
EXTERNAL DEBT, INSTITUTIONAL QUALITY, AND MACROECONOMIC PERFORMANCE IN SOME SELECTED WEST AFRICAN COUNTRIES.

BY

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Abstract

The study examines the relationship between external debt, institutional quality, and macroeconomic performance in some selected West African countries (Nigeria, Ghana, Cameroon, Senegal, and Togo). The study employs econometric tools to analyze the data sourced from World Development Indicators (WDI). The study utilizes panel data for six countries spanning from 2010 to 2021. Furthermore, the study uses pedroni residual-based panel cointegration test to examine the long-run relationship between the variables. The results of the panel cointegration test validate the presence of a long-run relationship among the variables. In addition, the study explores the fully modified OLS (FMOLS) estimation technique for the analysis. The results obtained from the panel FMOLS for the selected West African countries reveal that external debts have a negative impact on gross domestic product, while institutional quality has a positive impact on gross domestic product in the selected West African countries. The policy implication is that the governments of the selected countries should ensure that external debt is utilized effectively and efficiently in growth-enhancing sectors with a view to boosting growth and bringing about economic development. Additionally, rather than borrowing from abroad, the governments of the selected countries should turn to other sources of funding. The study also suggests that institutional quality be improved further in order to attain higher economic growth.

Keywords: External Debt, Institutional Quality, Macroeconomic Performance, West African Countries

1. Introduction

Making sure that there is both rapid and sustainable economic growth and price stability is one of the main goals of government macroeconomic policy (Ijaz, 2021). In the meantime, all countries but especially developing ones need sustainable economic growth to reduce the persistent fiscal deficits brought on by the servicing of external debt and rising current account deficits (Senadza et al., 2017). Any economy's primary source of finance is external debt. Due to their low savings and revenue, developing nations rely on external debt to fund their programs. According to S. Ayadi & O. Ayadi (2008), this leads to rising debt servicing obligations, which causes external debt to mount and stress a developing nation's economy. External debt is thought to have an impact on economic growth; this impact could be positive or negative. Economic growth is negatively impacted by rising external debt (Khaled & Mohammad, 2019). When external debt fosters economic expansion, this is advantageous (Thiora, 2021).

One of the key drivers of GDP development is institutional quality. Contextual controls are imposed by institutions to help them create and enforce rules and regulations in the open (Acemoglu and Robinson, 2010). In general, the policies domestic institutions execute to provide the legal and cultural context for socioeconomic activity are connected with the quality of the institution. This demonstrates the government's capacity to develop and implement laws and policies that support the private sector, enhance contract execution quality, protect property rights, uphold the rule of law, and ensure institutional independence from political influence (Canh et al., 2019). However, weak institutions ineffectively promote the private sector, which breeds corruption, a dysfunctional bureaucracy, and lax environmental restrictions (Asoni, 2008). The impact of institutional quality on the relationship between external debt and growth has begun to be studied in this field (Mensah et al., 2018; Cordella et al., 2010; Imbs and Ranciere, 2005). Daud (2020) finds that institutional quality plays a significant role in how external debt affects economic growth. The fact that institutional quality has a relatively minor impact on growth at high levels of foreign debt further supports the idea that external debt has a negative impact on a nation's economic growth.

Furthermore, estimates from the regressions show that institutional quality does in fact influence how much of an impact external debt has on economic growth. Additionally, actions to curb corruption and the rule of law were found to worsen the negative effects of foreign debt on economic growth. Institutional quality index, government stability, effectiveness, and law and order reduce the negative effects of external debt on economic growth. The institutional quality limits beyond which foreign debt promotes growth were also established. The study's policy implications include the requirement that fiscal authorities in HIPC review the current institutional framework governing the procurement, disbursement, and utilization of external debt with a view to identifying any gap and weakness that prevents it from fostering growth (Hassan & Meyer, 2021). Improvements in institutional quality have been shown to promote stronger economic growth (Mehmood et al., 2023). It is impossible to overstate the significance of institutions in figuring out how foreign debt might spur economic growth. According to Salman et al. (2019), local institutions are crucial for boosting economic growth. The critical impact of institutional quality on the GDP growth rate is further supported by Lau et al. (2014). According to the authors, fostering a local institutional framework will hasten economic progress.

