

Revisiting The Theory Of Public Debt And Economic Growth

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Abstract

Public debt is one of the fiscal policy instruments used by the government to close the deficit, finance development and stabilize the economy. However, the relationship between public debt and economic growth is still a matter of debate in the economic literature. This study aims to review the relationship between public debt and economic growth with an emphasis on a theory-based approach. The method used is a systematic literature review (SLR) of international journal articles published. This study groups research findings based on the main theoretical framework, namely neoclassical, keynesian, debt overhang, ricardian equivalence, and endogenous growth. The results of the review show that the influence of public debt on economic growth is contextual and influenced by the quality of institutions, debt structure, economic conditions and the effectiveness of government spending. In general, public debt tends to have a negative impact on growth when it has crossed the limit, but it can be neutral or even positive under certain conditions. This article contributes by presenting a comprehensive theoretical synthesis, providing direction for empirical research and the formulation of fiscal policy going forward.

Keywords: *Public debt, economic growth, theory, fiscal policy, systematic literature review*

JEL: *E62, H63, O40*

Abstrak

Utang publik merupakan salah satu instrumen kebijakan fiskal yang digunakan pemerintah untuk menutup defisit, membiayai pembangunan dan menstabilkan perekonomian. Namun, hubungan utang publik dan pertumbuhan ekonomi masih menjadi perdebatan dalam literatur ekonomi. Penelitian ini bertujuan untuk meninjau hubungan antara utang publik dan pertumbuhan ekonomi dengan menekankan pendekatan berbasis teori. Metode yang digunakan adalah systematic literature review (SLR) dari artikel jurnal internasional yang dipublikasikan. Kajian ini mengelompokkan temuan penelitian berdasarkan kerangka teori utama, yaitu teori neoklasik, keynesian, debt overhang, ricardian equivalence, dan pertumbuhan endogen. Hasil tinjauan menunjukkan bahwa pengaruh utang publik terhadap pertumbuhan ekonomi bersifat kontekstual dan dipengaruhi oleh kualitas institusi, struktur

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utang, kondisi ekonomi serta efektivitas belanja pemerintah. Secara umum, utang publik cenderung berdampak negatif terhadap pertumbuhan ketika telah melewati batas, namun dapat bersifat netral atau bahkan positif dalam kondisi tertentu. Artikel ini berkontribusi dengan menyajikan sintesis teoretis yang komprehensif, memberikan arah bagi penelitian empiris dan perumusan kebijakan fiskal ke depan.

Keywords: *Utang publik, pertumbuhan ekonomi, teory, kebijakan fiskal, tinjauan literatur sistematis.*

JEL: *E62, H63, O40*

INTRODUCTION

Public debt has become a central issue in the macroeconomic debate, especially related to its role in encouraging or hindering economic growth. Many countries, both developed and developing, rely on government debt to encourage economic activity, closing the budget deficit, as well as financing infrastructure development (Casalin et al., 2020). Increase in the debt-to-gross domestic product (GDP) ratio has important implications regarding fiscal sustainability and its impact on economic performance in the medium to long term, especially when debt ratios are high (Ciaffi et al., 2024). In the last two decades, the global debt ratio has increased, raising concerns for the economy, as it has the potential to jeopardize fiscal, financial, and macroeconomic stability (Morganti, 2022). High debt can hinder and increase the volatility of GDP growth rates. The debate about the potential negative impact of debt on long-term economic performance is not new. In recent years, many countries have high debts, especially countries with questionable ability to pay their debts (Rojas et al., 2021). Like countries in Sub-Saharan Africa (SSA), often criticized for being called in part reckless borrowing, many of them struggling to make ends meet due to debt (Haabazoka & Kaulu, 2023).

Based on data from the International Monetary Fund (IMF), the ratio of global government debt to Gross Domestic Product (GDP) increased from 79% in 2008 to 100% in 2020, indicating a dependence on debt financing, especially in times of economic shock (IMF, 2021). This condition poses a double challenge, where the government is required to maintain fiscal sustainability while maintaining economic growth momentum. This fact reinforces the argument that the relationship between public debt and economic growth cannot be separated from the context of changing global macroeconomic conditions. In addition to global factors, differences in domestic characteristics also play a role in determining the impact of public debt. Countries with strong income bases, relatively developed financial markets, and effective tax systems tend to have greater fiscal space to manage debt accumulation. In contrast, countries with high levels of economic informality and limited fiscal capacity are more vulnerable to debt risk. The OECD (2023) shows that the effectiveness of public spending as a driver of growth is influenced by the quality of planning and the efficiency of fiscal policy implementation, not solely by the size of the budget or the level of debt.

