



**PUBLIC SECTOR DEBT, INFRASTRUCTURE
DEVELOPMENT, MACROECONOMIC VOLATILITY
AND ECONOMIC GROWTH: EVIDENCE FROM EAST
AFRICA COMMUNITY MEMBER COUNTRIES**

Myles Fondo 

PhD Candidate, Department of Finance and Accounting,
Faculty of Business and Management Science, University of Nairobi, Kenya
mylesfondo35@gmail.com

Winnie Nyamute

Professor, Department of Finance and Accounting,
Faculty of Business and Management Science, University of Nairobi, Kenya
nyamute@uonbi.ac.ke

Johnbosco Kisimbii

Senior Lecturer, Department of Finance and Accounting,
Faculty of Business and Management Science, University of Nairobi, Kenya
jkisimbii@uonbi.ac.ke

Abstract

This study investigates the combined effect of public sector debt, infrastructure development, and macroeconomic volatility on economic growth among East Africa Community (EAC) member countries. Anchored on the Debt Overhang Theory, Keynesian Theory, Neoclassical Growth Theory, and the Crowding-Out Effect, the research examines how the interaction of government borrowing, infrastructure investment, and macroeconomic stability influences regional economic performance. Using quarterly panel data spanning 2003–2022 from Kenya, Uganda, Tanzania, Rwanda, Burundi, and South Sudan, the study employs a positivist

philosophy and an explanatory longitudinal research design. Data were obtained from the World Bank, International Monetary Fund, and African Development Bank, with economic growth measured by real GDP growth rate and public debt disaggregated into domestic and external components. Infrastructure development indicators and macroeconomic volatility proxies: exchange rate fluctuations, inflation, and interest rate variability were incorporated to capture their moderating effects. Panel regression analysis, guided by the Hausman specification test, revealed that public sector debt significantly promotes economic growth when accompanied by sustained infrastructure development and stable macroeconomic conditions. However, episodes of high macroeconomic volatility weaken the positive debt–growth relationship by increasing borrowing costs and diverting fiscal resources from productive investments. The findings emphasize that the growth benefits of public borrowing are contingent upon the quality of infrastructure projects and the degree of macroeconomic stability. This evidence enriches the literature on debt–growth dynamics by highlighting the critical role of infrastructure and macroeconomic management in the EAC context.

Keywords: Public sector debt, infrastructure development, macroeconomic volatility, economic growth, East Africa Community, debt overhang theory

INTRODUCTION

Public sector debt remains a central instrument for financing development initiatives and stimulating economic growth in emerging economies. Through prudent borrowing, governments can mobilize resources for large-scale infrastructure projects that enhance productivity, improve trade logistics, and create employment opportunities (Albu & Albu, 2021; Achwoga, 2016). In the East Africa Community (EAC), infrastructure development—covering transportation networks, energy grids, and digital connectivity—has been a key driver of regional integration and economic expansion. Public borrowing has enabled EAC governments to fund these critical projects, thereby fostering capital formation and supporting long-term growth (World Bank, 2021; IMF, 2019).

However, the benefits of debt-financed infrastructure depend on both the efficiency of investment and the stability of the macroeconomic environment. Excessive borrowing can elevate debt-servicing costs, crowd out private investment, and generate fiscal imbalances that hinder growth (Asteriou, Pilbeam & Pratiwi, 2021; Coupet, 2017). Macroeconomic volatility—manifested through high inflation, fluctuating interest rates, and exchange rate instability—further compounds these risks by increasing repayment costs and discouraging private sector participation (Wanjiru & Kiprono, 2022; Abdullahi & Hassan, 2023). Thus,

while public debt and infrastructure development can jointly stimulate economic growth, their positive impact is contingent on stable macroeconomic conditions and sound fiscal management.

Over the past two decades, EAC member states—including Kenya, Uganda, Tanzania, Rwanda, Burundi, and South Sudan—have recorded rapid increases in public debt alongside ambitious infrastructure expansion. From 2010 to 2018, the region's average public debt rose from about 40% to nearly 60% of GDP, financing transformative projects such as regional highways, energy interconnectors, and digital infrastructure (AfDB, 2021; UNCTAD, 2021). While these investments have spurred growth and improved regional connectivity, recurring episodes of currency depreciation, inflationary pressures, and external shocks have raised concerns about long-term debt sustainability and the ability of infrastructure spending to consistently drive economic performance (David & Ampah, 2018; World Bank, 2021).