Wang, Xue, and Zheng's (2021) study, the combined effects of institutional quality and external borrowing costs on a country's reaction to external debt expansion are examined.

Better institutions are intuitively seen as a source of comparative advantage among nations to lower conflict and boost economic effectiveness. The findings also imply that institutional strength and sovereign foreign spreads play a role in the marginal effect (ME) of an increase in external public debt on subsequent growth. Meanwhile, it has been discovered that nations with high levels of democracy and low levels of corruption have greater levels of debt at which the impact of external debt on economic growth becomes detrimental. This means that a country cannot take full advantage of its credit potential if its institutions are of inadequate quality. As a result, debt becomes a more important source of funding for economic growth as more nations adopt democracy (Nounamo et al., 2021).

2. Review of empirical literature

The impact of external debt, institutional quality, and macroeconomic performance around the world has been the subject of an expanding body of scholarship in recent years. The impacts of the available studies, to some extent, ranged from favorable to negative to no impact.

Aladejare (2023) examines the impact of external debt on longevity in developing countries, especially in West Africa from 1981-2020. The study adopts the cross-sectional augmented autoregressive distributed lag (CS-ARDL), dynamic common correlated effects (DCCE), and the Driscoll-Kraay (D-K) methods to ensure the robustness of the inferences. The study discovers that unsustainable, illiquid, and insolvent external debt and macroeconomic volatility shorten longevity mainly in the long-term in West Africa countries while longevity will decline when weak external debt management promotes poverty in developing countries.

Farooq, Zaib, Faheem & Gardezi (2023) investigate the effects of public debt and environment degradation in OIC countries: and institutional quality as the moderating role. This study aims to close this gap by evaluating if institutional quality is a factor in moderating the debt-environment relationship of OIC economies in the period 1996-2018. The study employs Panel data to estimate the derived. The results of the study reveal that public debt statistically significantly degrades the environment quality in the panels of low and overall OIC-income countries, but it improves the environmental performance in the high-income panel of OIC countries. Across the three income tiers of OIC nations, institutional performance is inversely correlated with all environmental detrimental metrics. Both the short-run and long-run outcomes of the interactive term between public debt and institutional quality show that it turns the unfavorable influence of public debt on environmental damaging measures.

Ashogbon, Onakoya, Obiakor & Lawal (2023) focuses on the impacts of public debt and institutional quality on economic growth in Nigeria from 1981 to 2021. The study applies Autoregressive distributed lag by using public debt, labour force, institutional quality, exchange rate and gross capital formation as the independent variables while real gross domestic product was the dependent variable. The research results show evidence of long run equilibrium relationship among the variables. Similarly, results show that in the long run domestic public debt establishes a positive significant influence on economic growth. Additionally, institutional quality has a significant negative effect on economic growth in the long run with no such evidence reveal in the short run.

Olaoye (2023) examines the impact of public debt on macroeconomic performance and the study also examines if the past relief from debt has a positive impact upon Sub-Saharan African economies. In order to account for potential endogeneity and feedback effects in dynamic panel models, the study uses the two-step system GMM. The study employs the

two-stage least squares (2SLS) estimation method as a robustness measure. The results show that prior debt reduction initiatives had a negligibly small impact on regional economic expansion. The study further discovers that corruption impacts negatively on the effectiveness of the debt relief to achieve the main economic results. The study also finds out that sub-Saharan African economies seem to have deviated from the traditional concessional sources of financing towards market-based lenders dominated by China

Mehmood, Mohy Ul Din, Aman-Ullah, Khan & Fareed (2023) evaluate the relationship between Institutional quality and economic growth: Indication from South-Asian countries including Bangladesh, Bhutan, India, Nepal, Pakistan and Sri Lanka from 2002 to 2018. The data are estimated through the dynamic heterogeneous panel (panel autoregressive distributed lag model) approach, precisely the dynamic fixed effect (DFE), mean group (MG), and pooled mean group (PMG). According to the findings, three governance indicators—namely, the control of corruption, accountability, and the presence of the rule of law—have a positive and significant impact on economic growth. Every country has consistent long-term projections, but different long-term projections and adjustability rates for long-term equilibrium.

