ratios
C	13.67	11.35
Δ*RBD*	0.199	2.943
Δ*INFR*	-0.031	-2.470
Δ*INTR*	0.058	0.938
Δ*GCON*	0.016	0.221
ECM(-1)	-0.754	-4.211
$R^2 = 0.694$	F = 11.3	D.W = 2.07

The particular contribution of each of the variables to short term movements in domestic debt is determined by observing the individual coefficients of the explanatory variables in terms of sign and significance. A closeinvestigation of the individual coefficients of the variables reveals that only that of inflation does not have the expected positive sign; all the other coefficients possess the expected a priori signs. This result indicates that inflation rate tendsto reduce amount of domestic debt accumulate3 d by the federal government.

In particular, we focus on the significance of the coefficients in the model. Only the coefficients of RBD and inflationpass the significance test at the 5 percent level. The coefficient of interest rate and government consumption fail the test.This shows that only budget deficit and price changes affect domestic debt significantly in Nigeria. Apparently, thesefactors are strong determinants of the accumulation of domestic debt in Nigeria in the short run. The rate of interest ongovernment Treasury bills or the government consumption expenditure does not sufficiently predict the behaviour ofdomestic debt in the short run in Nigeria.

The error correction term has the correct negative sign and also passes the significance test at the 1 percent level. Thisshows that any short-term deviation of GDP from equilibrium in the short-run will be restored in the long run. The valueof the error correction term (-0.754) is relatively high, meaning that adjustment to equilibrium in the long run is ratherfast. Indeed, about 75 percent of the adjustment of domestic debt in the long run is completed in the first year. The problem of autocorrelation is not present in the results since the Durbin-Watson statistic value of 2.07 shows absence of autocorrelation in the results.

Finally, we report the long run (steady state) result for the estimations. The relevance of this estimation is based on thefact that the variables in the analysis have been shown to be cointegrated (exhibiting unique long run properties). The result of the estimated long run model is reported in table 4.5 below. The goodness offit statistics for the results are also impressive. At 0.507, the R squared value is relatively high and indicates that about 50 percent of long run domestic debt accumulation is explained by the selected variables. The F-value also passes that significance test at 5 percent and shows that the relationship between the dependent variable and all the independent variables combined is strong. All the coefficients in the result are positive, showing that these variables have positive impact on domestic debt in the long run. Moreover, apart from INFR, all, the other coefficients pass the significance test at the 5 percent level. The coefficient of INFR passes the test at the 10

percent level. This result therefore indicates that all the selected variables have significant impacts on domestic debt in the long run.

Table 4.5: Long Run Results

Variables	Coefficient	T-Ratios
C	228157.1	10.72
RBD	0.043	3.799
INFR	0.079	1.985
INTR	0.019	3.774
GCON	3085.2	2.589
$R^2 = 0.507$	F = 6.94	D.W = 1.9

3.3 Effect of financing domestic debt through deficit financing

The effect of financing domestic debt using deficit financing are not limited to:

1. *Poor Management of Borrowed Funds:* Misapplication or embezzlement of borrowed funds can worsen debt burdens.
2. *High Cost of Debt Servicing:* Rising domestic debt can lead to increased debt servicing costs, further straining the economy.
3. *Excessive Borrowings:* Uncontrolled borrowing can lead to debt traps, crowding out private sector investment and hindering economic growth.
4. *Rising Budget Deficits:* Persistent budget deficits can fuel domestic debt accumulation, negatively impacting the economy.

3.4 Impact on the Economy:

Negative Economic Growth: Internal borrowings can affect economic growth negatively if not managed properly.

Increased Poverty: High domestic debt can lead to reduced government spending on social services and infrastructure, exacerbating poverty.

Crowding Out Private Investment: Large internal debt can crowd out private sector investment, forcing interest rates up and reducing economic activity.

3.5 Effective Debt Management Strategies:

Well-Considered Guidelines: Establishing clear guidelines for internal loans, including purpose, duration, negotiation fees, and conditions.

Limiting Domestic Borrowings: Curbing excessive borrowing and mobilizing untapped domestic resources.

Prudent Utilization of Borrowed Funds: Ensuring borrowed resources are productively utilized to enhance economic and social returns.

By adopting these strategies, Nigeria can better manage its internal debt and mitigate the negative impacts on the economy.

4.0 Summary of Findings

This study aimed at investigating the main determinants of domestic debt accumulation by government in Nigeria. Both theoretical and empirical factors were highlighted as being germane in the domestic debt situation in Nigeriaespecially with respect to the main reasons behind its accumulation. Due to the nature of the debt conditions in Nigeria, a dynamic framework was devised for the empirical analysis in order to observe the long run and short

run factors that contribute to movements in domestic debt in Nigeria. Using data covering the period 1981 to 2012, the error correction mechanism (ECM) was adopted as the empirical strategy. Based on the analysis, the following findings were made:

- That budget deficit is the main determinant of domestic debt in Nigeria. The positive impact of this factor ondomestic debt is significant both in the short run and in long run. This is a very plausible outcome since financing budget deficits require funds outside of government resources.
- That inflation rate has a divergent significant impact on domestic debt in Nigeria. While the impact is negativein the short run, it becomes positive in the long run.
- That government consumption spending has only a long run impact on domestic debt in Nigeria. The short runimpact is not significant, but the long run impact is strong and positive.
- That interest rates on government debt instruments (Treasury bills) has a long run, and not a short term, effecton domestic debt accumulation in Nigeria.