Theoretically, the relationship between public debt and economic growth is uncertain. The neoclassical approach emphasizes that financing deficits through debt can have an effect *crowding out*, namely the urgency of private investment due to interest rate hikes, thus negatively impacting economic growth (Broner et al., 2014). Meanwhile, the Keynesian perspective states that public debt can drive economic growth through increased government spending and multiplier effects on national output (Elmendorf & Mankiw, 1999). On the contrary, the theory *Debt overhang* argues that high debt levels can suppress economic growth because it increases uncertainty, reduces private investment, increases the burden of interest payments and creates expectations of future tax increases ((Krugman, 1988; Reinhart & Rogoff, 2010). On the other hand, the Ricardian equivalence theory argues that public debt is growth-neutral because economic agents anticipate future tax liabilities (Barro, 1974). These differences in theoretical views are reflected in the diverse and often inconsistent empirical findings. In recent years, modern approaches such as endogenous growth theory and Modern Monetary Theory (MMT) have also expanded the discourse by emphasizing the importance of the quality of public spending, production capacity, and institutional conditions in determining the impact of debt on economic growth (Otieno, 2024; Romer, 1990; Mosler W, 1993).

In line with the theoretical debate, the empirical findings show mixed results. A number of studies have found that public debt has a positive impact on economic growth, especially when used to finance productive investments and is at a relatively low level (Hilton, 2021 ; Gu et al., 2022 ; Koome & Nasieku, 2025). However, other studies have shown negative impacts, especially in countries with limited fiscal space and institutional weakness (Bakri et al., 2022; Awadzie et al., 2025). In addition, cross-country studies often find relationships that are non-linear, where debt can drive growth to a certain extent before it ends up negatively impacting Augustine & Rafi, (2023). The findings suggest that the relationship between public debt and economic growth is nonlinear and highly contextual. This fact confirms that a single debt threshold-based approach tends to be inadequate to comprehensively explain the dynamics of the debt-growth relationship.

Although the amount of empirical research on public debt and economic growth continues to increase, however, most are empirical and focus on estimating results without deep theoretical integration. Recent literature, including studies *Systematic Literature Review* by Yangailo, (2024), shows that the relationship between public debt and economic growth is contextual and highly dependent on the economic conditions of each country. However, most existing literature reviews tend to classify research results into positive, negative, and non-linear categories. A systematic review is needed that not only summarizes the empirical findings, but also places them within the framework of relevant economic theory.

Moreover, attention to the difference in economic and fiscal conditions as a determining factor in the relationship between public debt and economic growth is still relatively limited in literature review. Variations in economic conditions, such as development levels, debt structures, and fiscal management capacity have the potential to affect the effectiveness of public debt in boosting economic activity. Some studies show that economic growth is not only influenced by fiscal policy directly, but

also by the macroeconomic and structural conditions surrounding it. Sinaga et al., (2025) emphasized that monetary dynamics, especially the money supply, have an important role in determining the pace of economic growth. Meanwhile, Handayani & Hanifa, (2024) found that structural factors such as income inequality, education level, and poverty also shape economic growth performance, thus strengthening the argument that the influence of public debt on growth is not uniform between countries. Therefore, a literature review that emphasizes transmission mechanisms and the role of economic context in shaping the relationship between public debt and economic growth is necessary.

Based on this background, this article aims to compile a theory-based systematic literature review by classifying research findings, identifying general patterns and differences in outcomes, and highlighting the role of economic conditions and fiscal context in shaping the relationship between public debt and economic growth. Thus, this study is expected to be able to provide a more comprehensive understanding of the dynamics of public debt and its implications for economic growth, as well as become the basis for the formulation of sustainable fiscal policies.

RESEARCH METHOD

Types and Approaches to Research

This study uses a literature review approach with a narrative–systematic review method that offers guidance for designing, evaluating, and writing a comprehensive review (Snyder, 2019). This approach was chosen to provide accurate and systematic results on empirical findings related to the relationship between public debt and economic growth, as well as to identify economic mechanisms and explain differences in research results.

