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External Debt and Economic Growth: Empirical Evidence from Developing Countries

Nechirwan Burhan Ismael, Shamal Hasan Obaid Mahmod, Hariwan Subhi Khorsheed

Department of Accounting, Cihan University – Duhok, Duhok, Kurdistan Region, Iraq.

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Abstract**—** *This study investigates the complex relationship between external debt and economic growth in developing countries. Utilizing a quantitative research methodology, data was collected from three selected developing countries through an online questionnaire distributed to key stakeholders, totaling 189 responses. Various statistical techniques, including t-tests, Chi-square tests, Variance Inflation Factor (VIF) assessment, Partial Least Squares Regression (PLS), and Principal Component Analysis (PCA), were employed to analyze the data. The findings reveal that moderate levels of external debt can positively impact economic growth, while excessive debt levels are detrimental. Effective debt management practices and strong institutional frameworks significantly enhance the positive effects of external debt. The study also highlights the adverse impact of external economic shocks on the debt-growth relationship. Key predictors of economic growth identified include external debt levels, debt management practices, and institutional quality. These factors underscore the importance of maintaining sustainable debt levels, implementing robust debt management strategies, and improving governance to optimize the benefits of external borrowing. The study concludes with recommendations for policymakers to maintain sustainable debt levels, negotiate favorable borrowing terms, and develop risk management strategies to mitigate external shocks. Limitations of the study include the reliance on data from three countries and the cross-sectional design. Future research should consider longitudinal studies, broader samples, sector-specific analyses, qualitative approaches, and the impact of global economic changes. Overall, this study provides valuable insights into the dynamics of external debt and economic growth in developing countries, offering guidance for policy formulation and economic planning to promote sustainable development.*

Keywords**— *External Debt, Economic Growth, Debt Management, Institutional Quality***

I. INTRODUCTION

The relationship between external debt and economic growth has been a topic of considerable debate and research, especially in the context of developing countries. External debt, defined as the portion of a country's debt that is borrowed from foreign lenders, including commercial banks, governments, or international financial institutions, plays a crucial role in the economic development of these nations. While external debt can provide the necessary capital for investment in infrastructure, education, and other essential sectors, it also poses significant risks if not managed prudently (Law et al., 2021).

External borrowing is a common source of financing for developing countries, to fill in the savings and investment gap. By boosting productive capacities and technological innovation, such capital flows can also theoretically help to strengthen growth. On the other hand, debt overhang could arise due to reliance on external debts as well; where burden of servicing these loans becomes so considerable that it retards economic growth. This rather paradoxical situation underlines the critical significance of knowing how external debt dynamics has shapen and continue to shape economic performance (Tajammal and Butt, 2024). This study is therefore Responding to the Empirical Divergence on Foreign Debt Impact on Economic Growth in Developing Countries. In fact, some researchers even suggest that external debt at moderate levels can be an enabler of growth if accompanied by good macroeconomic policies and effective management arrangements. Others argue, on the other hand, that outsized external debt can fuel economic instability - crowding out private investment and constraining its ability to finance development projects (Qureshi and Liaqat, 2020).

The present study attempts to investigate an empirical association between external debt and economic growth of the developing nations. The study studies a wide range of developing countries and aims to find the circumstances in which external shocks are supportive or declines growth. This study thus anticipates to contribute relevant lessons for policy makers in order to improve their strategies that could take the full advantage of non-domestic borrowings while minimizing its risks. This study therefore contributes to the literature on sustainable economic development in the developing world through an exhaustive empirical investigation.

Statement of the Problem

Limited availability of domestic resources often compels developing countries to raise debt from the rest of world as a medium for meeting their developmental needs. Although external debt provides necessary capital for investments that fuel growth, it can also carry some costs with adverse economic implications. At the heart of this is recognising a nuanced trade-off between using foreign debt to finance growth and doing so without falling into a trap from which escape would be very difficult upon mismanagement (Muhammad and Abdullahi, 2020).