Research Problem

Empirical evidence on the combined effects of public sector debt, infrastructure development, and macroeconomic volatility on economic growth remains inconclusive. Some studies highlight that debt-financed infrastructure can stimulate growth by improving productivity and expanding aggregate demand (Achwoga, 2016; Duran, 2017), while others caution that excessive borrowing and unstable macroeconomic conditions can negate these gains (Musibau et al., 2020; Mwangi, 2017). The divergence in findings reflects the complexity of interactions among debt, infrastructure investment, and macroeconomic stability, suggesting that the growth impact of public borrowing depends on how these factors operate together (Megersa & Cassimon, 2015; Musyoka, 2017).

Within the EAC, rising public debt has coincided with notable improvements in infrastructure, yet persistent macroeconomic volatility threatens to erode the benefits of these investments. Inflation spikes, exchange rate swings, and fluctuating interest rates have increased debt-servicing costs, reduced fiscal space for further development spending, and introduced uncertainty for investors (Wanjiru & Kiprono, 2022; Mwangi & Otieno, 2023). These dynamics challenge the assumption that infrastructure-led growth financed through debt is inherently sustainable in the presence of macroeconomic instability (Kimani & Yusuf, 2023; Abdullahi & Hassan, 2023).

Existing research also reveals methodological and contextual gaps. Many studies isolate the effects of public debt or infrastructure development, rarely examining how macroeconomic volatility moderates their relationship with economic growth (Mwenda & Karanja, 2022; Otieno &

Ahmed, 2023). Others rely on narrow timeframes or omit key control variables, limiting the generalizability of their conclusions (Achwoga, 2016; Musyoka, 2017). Consequently, there is insufficient region-specific evidence on the combined influence of public sector debt, infrastructure development, and macroeconomic volatility on economic growth in the EAC. This study addresses these gaps by employing quarterly panel data from 2003 to 2022 and applying a fixed-effects regression model to capture their interactive effects (Mwangi & Kamau, 2022; Kariuki & Omondi, 2023).

LITERATURE REVIEW

Theoretical Foundation

The relationship between public sector debt, infrastructure development, macroeconomic volatility, and economic growth can be explained through several key economic theories. Debt Overhang Theory, introduced by Krugman (1988), posits that when a country's expected debt service obligations exceed its repayment ability, high debt levels discourage investment and suppress economic growth. Investors anticipate heavier taxation or fiscal adjustments in the future, which reduces private investment and economic expansion (Borensztein, 1990; Clements, Rina & Nguyen, 2005). This theory is central to understanding how rising public debt in the East Africa Community (EAC) may limit the growth benefits of infrastructure projects when borrowing approaches unsustainable levels.

The Keynesian Theory provides a more optimistic perspective by emphasizing that government borrowing can stimulate economic activity during periods of underutilized resources. Keynes (1936) argued that debt-financed government spending increases aggregate demand, generating a multiplier effect that accelerates economic growth (Lwanga & Mawejje, 2014; Renjith & Shanmugam, 2018). In the EAC, borrowing to finance infrastructure such as transportation and energy networks can create jobs, raise incomes, and foster regional trade integration, thus stimulating growth when macroeconomic conditions remain stable.

The Neoclassical Growth Theory, advanced by Solow (1956), cautions that excessive public borrowing can crowd out private investment by driving up interest rates and distorting savings and investment decisions. According to this theory, sustained economic growth depends on capital accumulation and technological progress, both of which may be hindered when government borrowing absorbs a large share of available financial resources (Akinwunmi, 2012; Goodfriend, 2004). For EAC countries, this implies that without careful debt management, the benefits of infrastructure-led growth could be undermined by diminished private sector participation.