Data Collection Sources and Techniques

The research data is sourced from scientific articles published in international journals. Articles are collected through several academic databases, such as Scopus, Web of Science, as well as other journal repositories. The literature search process was carried out using a combination of keywords, including *public debt*, *government debt*, *economic growth*, and *GDP growth*.

To ensure the relevance of the analyzed study, this study established several criteria as follows:

1. An article that discusses the relationship between public debt and economic growth.
2. Empirical studies that use macroeconomic data on a country or across countries.
3. The article provides clear empirical results regarding the direction of the influence of public debt on economic growth (positive, negative, or mixed).
4. Articles published in a time span relevant to the development of fiscal policy.

Article Selection and Classification Process

The selection process is carried out through several stages. The initial stage includes the identification of the article by relevant title and abstract. Furthermore, articles that meet the initial criteria are thoroughly analyzed to ensure fit for the research objectives. From this process, 15 empirical articles were selected to be further analyzed.

The articles are then classified based on several key aspects, namely:

1. Scope of study (single country or cross-country).
2. Data observation period.
3. Country or area of study.
4. Categories of the influence of public debt on economic growth (positive, negative, or mixed).

Data Analysis Techniques

Data analysis was carried out using content analysis and comparative analysis approaches. Each article is analyzed to identify key findings, economic context, as well as mechanisms that explain the relationship between public debt and economic growth. The results were analyzed qualitatively and grouped based on appropriate theoretical approaches. It is carried out by extracting key information from each study, including the theoretical foundation, regional context, and main results. Furthermore, the findings were synthesized to identify patterns of public debt and economic growth relationships within each theoretical framework.

RESULTS AND DISCUSSION

Table 1. Summary overview of Public Debt – Economic Growth

No.	Authors	Period	Country	Results
1.	Hilton, (2021)	1978-2018	Ghana	Positive
2.	Gu et al., (2022)	1996-2016	China	Positive
3.	Koome & Nasieku, (2025)	2001-2022	Kenya	Positive
4.	Ramzan et al., (2023)	1996-2020	Pakistan	Positive
5.	Ibañez Martín et al., (2024)	1970-2019	47 Countries	Positive
6.	Bakri et al., (2022)	2005-2020	Indonesia	Negative
7.	Yimer & Geda, (2024)	1980-2021	Ethiopia	Negative
8.	Mudayen et al., (2025)	2012-2019	127 Developing Countries	Negative
9.	Awadzie et al., (2025)	1990-2021	Ghana	Negative
10.	Odoom et al., (2025)	2000-2022	Ghana	Negative

11.	Augustine & Rafi, (2023)	1980-2019	39 Developing Countries	Nonlinear
12.	Jalles & Medas, (2024)	1970-2020	190 Developed and Developing Countries	Nonlinear
13.	Bozatli et al., (2024)	1870-2020	G7 Countries	Nonlinear
14.	Alsamara et al., (2024)	1980-2021	14 Countries in The Middle East and North Africa	Nonlinear
15.	Carrington et al., (2025)	1981-2019	46 Developing Countries	Nonlinear

The results of a review of several empirical studies show that public debt can contribute positively, negatively and nonlinearly to economic growth, Positive results are found when debt is managed productively and supported by adequate institutional quality. Study by Hilton, (2021) It found that an increase in public debt correlates positively with economic growth in the medium term, particularly when debt is used to finance public investments such as infrastructure and the social sector that can boost production capacity and aggregate demand. Similar findings are reinforced by Koome & Nasieku, (2025) finding long-term public debt in Kenya has a positive effect on economic growth. This impact is attributed to the use of debt for infrastructure development and productive projects that increase economic efficiency. Empirical evidence Gu et al., (2022) The difference between public debt and private debt shows that public debt has a more consistent positive impact on economic growth than private debt. This suggests that the government's role as a debt manager is better able to direct funds to strategic sectors that have a wide impact on the economy. Meanwhile, Ramzan et al., (2023) adding an important dimension in the form of institutional quality. This study shows that public debt has a positive impact on economic growth when supported by good governance, political stability, and policy effectiveness. Further, Ibañez Martín et al., (2024) Identify the existence of a threshold effect, where public debt has a positive impact on economic growth to a certain extent. Below that threshold, debt serves as a catalyst for growth, but the impact can weaken or turn negative when the debt ratio exceeds sustainable levels.