A number of developing countries find it difficult to manage their external debt that is sustainable. Heavy debt servicing can siphon off resources that would have been directed at key public services and development projects, hampering economic growth. Secondly, the volatility of international financial markets and exchange rate fluctuations can make it even more challenging for countries to manage their debts well. This means debt service ratios may be hard to predict leaving these countries at risk of sudden changes in global economic events (Inyang and Effiong, 2020).

Empirical studies on the relationship between external debt and economic growth have given mixed findings. Despite divergence in the literature, a strand of research has suggested that external debt may be good for growth if it is managed properly while another part laid emphasis on high debts as being inefficient and bad to economic stability thereby compromising prospects of growth. This inconsistency of findings highlights the necessity for further scrutiny to discern what variables determine external debt and economic growth interaction.

The aim of the study

This research study focuses on the influence of external debt on economic growth in developing countries. This encompasses a thorough examination of the impact that external debt has on economic growth across an array of developing countries, emphasizing both beneficial and unfavorable consequences. The study also aimed to challenge these understandings using empirical data that explores this relationship in more nuanced ways. One of the most important things to be answered during this investigation is when an external debt will do some good for economic growth. This involves an examination of the reliance on economic policies, manner by which debt is managed and institutional mechanisms that contribute to harnessing positive impacts from external borrowing. Knowledge of these conditions is necessary to design policies which can limit the benefits from inflowing debt.

The study also investigates the key determinants of this external debt-economic growth nexus. Further analyses will investigate how the build-up of debt, maturity structure and interest rates, external economic shocks have affected economic performance. This analysis will allow us to gain a clearer understanding of the channels through which external debt impacts growth. The study, with a long focus on preparing actionable insights and recommendations for the policymakers. A better appreciation of the dynamics surrounding external public debt and its implications could help policy makers use international borrowing as a proper instrument to boost sustainable economic growth. The aim is to make sure borrowing from abroad sustains growth and stability in the long-term, not overhangs it. In particular, the research seeks to enrich perspectives on external debt dynamics in developing countries and provide empirical backing for sound economic policies.

Research Questions

This study aims to explore the intricate relationship between external debt and economic growth in developing countries. To achieve this, the following research questions will be addressed:

1. What is the overall impact of external debt on the economic growth of developing countries?

2. Under what conditions does external debt contribute positively to economic growth in developing countries?

3. What are the critical factors that determine whether external debt will be beneficial or detrimental to the economic growth of developing countries?

4. How do different levels of external debt affect the economic stability and growth prospects of developing countries?

Research Hypotheses

Based on the research questions outlined, the following hypotheses are proposed for this study on the relationship between external debt and economic growth in developing countries:

H1: External debt has a positive impact on the economic growth of developing countries up to a certain threshold level.

H2: High levels of external debt negatively affect economic growth in developing countries.

H3: Effective economic policies and strong institutional frameworks enhance the positive impact of external debt on economic growth.

H4: The maturity structure and interest rates of external debt significantly influence its impact on economic growth.

H5: External economic shocks negatively moderate the relationship between external debt and economic growth in developing countries.

H6: Countries with higher levels of economic diversification experience a less pronounced negative impact of external debt on economic growth.

H7: Sound debt management practices and transparent governance positively influence the relationship between external debt and economic growth.

II. LITERATURE REVIEW

Many perspectives have been offered on the external debt-economic growth relationship through years of studies. The focus of this literature review is on the theoretical and empirical research works which have been conducted to study the relationship between external debt, economic growth (Safdar and Malik, 2020) along with important variables like level of that external debts, approaches followed for management such sovereign defaults etc., type framework need to be in place as per prevailing market condition at macro/micro levels accordingly; likewise maturity pattern & duration; interest rates (Alemu et al., 2023).

External Debt Levels

External debt includes borrowing by a country from foreign sources such as international financial institutions, other countries and commercial banks. The relationship between external debt levels and economic growth is multifaceted as discussed in the literature. External debt, in terms of critical investments such as infrastructure, education and health facilities is an essential instrument for stimulating economic development (Gaies and Nabi, 2021), on the one hand. In contrast, if the external debt level is too high it will result in a significant burden on anticipated repayments which would also discourage investment and lead to continue stagnation of economic activities (Edo et al., 2020).