4.1 Policy Implications of Results

The results obtained in the empirical analysis are quite instructive and far reaching with relevant policy implications. Inthe results, we find that short term changes in domestic debt respond quite significantly to fiscal deficits. This implies that as fiscal deficits rise, domestic debt also rises immediately or within the short time. This is rational since this debt accumulation is the faster way to finance budget deficits when compared with foreign debt. Herein lies the main advantage of domestic debt, namely, it is generally easier and faster to negotiate and procure. In the result, budget deficits still have a significant positive impact on domestic debt. This implies that budget deficit has a persistent positive impact on domestic debt and it tends to increase debts even in the long run.

The results also show that inflation rate is a strong determinant of shortterm domestic debt. However, the pattern of relationship is rather pervasive. It suggests that as inflation rises, domestic debt tends to fall as an initial response. The implication for this is that rising price levels tends to immediately discourage government from involving in domestic borrowing since repayment may become difficult with rising inflation. Moreover, at these periods, government may bemore interested in inflation financing to generate its income. In the long run, rising price levels now tend to stimulate government domestic debt accumulation. Thus, inflation is a long run factor in domestic debt accumulation in Nigeria.

In the result also, the coefficients of interest rate and government consumption that failed the test in the short run passed the test in the long run. This implies that after all adjustments have been made and a sufficiently long period has elapsed, a change in Treasury bill rates and government consumption spending will cause significant increase in domestic debt in Nigeria. Therefore, government should consider the long run implications of its interest rate policy on Treasury bills and its consumption expenditure as it applies to domestic debt in Nigeria.

5.0 Conclusion

In an attempt to investigate the Management of Federal Government Fiscal Deficit as a correlate to Internal Debt and Managing Domestic Debts in Nigeria, three theoretical facts has emerged as the reason advanced for government domestic debt. The first is budget deficit financing, the second is implementingmonetary policy (buying and selling of treasury bills in the open market) and the third is developing the financial sector (supplying tradable financial instruments so as to deepen the financial market). But in Nigeria, several factors have been advanced towards explaining the changing domestic debt profile. Some of those factors are

high budget deficit, low output level, increased government expenditure, high inflation rate and narrow revenue base.

The purpose of this study has been to examine financing fiscal deficit with internal debt and Nigerian domestic debt management. The review of domestic debt profile shows that the country has accumulated a large amount of debt over ashort period of time. Interest servicing is also assuming serious proportions in relation to government revenue andexpenditure. The composition of domestic debt also changed markedly over time. The classification of domestic debt by owner is also changing towards scheduled bank debt, which is likely to be harmful for domestic private investment. Poorly structured debt in terms of maturity, currency and interest rate structure has been important factors in resulting economic crisis in the country. Crises have often arisen because of an excessive focus by government on large volumes of short-term debt. This has left government budget seriously exposed to changing financial market condition, when that debt has to be rolled over. Thus, not only Nigeria's domestic debt is becoming unsustainable but also the changing terms, composition, and classification are going to make it much harder for the country to keep it at sustainable limits.

Faced with the prospects of painful adjustments sometime voices are raised in the country advocating for outrightdefault on domestic debt. However, the domestic debt default imposes a heavy financial burden on government as it results to a loss of reputation, impedes domestic government finance and stimulates capital flight. Another difficulty isthat, domestic banks are very important lenders to the government and domestic default could severely deplete their capital and would drive them into bankruptcy. This would bring economic chaos and negatively affect domestic output.

6.0 Recommendations

The results obtained in the empirical analysis are apt for some basic recommendations.

1. Government must endeavour to implement the fiscal responsibility act of limiting the level of domestic debt to 3 percent of GDP. This action it is hoped will serve to additionally discipline the government in carrying out its fiscal responsibility. The contribution of primary fiscal balance to the growth rate of domestic debt still remains high. This is clearly unsustainable.

2. Current effort at mobilizing resources through the capital market by issuing bonds should be intensified so that government can achieve the twin objective of financing its programmes while at the same time helping to achieve a sustainable level of domestic debt in the medium to long term.

3. The time perspective of government spending and interest rates on debt instruments should be a strong factor in the negotiation for domestic debt in Nigeria. Since treasury bills are often non-long term debt instruments, it is quite essential that authorities should consider its perspective implications for debt in Nigeria.

4. There is need for Nigeria to obtain loans that are channelled in such a way as to increase the productive capacity of the economy in order to enhance easy repayment and promote economic development. In this regard, as suggested in Obadan (2004), the financing of domestic investment with funds should be rationalized under the following considerations:

- loans are used to finance export increasing projects or import decreasing investments since loans must be repaid in foreign exchange;
- the investment financed by borrowing hasa real economic rate of return that is at least equal to the rate of interest.

- repayments are scheduled so as not to run ahead ofthe benefits.

This pattern of domestic debt accumulation will promote its financing in the short run and sustainability in the long run.

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