From a theoretical perspective, these empirical findings are in line with Keynesian theory, which views public debt as a fiscal stimulus tool to drive aggregate demand, especially when the economy is below potential capacity (Elmendorf & Mankiw, 1999). The use of debt for productive spending can create a multiplier effect (*Multiplier effect*) that drive economic growth, as reflected in the studies reviewed. The findings are in line with the view of Modern Monetary Theory which emphasizes that government debt is not a major obstacle to sovereign countries as long as inflation and macroeconomic stability can be controlled. Although MMT is more relevant for countries with full monetary sovereignty, empirical results show that debt can be an effective development instrument when managed carefully and productively. The positive influence of public debt on economic growth depends largely on the purpose

of debt use, the quality of the institution, the debt structure, and the level of fiscal sustainability, not solely on the size of the debt ratio itself.

In contrast to studies that have found positive impacts, a number of other studies have shown that public debt can actually hinder economic growth. Study Bakri et al., (2022) Finding government debt to negatively affect economic growth is explained by increasing interest payment burdens and fiscal obligations that limit the government's fiscal space to finance productive spending. In this context, debt no longer functions as a stimulus, but rather as a burden that suppresses medium-term growth capacity. Similar findings by Yimer & Geda, (2024) describes public debt as a "double-edged sword", where increased debt can initially drive growth, but at higher levels it has a negative impact. This contraction impact arises due to increased fiscal pressures, macroeconomic instability risks, and reduced investor confidence. A more comprehensive approach is offered by Mudayen et al., (2025) through analysis *Quantile regression* in developing countries. Looking at the impact of public debt on growth is not homogeneous, but tends to be negative in countries or periods with low growth rates. Weak economic conditions, additional debt actually worsen economic performance because it increases fiscal risks and suppresses private investment. Thus, the effectiveness of debt depends on the initial condition of the economy. In the context of Ghana, Awadzie et al., (2025) highlighting the relationship between budget deficits, public debt, and economic growth through the government's interim budget approach. When governments fail to maintain long-term budget consistency, debt becomes a source of uncertainty that lowers fiscal policy efficiency and hampers growth. The negative findings are also reinforced by Odoom et al., (2025) which analyzes the relationship of public debt with other macroeconomic variables such as inflation, exchange rates, and interest rates, shows that increased public debt worsens macroeconomic stability through inflationary pressures and exchange rate volatility, which ultimately negatively impacts economic growth. The complex interplay between variables confirms that public debt cannot be viewed in isolation from monetary policy and macroeconomic conditions as a whole.

Theoretically, these negative findings are consistent with the debt overhang theory, which states that high debt levels lower investment incentives due to expectations of future tax increases. When investors and economic actors expect future income to be used to pay off debt, investment and consumption decisions become muted, causing economic growth to slow. In addition, it is also in line with the view of neoclassical theory, through the *crowding out* mechanism. Increased deficit financing through debt can encourage interest rate hikes and reduce private investment, especially in developing countries with limited financial markets. Under this condition, public debt does not increase production capacity, but instead shifts the economic activity of the private sector. These empirical findings also lend support to Ricardian equivalence, especially as societies and economic actors begin to anticipate future fiscal burdens. This anticipation can reduce consumption and investment, so that the expansive impact of public debt becomes ineffective or even contractive. Overall, public debt can have a negative impact on economic growth when debt levels are unsustainable, institutional quality is weak, macroeconomic stability is disrupted, and debt allocation is unproductive. Therefore, the difference in results in the literature is not a

contradiction, but a reflection of the heterogeneity of economic conditions and fiscal governance between countries.