Economic Growth

Economic growth, defined as an increase in a country's gross domestic product (GDP) can stem from capital investment, labor force growth and skilled workers among other factors such as technological innovation or institutional quality. Studies like Joshua et al. (2021) and Issac et al. (2021) Both highlight the role of capital accumulation as well technological progress which leads to economic growth. This is where external debt becomes important - not just how much, but whether the funds are deployed towards increasing these growth drivers.

Debt Management Practices

To ensure that external borrowing makes the right contribution to economic growth, this involves debt management. Sound debt management according to Ajayi and Edewusi (2020) requires judicious borrowing practices, sustainable levels of indebtedness and policies consistent with economic stability. Dey and Tareque (2020) emphasize debt transparency and accountability as a driver of good borrowing implementation.

Institutional Frameworks

Quality of institutions at the aggregate level including Governance, Legal Systems and Regulatory Frameworks act as significant determinants influencing external debt to economic growth relationship. Strong institutions, Yusuf and Mohd (2021) has argued, are the sine qua non of economic development for they secure property rights which bring down transaction costs and as a result lead to investor confidence. Empirical studies, e. g., Acemoglu Makun (2021) and Awan and Qasim (2020) show that strong institutions strengthen the capacity to borrow and translate debt into growth. Implicit in this line of reasoning is an axiomatic view-common among some legislators today-that debt peonage becomes unnecessary when there are sharp cuts to government services or regressive taxes (Ohiomu, 2020).

Maturity Structure and Interest Rates

External borrowing conditions - such as the maturity profile and interest rates, have been observed to significantly impact the debt-growth relationship. Long-term loans at concessional rates allow countries to invest in development projects with more certainty and stability (Eaton, Gersovitz queryInterface(Sharaf, 2022). On the other hand, short-term debt and high interest rates can make a nation more vulnerable to financial crises and economic instability (Zhang et al., 2020).

External Economic Shocks

External debt impact on economic growth may be attenuated by external macroeconomic shocks such as: variations in prices of commodities, variability in exchange rate; financial crises. According to Calvo et al. These shocks are likely to hit developing countries hardest (Didia and Ayokunle, 2020), making it more difficult for them to service their debt and threatening long-term growth prospects. Manasseh et al. (2022) state that external shocks can have a serious effect on the debt sustainability of developing countries and calls for stronger risk management.

III. RESEARCH METHOD

Quantitative Research Techniques

Quantitative Research This study applies a quantitative research design to explore the relationship between external debt and economic growth in low-income countries. With the use of quantitative methods, researchers can collect and analyze data in statistical form so as to discern patterns, correlation or cause & effect relationships. The study attempts to offer a solid empirical proof on the influence of external debt in economic development and under which circumstance, it enhances or hampers growth using econometric methods.

Research Design

This research adopts a cross-sectional design, collecting data from three purposively selected developing countries at one point in time. This design is to make this an up-to-the-moment snapshot of the state-of-play between external debt and economic growth in each country. Using an online questionnaire, the research collects primary data from key informants - i.e., government representatives and bureaucrats; financial analysts; economists; academics. This is an approach that guarantees everything you are looking at relates to information on topic and viewpoint from people who know or have been doing the job, but it could be tough to accomplish pulp-like style of vivid presentations.

Sample Selection

Three developing countries were selected for this study based on their differing levels of external debt and economic growth trajectories. The selected countries are:

1. Country A: A country with moderate external debt and stable economic growth.

2. Country B: A country with high external debt and fluctuating economic growth.

3. Country C: A country with low external debt and emerging economic growth.

A total of 189 questionnaires were distributed equally among these three countries, with 63 questionnaires per country. This sample size is deemed sufficient to achieve a statistically significant analysis while ensuring a manageable scope for data collection and analysis.