Manasseh, Abada, Okiche, Okanya, Nwakoby, Offu & Nwonye (2022) examine the impact of external debt on economic growth in thirty selected Sub-Saharan African (SSA) countries by using annual time series data from 1997 to 2020. The study makes use of the Dynamic System Generalised Method of Moments estimation technique to analyze the data. The results of the empirical findings show that external debt and external debt volatility have a negative and significant impact on economic growth in SSA. Further findings show that the interaction between governance indices and external debt and its volatility have a positive impact on economic growth of Sub-Saharan African countries.

Sadow, Oteng-Abayie & Duodu (2022) evaluate the empirical effect of external debt on economic growth, taking into consideration heterogeneity in the public sector management (PSM) in selected 31 Sub-Saharan African countries spread over from 2005 to 2017. The study adopts the system-generalized method of moment (system-GMM) and the panel smooth transition regression (PSTR) estimation techniques to analyze the data. The findings indicate that, without regard to PSM quality, external debt in SSA significantly retards economic growth. When foreign debt interacts with PSM quality, however, the effect of external debt on economic development for SSA nations with a high PSM quality tends to be positive. Additionally, the findings demonstrate that nations with high PSM quality saw faster economic growth than nations with low PSM quality.

Beyene & Kotosz (2022) investigate the impact of external debt on total factor productivity and growth in heavily indebted poor countries (HIPC). The study uses panel econometrics – basically the seemingly unrelated regress (SUR) and alternative n-Linear (panel threshold) models. For a robustness check it also uses panel-corrected standard error, feasible generalized least squares and SUR (using alternative variables). The results of the findings show that external debt reduces both growth and TFP significantly. It confirms besides, that the relation between external debt and TFP and gross domestic product growth are non-linear. Further external debt could impact growth of HIPC through the TFP channel. Nevertheless the result of the threshold model reveals a weak evidence of threshold values despite some threshold values 67 and 54 for growth models.

Agyeman, Sakyi & Oteng-Abayie (2022) examine the impact of external debt and economic growth in selected sub-Saharan African countries. The study employs dynamic system

generalized method of moments technique with data ranging from 2000 to 2015. The results reveal that the direct impact of both capital flight and external debt and their combined effect on economic growth is negative and statistically significant. Additionally, marginal effects results show that a low level of capital flight has no visible effect on the negative impact of the external debts on economic growth. A high rate of capital flow in comparison to the negative effect of external debt exacerbates the economic growth.

Gibogwe, Nigo & Kufuor (2022) examine the relationship between *Institutional Quality and Economic Growth in Tanzania*. The study employs the ARDL technique of estimation to find out the impact institutional quality has on economic growth in Tanzania from 1990 to 2021. According to our findings, every adjustment term in each model with a long-run relationship has the correct (negative) sign and has more than one occurrence, indicating that there is long-term convergence. In other words, the models returned to their long-run equilibrium, and the rate (or speed) at which this occurred ranged from 15% to 106.6% annually. The long-term causal effect of institutional quality on economic development is significantly positive (0.047).

Chien, Chau, Aldeehani, Huy, Tan & Mohsin (2022) investigate external debt as a new determinant of fiscal policy influence sustainable economic growth within the South Asian sub-region for the period of 2000-2018. Quantile estimation, pooled ordinary least square, longitudinal root-analysis, and output estimation are all used to assess the data from the World Bank Development Indicators. After conducting a robust regression analysis, the study discovers that the effects of total external debt and the services related to external debt are 39% and 31%, respectively. In addition, the results show that, during the research period, fiscal policy had direct cross-country expansionary effects on developing economies.

Omotor (2021) examines external debt sustainability in West African countries for the period of 2010 to 2017. In order to analyze the external debt sustainability and solvency of ECOWAS members, the research employs a debt sustainability framework using a variety of ratios (including the present value approach, Country Policy and Institutional Assessment debt policy assessment ranking, and solvency ratio of external debt). According to the findings, the majority of ECOWAS nations are already on an unsustainable debt trajectory and may default on their debt obligations, which would start a vicious cycle of external borrowing and perhaps cause capital flight.

