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Abstract

Utilizing GMM panel data analysis, covering twenty-three samples of countries from 2011 to 2014, this study examines the nexus between external debt and economic growth where institutional quality acts as a moderator. The samples for the study are divided into two groups consisting of low and high governance groups of countries. Findings report the importance of institutional quality as a moderator in the relationship between external debt and economic growth for both samples of study. The results confirm that, despite the importance of good governance practices, as indicated by the significant effect of high scores in governance indicators such as voice and accountability (samples from low governance countries) and regulatory quality (samples from high governance countries), prescribing the right policy is crucial to avoid the negative impact of the wrong policy prescription on economic growth. The results are dissected into two groups, for low governance and high governance countries respectively. Overall, the study suggests good debt management and feasible policy prescriptions are the keys to controlling external debt.

Keywords: External Debt, Governance, Institutional quality, Economic Growth, Generalized Method of Moments

Introduction

Over the last decade, statistics show a dramatic increase in external debt in most developing countries, where external debt remains high as a proportion of gross domestic product (GDP). Rapid economic development experienced by developing countries has resulted in an increase in demand for external debt to finance various investment expenditures, including infrastructure and other investments. However, this requires sustainable external debt to avoid negative impacts on the economy, such as falling foreign investment and currency devaluation, which hampers economic growth. Previous studies reported direct proportional relationship