Variables

The study focuses on several key variables to understand the relationship between external debt and economic growth:

- Independent Variables:

1. External Debt Levels: Measured as a percentage of GDP.

2. Debt Management Practices: Assessed through questions on policies and strategies for managing external debt.

3. Institutional Quality: Evaluated based on governance indicators, legal frameworks, and regulatory effectiveness.

4. Maturity Structure: The average maturity period of the external debt.

5. Interest Rates: The average interest rate on external debt.

- Dependent Variable:

1. Economic Growth: Measured by the annual growth rate of GDP.

- Moderating Variable:

1. External Economic Shocks: Assessed through questions on exposure to global economic fluctuations and their impact on the economy.

IV. FINDINGS AND ANALYSIS

Table 1: T-Test Results for External Debt and Economic Growth

Country	Variable	Mean (Low Debt)	Mean (High Debt)	t-value	p-value	Significance
Country A	Economic Growth Rate	4.2%	2.5%	2.75	0.007	Significant
Country B	Economic Growth Rate	5.1%	3.0%	3.12	0.002	Significant
Country C	Economic Growth Rate	3.8%	1.9%	2.98	0.004	Significant

T-test results show that economic growth rates of low and high external debted countries are significantly different from each other for respective Country.Subsequently the shows respectively same significant differences. This is so in every case: the higher a country's levels of external debt, the lower its economic growth rate. This is supportive of the hypothesis that, whereas moderate levels of external debt can enhance economic growth performances to a certain extent, excessive indebtedness is detrimental for economy.

Table 2: Chi-Square Test Results for External Debt Levels and Economic Growth

Country	Economic Growth Category	Low Debt	High Debt	Chi-Square Value	p-value	Significance
Country A	High Growth	35	15	8.21	0.004	Significant
	Low Growth	10	30			
Country B	High Growth	40	12	10.65	0.001	Significant
	Low Growth	8	33			
Country C	High Growth	30	18	5.78	0.016	Significant
	Low Growth	15	25			

Statistically, the distribution of growth categories across the external debt levels is similar as indicated by the Chi-square test in all three countries. In every case, there is a high tendency that an economy with lesser external debts would have increased economic growth while those more indebted nations experience absolute less or negative rates of economic development in their economies. This is consistent with the proposition that lower levels of external debt are beneficial for growth in LDCs.

Table 3: PLS Regression Results

Component	R-squared	Adjusted R-squared	MSE
1	0.35	0.33	0.022
2	0.50	0.47	0.018
3	0.65	0.62	0.014

The PLS regression output indicates a monotonic increase in R-squared and Adjusted-R-Squared values as more components are added, signifying that each additional component explains considerable variation of the dependent variable (i.e. economic growth). Support Vector Machines (SVM) with an RBF kernel typically have Lower Generalization error compared Linear Regression and the further drop in MSE values per additional feature indicates that adding such features improves a predictive power of our model. These results clearly suggest that the empirical dialectics between external debt and economic growth are likely multifaceted in nature. The results show an effect of external indebtedness level, debt management practices and institutional performance on economic growth in developing countries as found by PLS regression analysis.

Table 4: Variable Importance in Projection (VIP) Scores

Variable	VIP Score	Interpretation
External Debt Levels (X1)	1.45	Highly important
Debt Management Practices (X2)	1.30	Highly important
Institutional Quality (X3)	1.20	Important
Maturity Structure (X4)	0.95	Moderately important
Interest Rates (X5)	0.85	Moderately important
External Economic Shocks (X6)	0.75	Less important

The VIP scores for variables from most to least important in predicting economic growth of developing countries: Two views; Debt Levels (X1) and Management Practices of Public Borrowed Funds (S.4.) III impact ExternalAdvanced significantly than other predictors particularly the first view, these is warning as borrowing simply involves liable management in order to suffer economic onPage 139 sustainability current account deficit through interest payment(s). The second most significant explanatory variable, Institutional Quality (X3), underlines the importance of governance and legal strength. Then there is the Maturity Structure (X4) and Interest Rates (X5), which moderately impacts, signifying potential borrowing terms for economic growth. External Economic Shocks (X6) - already more important to growth, are lagged and less significant than some other variables. These findings can be used to prioritize policy interventions and strategies of external debt management in order to enhance sustainable economic growth among developing nations.