Wang, Xue & Zheng (2021) evaluate how high external debt predicts lower economic growth; role of sovereign spreads and institutional quality between 1970 and 2018. The study adopts panel regression using data from low and middle-income countries (LMSs). The findings suggest that slower short- and medium-term growth is consistently predicted by rising total, long-term, or external public debt. The fact that external borrowing, especially by the public sector, significantly contributes to macroeconomic fragility is shown by the paucity of data on the non-linear relationship between external debt growth and debt.

Hassan & Meyer (2021) examine the moderating effect of institutional quality on the external debt-economic growth nexus: Insights from highly indebted poor countries (HIPC). Using a two-step system generalized method of moments (GMM) estimator, the study is estimated. Regression estimates show that institutional quality does in fact influence how much external debt has an impact on economic growth. Additionally, measures to curb corruption and the rule of law are found to worsen the negative effects of external debt on economic growth,

while the institutional quality index, government stability, effectiveness, and law and order alleviate the effects.

Kur, Chukwu & Ogbonna (2021) investigate the impact of external debt on sectoral performance: Comparative study of Nigeria and Botswana between 1981 and 2019. The study employs the Autoregressive Distributed Lag (ARDL) to estimate and evaluate the data, as well as the dual gap theoretical framework. The study uses information from the World Development Indicators (WDI) to concentrate on the following three sectors: services, agriculture, and industry. Results show that only the agricultural sector in Botswana is positively impacted by external debt, whereas external debt has a long-term, significantly negative impact on the agricultural sector in Nigeria.

3. METHODOLOGY

This study employed panel data for the period 2010 to 2021. It utilizes secondary data obtained from the World Bank Development Indicators, the National Bureau of Statistics and the Central Bank of Nigeria’s statistical bulletins.

Model Specification

$$EXD = (\text{GDP, IQ} \dots \dots \dots) \quad (1)$$

$$EXD = \alpha_0 + \alpha_1 \text{GDP} + \alpha_2 \text{IQ} + \epsilon \dots \dots \dots (2)$$

Where;

EXD= External debt

EX= Institutional quality

GDP= Gross domestic product

And α_0 = Intercept and α_1, α_2 , are the parameters and ϵ is the error term.

4. Results and Discussions

Table 1: Descriptive Statistics

	GDP	EXD	IQ
Mean	4.619998	26.11882	3.136667
Median	4.893718	26.02787	3.000000
Maximum	14.04712	58.84075	4.000000
Minimum	-1.794253	4.950816	2.500000
Std. Dev.	2.634237	12.90430	0.458430
Skewness	0.206790	0.400965	-0.148117
Kurtosis	4.813749	2.824009	1.834661
Jarque-Bera	8.651839	1.685165	3.614421
Probability	0.013221	0.430597	0.164111
Sum	277.1999	1567.129	188.2000
Sum Sq. Dev.	409.4131	9824.738	12.39933
Observations	60	60	60

From the data in table 4.1 above, the Jaque-Bera statistics shows values less than 10%, implying that all the variables were normally distributed. The skewness statistics were positive for all the variables except for institutional quality which is negative, all variables

were skewed to the right implying that they all had a long right tail. Kurtosis which measures the level of sharpness of the distribution revealed that all the variables were platykurtic in nature as their values are less than 3, except for gross domestic product with value greater than 3, which implies that it is leptokurtic

Table 2: Correlation Matrix

variable	GDP	EXD	IQ
GDP	1.000000	0.055165	0.204861
EXD	0.055165	1.000000	0.315415
IQ	0.204861	0.315415	1.000000

Table 3: Unit root results

Variable	Level	1 st Diff	prob	Remark
GDP		1.67178	0.0047	I(1)
EXD		1.86898	0.0345	I(1)
IQ		0.9762	0.0000	I(1)

The unit root test is a pre-estimation test for stationarity of the variables under investigation. Augmented Dickey Fuller (ADF) and Phillip Perron (PP) unit root tests were used to check for the stationarity or trend of the variables under consideration. The results in table 1 revealed that all the variables were not stationary at levels, indicating the presence of unit root in the series. The variables were further checked for their stationarity at first difference. The results from the table revealed all the variables were integrated of order 1. This implies that all the variables became stationary after taking their first difference. Since the results revealed that all the variables are I(1), we therefore proceed with co-integration test. This is to test for the presence of long run relationship among the variables. This validates the adoption of panel cointegration test.