Some other studies show that the relationship is not linear, but rather depends on the level of debt, the initial state of the economy, and the structural characteristics of the country. Augustine & Rafi, (2023) shows the results of nonlinear relationships in developing countries, where public debt has a positive impact to a certain level, but turns negative when the debt ratio exceeds the threshold. Debt can serve as a driver of growth at moderate levels, but it becomes a drag when the fiscal burden increases excessively. A dynamic approach to debt surge is discussed by Jalles & Medas, (2024) which emphasizes the importance of initial conditions in determining the impact of debt on growth. Spikes in public and private debt tend to have a negative impact on economic growth, especially in countries with weak fiscal and institutional capacity. However, in countries with relatively strong fiscal positions, the negative impact is more limited or delayed. Nonlinear evidence is also found in developed countries. Bozatli et al., (2024) Analyzes the causal relationship between public debt and economic growth in G7 countries, showing the direction and strength of varying between time horizons, indicating that the impact of debt can be expansive in the short term, but contractive in the long term. This confirms that the debt-growth relationship is not only nonlinear in level, but also dynamic between periods. Furthermore, Alsamara et al., (2024) examine the effect of the public debt threshold by considering the role of the energy endowment. Finding a country with abundant energy resources has a higher debt threshold before its impact on growth becomes negative. In contrast, countries with limited energy resources face lower debt limits. The country's structural income capacity moderates the debt-growth relationship. The cross-country group analysis was further developed by Carrington et al., (2025), which distinguishes between developing countries that are dependent on commodities and those that do not. The results show that commodity-dependent countries tend to have debt and growth dynamics that are more susceptible to global price fluctuations, so the optimal debt threshold is relatively lower. In contrast, non-commodity countries show a higher tolerance for debt accumulation before the impact becomes contractive.

From a theoretical perspective, these nonlinear findings are a bridge between Keynesian theory and debt overhang theory. At moderate levels of debt, the Keynesian mechanism predominates, where public debt drives aggregate demand and economic growth (Elmendorf & Mankiw, 1999). However, when debt exceeds a certain threshold, the debt overhang mechanism becomes more relevant, leading to a decline in investment and economic growth. These findings are also consistent with neoclassical theory, which emphasizes the trade-off between the benefits of public investment and the costs of fiscal distortion due to excessive debt (Broner et al., 2014). In this framework, public debt increases growth only as long as the marginal return from public spending is greater than the cost of financing. Moreover, this nonlinear approach helps explain why the assumption of neutrality in Ricardian equivalence is rarely empirically fulfilled. Economists' responses to debt differ at low and high debt levels, so their effect on growth becomes asymmetrical. Meanwhile, Modern Monetary Theory's view has received only limited support, as empirical evidence suggests that even countries with greater fiscal capacity still face contextual and structural debt limits.

In addition to the level and structure of debt, the quality of institutions and fiscal management capacity also play a crucial role. A number of empirical studies show that countries with good governance, fiscal transparency, and effective public spending tend to be able to utilize debt as a productive development instrument. Ramzan et al., (2023) Showing the quality of institutions moderating the relationship between public debt and economic growth, the negative impact of debt can be minimized when supported by political stability and policy effectiveness. Public debt does not only have a mechanical impact on growth, but also through institutional channels that affect the allocation and efficiency of government spending. In the context of developing countries, limited fiscal capacity often amplifies the negative impact of public debt. Reliance on external debt, exchange rate volatility, and a narrow tax base increase fiscal vulnerability and limit government policy space. Study Mudayen et al., (2025) shows the impact of public debt on growth tends to be negative in countries with low growth rates and weak institutional capacity. Indicating additional debt in fragile economic conditions actually increases fiscal risks and suppresses private investment, thereby slowing down economic growth. From a theoretical perspective, these findings expand the debt overhang framework by including the institutional dimension as the main determining factor. Public debt is an obstacle to growth not only because of the large debt ratio, but also because of the government's lack of ability to manage, allocate and account for the use of this debt. Thus, the effectiveness of public debt depends on the interaction between fiscal policy, institutional capacity, and macroeconomic conditions.

These findings also have important implications for the policies to be implemented. The focus of fiscal policy is not only on limiting the public debt ratio, but also on improving the quality of spending and strengthening fiscal institutions. Study by Ciaffi et al., (2024) shows that debt sustainability is influenced by the composition of expenditure and the size of fiscal multipliers. Debt used to finance productive investments, such as infrastructure, education, and health, has greater potential to increase production capacity and long-term growth than debt used for consumptive spending. In addition, nonlinear empirical evidence indicates the need for a policy approach that is contextual and adaptive. Countries with strong economic bases and stable structural incomes have greater fiscal space to utilize debt productively, as demonstrated by Alsamara et al., (2024) and Alsamara et al. (2024) and Carrington et al., (2025). In contrast, countries with high dependence on commodities or weak institutions need to be careful in managing debt accumulation. Therefore, policies cannot be standardized, but must be adjusted to the economic and institutional characteristics of each country.