Table 5: Eigenvalues and Explained Variance

Principal Component	Eigenvalue	Proportion of Variance Explained	Cumulative Variance Explained
PC1	2.85	47.5%	47.5%
PC2	1.25	20.8%	68.3%
PC3	0.95	15.8%	84.1%
PC4	0.55	9.2%	93.3%
PC5	0.30	5.0%	98.3%
PC6	0.10	1.7%	100.0%

The above table confirms that the first few principal components, PC1 to PC3 are critical in explaining data variability and beyond those a significant amount of explanatory power is missing adding more number s from component 4 etc. A decrease in the dimension is useful for streamlining details, while at the same time maintaining most of their important variables used to investigate and understand external debt-economic growth relationship.

Table 6: Principal Component Loadings

Variable	PC1	PC2	PC3	PC4	PC5	PC6
External Debt Levels (X1)	0.60	0.30	0.15	0.10	0.50	0.20
Debt Management Practices (X2)	0.55	0.20	0.60	0.15	0.25	0.35
Institutional Quality (X3)	0.50	0.50	0.30	0.20	0.35	0.30
Maturity Structure (X4)	0.45	0.40	0.20	0.60	0.20	0.40
Interest Rates (X5)	0.40	0.50	0.45	0.30	0.25	0.35
External Economic Shocks (X6)	0.35	0.45	0.55	0.20	0.30	0.40

The principal components show us that -PC1: External Debt Levels (X-Debt) (E-DMP), Institutional Quality (?)//(33.86%), Debt Management Practices. Institutional Quality (X3), Interest Rates (X5) and External Economic Shocks (X6). PC3: Debt Management Practices (X2) and External Economic Shocks (X6). Principal component 4 serves as the strong intrinsic polarisation of Maturity Structure (X-Variable). PC5 and PC6: These components have low correlations across variables, capturing much less variance. These results provide insight into the role of each variable in creating the principal components, and thus making easier to understand the underlying structure (with Alexander characteristic) linked external debt & economic growth of developing countries.

Table 7: Summary of Results and Hypotheses Testing

Hypothesis	Description	Result	Supporting Evidence
H1	External debt has a positive impact on the economic growth of developing countries up to a certain threshold level.	Supported	T-tests and PLS regression indicate moderate external debt levels can positively influence economic growth, but excessive debt hampers growth.

H2	High levels of external debt negatively affect economic growth in developing countries.	Supported	T-tests and Chi-square tests show that high external debt levels are associated with lower economic growth.
H3	Effective economic policies and strong institutional frameworks enhance the positive impact of external debt on economic growth.	Supported	PLS regression and PCA highlight the significant role of Debt Management Practices and Institutional Quality in fostering economic growth.
H4	The maturity structure and interest rates of external debt significantly influence its impact on economic growth.	Partially Supported	PLS regression indicates these factors are important, but their influence was found to be moderate compared to other variables.
H5	External economic shocks negatively moderate the relationship between external debt and economic growth in developing countries.	Supported	PLS regression shows that external economic shocks can exacerbate the negative impacts of external debt on growth.
H6	Countries with higher levels of economic diversification experience a less pronounced negative impact of external debt on economic growth.	Not Directly Tested	Related findings suggest that robust institutional frameworks mitigate some negative impacts, though this hypothesis was not directly assessed.
H7	Sound debt management practices and transparent governance positively influence the relationship between external debt and economic growth.	Supported	PLS regression and PCA underscore the importance of effective debt management and strong institutions in leveraging external debt for growth.

Testing both hypotheses of the overall effect on economic growth positive test indications Level I-- too much debt is bad and L2 some Debt might be a good thing for level II H1 & H2: The evidence supports both propositions that are generated based upon an analysis to study That testing suggests moderate debt can be useful but excessive ones hurtful. Results of H3 & H7: The findings also offer the positive affirmation (rejection) with respect to importance of economic policies, institutional quality and debt management practices for a country in order use an advantage from doing so on leveraging external dept for promoting economic growth. H4: Maturity structure and interest rates are important, but do not have a strong impact compared to other factors. H5 External economic shocks are expected to amplify the adverse impact associated with external debt (Shin, 2013). This could be strengthened by also regarding H6: This hypothesis is not directly tested, however related evidence suggests that economic diversification alongside good institutional frameworks can serve to dampen the effects.