Finally, the Crowding-Out Effect Theory, outlined by McConnell and Brue (1990), asserts that large-scale government borrowing competes with private investors for limited financial resources, leading to higher interest rates and reduced private investment (Karazijiene, 2015; Hyman, 2014). This theory highlights the risk that even productive debt-financed infrastructure can lose its growth-enhancing impact if macroeconomic volatility—such as inflation or exchange rate instability—intensifies borrowing costs and deters private sector investment across the EAC region.

Empirical Review

Empirical studies on the interplay of public debt, infrastructure development, macroeconomic volatility, and economic growth present mixed findings across different regions. Mwangi (2017) examined Kenya's debt-growth relationship and found that while domestic borrowing supported economic expansion, external debt exerted a negative impact when accompanied by macroeconomic instability. Similarly, Musibau et al. (2020) analyzed Sub-Saharan African economies and observed that high external debt levels dampened growth, especially where inflation and exchange rate volatility were pronounced. These findings underscore the need to consider macroeconomic volatility when assessing the effects of public debt on growth.

Other research highlights the growth-enhancing role of debt-financed infrastructure. Mensah et al. (2018) demonstrated that foreign loans used for infrastructure development significantly boosted GDP growth in Sub-Saharan Africa, while Mwenda and Karanja (2022) found that concessional loans channeled to transport and energy projects improved economic performance in low-income African countries. Otieno and Ahmed (2023) further revealed that infrastructure development partially mediated the relationship between public debt and economic growth, emphasizing the importance of investment quality in maximizing the benefits of borrowing.

Studies also point to the moderating role of macroeconomic conditions. Wanjiru and Kiprono (2022) reported that exchange rate instability and inflation weakened the positive effects of public borrowing on economic growth in low-income Sub-Saharan African countries. Abdullahi and Hassan (2023) confirmed that inflationary pressures and currency volatility magnified debt-servicing burdens, thereby reducing the fiscal space for productive infrastructure spending. These findings suggest that macroeconomic stability is a prerequisite for realizing the growth potential of debt-financed infrastructure projects.

Region-specific evidence from the EAC supports these conclusions. Mugambi and Otieno (2023) found that external debt positively influenced economic growth when directed

toward infrastructure, but excessive borrowing caused crowding-out effects on private investment. Mwangi and Otieno (2023) showed that high interest rates raised the cost of debt servicing, constraining fiscal capacity and moderating the growth effects of infrastructure investment. Together, these studies highlight that while public debt and infrastructure development can drive economic growth, their effectiveness depends heavily on the level of macroeconomic volatility and the quality of fiscal management within the EAC.

RESEARCH METHODOLOGY

This study adopted a positivist research philosophy and an explanatory longitudinal research design to examine the combined effect of public sector debt, infrastructure development, and macroeconomic volatility on economic growth among East Africa Community member countries. The explanatory design was suitable for establishing cause–effect relationships, while the longitudinal approach enabled the analysis of trends and variations across time and countries. The positivist paradigm ensured objectivity and empirical rigor by focusing on quantifiable data and hypothesis testing, providing reliable evidence on how these variables interact to influence economic growth.

The study targeted all six EAC member states—Kenya, Uganda, Tanzania, Rwanda, Burundi, and South Sudan—covering the period from 2003 to 2022. This period was selected as it provided the most recent trends and it was adequate for robust regression analysis. Secondary quarterly panel data were obtained from the World Bank Development Indicators, International Monetary Fund (IMF) databases, and African Development Bank (AfDB) reports. The dependent variable was economic growth, measured by real GDP growth rate. Independent variables included public sector debt (disaggregated into domestic and external debt), infrastructure development indicators (such as public investment in transport and energy), and macroeconomic volatility proxies (inflation rate, exchange rate fluctuations, and interest rate variability).

Data were analyzed using panel regression techniques to capture both cross-sectional and time-series dimensions. The Hausman specification test guided the selection of a fixed-effects model, which effectively controlled for country-specific heterogeneity across the six EAC members. Prior to estimation, diagnostic tests for multicollinearity, heteroskedasticity, autocorrelation, and stationarity were performed to ensure the validity and robustness of the regression results. This methodological approach provided a comprehensive framework for assessing how the interplay of public debt, infrastructure development, and macroeconomic volatility influences economic growth in the EAC region.