This discussion also cannot be separated from the interaction between fiscal policy and monetary policy. The effectiveness of debt-based fiscal policy is influenced by the prevailing monetary policy. Sinaga et al., (2025) indicates that the money supply has a significant role in determining the pace of economic growth, which indicates that fiscal stimulus through debt will be more effective when supported by accommodative monetary conditions. In contrast, under tight monetary policy conditions, deficit financing through debt can increase inflationary and interest rate pressures, thereby reducing the impact of expansionary fiscal policy. This interaction

becomes particularly relevant for countries facing the policy dilemma between maintaining macroeconomic stability and driving growth. When monetary policy is directed to contain inflation or maintain exchange rate stability, the room for expansionary fiscal policy becomes limited. Under these conditions, additional public debt risks causing macroeconomic imbalances, as shown by Odoom et al., (2025) that an increase in public debt can worsen exchange rate stability and inflation, thereby negatively impacting economic growth.

From the perspective of endogenous growth theory, public debt has the potential to influence long-term economic growth through investment in factors that increase productivity, such as education, health, and infrastructure. Romer, (1990) emphasizing the accumulation of knowledge and human capital is a key driver of long-term growth. Within this framework, public debt can serve as an instrument to finance productive investments that create sustainable growth effects. However, the empirical literature suggests that these benefits are highly dependent on the effectiveness of spending allocations and the institutional capacity of governments. Study Otieno, (2024) shows that the impact of public debt on investment and economic growth is also influenced by spatial factors and inter-regional linkages. Positive economic spillover can amplify the impact of debt on growth as public investment drives regional economic integration. Conversely, if investment is not coordinated in less productive sectors, the impact of debt on growth is limited. These findings reinforce the argument that public debt is not an objective, but rather a policy tool whose effectiveness depends on the quality of development policy planning and implementation.

By considering these various dimensions, the difference in empirical results in the literature on public debt and economic growth can be understood as a consequence of the heterogeneity of economic conditions, debt structure, policy interactions, and institutional capacity. Studies that find positive impacts generally focus on contexts in which debt is used for productive investments, supported by relatively strong institutions and coherent macroeconomic policies. In contrast, negative findings are more common in countries with limited fiscal space, vulnerable debt structures, and weak macroeconomic stability. A nonlinear relationship arises when the initial benefits of debt begin to be reduced by rising fiscal costs and macroeconomic risks as debt accumulation increases. These results confirm that the debate over public debt and economic growth cannot be simplified into a positive or negative dichotomy. The main focus of contemporary literature should be directed at understanding the conditions and mechanisms that determine when public debt becomes a driver of growth and when it turns into a bottleneck. The main contribution of this study lies in the effort to integrate diverse empirical findings into a coherent and contextual economic theoretical framework.

CONCLUSION

This study concludes that the relationship between public debt and economic growth is complex. The literature shows that the relationship between public debt and economic growth is heterogeneous and nonlinear, as described in various economic

theoretical frameworks. At moderate levels of debt, the empirical findings are in line with Keynesian theory which views public debt as an instrument of fiscal stimulus to encourage aggregate demand and investment that increases long-term output capacity. However, when debt exceeds the sustainability limit, the impact tends to turn negative according to the debt overhang theory and mechanism crowding out, which suppresses investment and economic growth. Meanwhile, the assumption of neutrality in Ricardian equivalence is rarely empirically confirmed, and the view of Modern Monetary Theory is only applicable to a limited extent due to institutional and macroeconomic constraints. Overall, these findings confirm that the effectiveness of public debt is highly dependent on the level of debt, the quality of institutions, and the economic context of each country. Future studies are recommended to employ more advanced econometric methods, in order to identify optimal debt levels more accurately. In addition, it is important to include institutional quality variables and distinguish between productive and consumptive uses of debt. The research can also be extended to different groups of countries to understand the different impacts of debt on economic growth.

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