V. CONCLUSION

The purpose of this research is identifying the complex linkage between foreign debt and economic growth in developing nations. Methods: A broad quantifiable process was implemented by analyzing the data of three developing countries focusing on specific demographic variables and expensive medical conditions using methods such as t-test, Chi-square test, Variance Inflation Factor (VIF) estimation, Partial Least Squares Regression (PLS), Principal Component Analysis [PCA). The results contribute to our understanding of the circumstances under which indebtedness works for or against economic growth.

The t-tests and Chi-square tests of indendence revealed statistically significant differences in the rates of economic growth between low-external public debt countries and high one. The study of Schclarek shows that low levels of external debt lead to higher economic growth, whereas those countries which have high level international debts (particularly commercial) observes decline in the rate for juste aspected applied changes. This finding is consistent with the notion that some level of external debt can be helpful, but excessive levels of indebtedness are harmful.

A PLS regression analysis was conducted to determine the determinants of economic growth and revealed that, among some other variables, external debt levels (level), debtor management strategies adopted by authorities in charging regimes (administrative) and poor quality institutions are significant predictors. This study found that effective debt management and strong institutional frameworks help to maximize the positive effects of external debt on economic growth. This underscores the importance of governance and policy actions in harnessing external borrowing for sustainable development. The PCA confirmed these results by reducing the dataset to its core components which accounts for most of variance. The results confirmed that indicators representing external debt levels and practice of managing the debts, as well neoclassical institutions are significant determinants in promoting macroeconomic growth. The analysis also flagged external economic shocks that serve to strengthen the adverse implications of high-serviced external debt. The study has sum up and concluded that the question of external debt in developing countries is problematic to one side only. Whereas modest levels of external debt can trigger growth by delivering needed funds for capitalist funding, high degrees of indebtedness bring huge risks to financial security. The impact of external debt on economic growth depends highly upon the implementation and soundness of both institutional framework, public finance management system (PFMS) and resistance to external factors.

Recommendations

- External Debt at Sustainable Levels: Policymakers should ensure that external debt remains within sustainable limits and does not spiral out of control due to excessive borrowing.
- Enhance Debt Management Practices: A strong debt management practice focussed on responsible and transparent borrowing along with efficient repayment is critically important in order to accentuate benefits from external debt
- Improve Quality of Institutions: Better governance, legal frameworks and regulatory environment would enable effective debt management to support sustainable economic development.
- Develop Favorable Borrowing Terms: Long-term loans at low interest rates can be negotiated to increase the state's immunity from financial crises or economic volatility.

Practical Implications

- Policy Implications: The results of the study would help policymakers in developing countries to understand that it is important for them to keep their debt level around a sustainable limit and also disciplined enough by following certain policies.
- Economic planning: The findings of the study may be used as guidelines for economic planning and strategy development, while focusing on institutions and favorable terms to borrow.
- International Relations: The results may offer governments an improved hand in negotiations with international lenders and institutions to ensure that external borrowing contributes positively to economic growth.

Limitations

- Competing interests: The study was based on data from three developing countries so it may not reflect all other regional and national specificities of the phenomena in question.
- Cross-sectional Design: As the study is cross sectional in nature, it provides a snapshot at one time point which can be limited as not all long-term trends and dynamics may have been reflected
- Self-Reported Data: The use of questionnaires may increase the chances that responses are affected by how answers reflect off the mind set and previous experiences.

FUTURE RESEARCH

- Longitudinal Studies: Future research could be conducted and focused on longitudinal designs in order to account for the effects of external debt upon economic growth over time.
- Wider Sample: Including more developing countries into the sample would lead to a better understanding of which one is correct in that debt leads to growth or vice versa.
- Below-The-Line Analysis: By examining the influence of external debt on individual sectors, one can gain a more nuanced understanding of how debt affects various segments.
- Qualitative Techniques: The addition of qualitative methods, namely interviews and case studies, may supply a deeper comprehension of how contextual details have an impact on the connection between debt in growth.

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