Dependent Variable: GDP
 Method: Panel Fully Modified Least Squares (FMOLS)
 Date: 06/04/23 Time: 10:10
 Sample (adjusted): 2012 2020
 Pedroni Residual Cointegration Test
 Series: GDP EXD IQ
 Date: 06/04/23 Time: 10:13
 Sample: 2011 2020
 Included observations: 60
 Cross-sections included: 4 (2 dropped)
 Null Hypothesis: No cointegration
 Trend assumption: No deterministic trend
 User-specified lag length: 1
 Newey-West automatic bandwidth selection and Bartlett kernel

Alternative hypothesis: common AR coefs. (within-dimension)

	Statistic	Prob.	Weighted Statistic	Prob.
Panel v-Statistic	0.644792	0.2595	0.217129	0.4141
Panel rho-Statistic	0.522565	0.6994	0.570489	0.7158
Panel PP-Statistic	-0.741150	0.2293	-0.839310	0.2006
Panel ADF-Statistic	-1.043814	0.1483	-1.602621	0.0545

Alternative hypothesis: individual AR coefs. (between-dimension)

	Statistic	Prob.
Group rho-Statistic	0.989688	0.8388
Group PP-Statistic	-1.164733	0.1221
Group ADF-Statistic	-1.518974	0.0644

Cross section specific results

Phillips-Peron results (non-parametric)

Cross ID	AR(1)	Variance	HAC	Bandwidth	Obs
Nigeria	Dropped from Test				
Ghana	0.216	5.774164	6.391126	1.00	9
Benin	0.177	2.675922	0.814402	6.00	9
Cameroon	0.483	0.267663	0.375271	1.00	9
Senegal	Dropped from Test				
Togo	-0.810	0.556280	0.544592	1.00	9

Augmented Dickey-Fuller results (parametric)

Cross ID	AR(1)	Variance	Lag	Max lag	Obs
Nigeria	Dropped from Test				
Ghana	0.100	5.766165	1	--	8
Benin	-0.342	1.293678	1	--	8
Cameroon	0.252	0.141063	1	--	8
Senegal	Dropped from Test				
Togo	-0.861	0.621432	1	--	8

The results obtained from the table above revealed that the within group dimension reports that Phillip Perron is statistically significant while the other estimators are not statistically significant. This simply implies that panel Phillip Perron statistics failed to accept the null hypothesis of no cointegration, which indicates that the variables in the model are cointegrated in the long-run. This implies that there is evidence of long-run relationship

between external debt and gross domestic product in West African countries. Furthermore, since it has been established that there is presence of long-run relationship among the variables, then we proceed to estimate the coefficients of the model using the panel cointegration estimation.

Panel cointegration estimates

The panel cointegration estimate is used to determine the effects of the explanatory variables on the dependent variable. The cointegrating vector is estimated using the Fully modified Least square (FMOLS). Table 3 shows the coefficients of explanatory variables for the selected countries and gross domestic product, the dependent variable.

The Fully modified least square results for the selected countries shows that external debt has negative but not significant impact on gross domestic product in ECOWAS countries. The results further revealed that institutional quality have positive but not significant impact on the gross domestic product in the countries. The implication of these results is that, an increase in the external debt will lead to a decrease the gross domestic product in the countries. On the other side, an improvement in institutional quality will bring about an increase in the gross domestic product in west African countries.

5. Summary and Conclusion

The study examines the relationship between external debt, institutional quality and gross domestic product in West African countries. The study employed econometrics tools to analyze the data sourced from World Development Indicators (WDI) of the World Bank. The study employed a panel cointegration technique to examine the properties of the time series using panel unit root test.

The results of the panel unit root test revealed that all the data series were not stationary at their respective level but became stationary after their first difference. Furthermore, the study employed Pedroni residual based panel cointegration test to investigate the long run relationship between the variables. The results of the panel cointegration test validate the presence of long-run relationship among the variables. In addition, the study explored the fully modified OLS (FMOLS) estimation technique for the analysis. The results obtained from the panel FMOLS for the selected West African countries revealed that external debts have negative impact on gross domestic product, while institutional quality has positive impact on the gross domestic product in the selected West African countries. By implication, level of external debt exhibits a negative influence on the gross domestic product of West African countries.

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