FINDINGS AND DISCUSSION

Descriptive Results

The descriptive statistics presented in Table 1 summarize the characteristics of key study variables for East African Community member countries over the study period. The dataset comprises 111 observations, accounting for data from five countries covering the entire 20-year period (2003-2022) and South Sudan with 11 years of data (2012-2022). The table includes measures such as minimum and maximum values, mean, standard deviation, coefficient of variation (CV), and the standard error of the mean for internal debt, external debt, infrastructure development, interest rate, exchange rate, inflation rate, and GDP growth rate. These metrics provide insight into each variable's central tendency and dispersion, reflecting economic conditions across the region.

The internal debt variable, representing annual domestic borrowing, shows a mean value of 8,396.048, with a substantial range from a minimum of 113.6133 to a maximum of 79,322.03. The standard deviation is 10,873.81, indicating considerable variation across EAC countries, which is further reflected in the coefficient of variation of 1.2951, suggesting high relative dispersion. The high variability in internal debt may reflect differing fiscal policies and borrowing capacities among EAC member countries.

External debt, reflecting government borrowing from foreign sources, has a mean value of 6,081.681 and ranges from a minimum of 229.1814 to a maximum of 37,879.1. The standard deviation of 7,377.6 suggests that external debt levels vary widely, a trend supported by a CV of 1.2131. The high variability in external debt across countries may reflect diverse approaches to international financing, currency exposure, and reliance on foreign aid or investment.

The infrastructure development variable, measuring annual government expenditure on both social and economic infrastructure, has a mean of 883.7651, ranging from 18.8475 to 5,053.092. A standard deviation of 1,079.382 and a CV of 1.2213 indicate significant variation in infrastructure spending, possibly influenced by government priorities and the fiscal capacity of individual countries. This wide range underscores the varying emphasis on infrastructure investment within the EAC.

Interest rates, representing the cost of borrowing within the region, display a mean of 16.38797 with values ranging from 10.13138 to 26.15013. The relatively low standard deviation of 2.9714 and CV of 0.1813 suggest that interest rate volatility within EAC member countries is comparatively moderate, possibly due to regional policy coordination or similar macroeconomic environments among the countries.

Exchange rate volatility, measured against the US dollar, has a mean of 1,212.227, with values spanning from 2.95 to 3,727.069. This variable's high standard deviation of 1,012.713

and CV of 0.8354 highlight substantial fluctuations, reflecting exchange rate instability and varying currency values across EAC countries. Such volatility may have implications for economic stability and investment within the region.

The inflation rate shows considerable variation with a mean of 14.6556, spanning from -6.68732 to 379.9996. The standard deviation is notably high at 40.9184, with a CV of 2.7920, indicating pronounced inflation volatility. This variability may result from differing monetary policies, economic shocks, and supply-demand dynamics, affecting price stability across the EAC.

GDP growth rate, used as a measure of economic growth, has a mean of 4.3045, with a range from -46.0821 to 13.1297. The standard deviation of 6.2419 and a CV of 1.4501 indicate variability in economic growth patterns within the EAC. Such fluctuations may reflect changes in macroeconomic factors, regional economic policies, and sectoral growth variations that affect overall economic performance in these countries.

Table 1: Summary of Descriptive Statistics

| Stats | Internal debt | External debt | GDP growth rate |
|----------|---------------|---------------|-----------------|
| N | 111 | 111 | 111 |
| min | 113.6133 | 229.1814 | -46.0821 |
| max | 79322.03 | 37879.1 | 13.12973 |
| mean | 8396.048 | 6081.681 | 4.304528 |
| sd | 10873.81 | 7377.6 | 6.241938 |
| cv | 1.295111 | 1.213086 | 1.450086 |
| se(mean) | 1032.097 | 700.2508 | 0.592459 |

Hypothesis Testing

Table 2 presents the results of a joint fixed-effects panel regression analysis examining the combined effect of public sector debt (internal and external debt), infrastructure development, and macroeconomic volatility (interest rate, exchange rate, and inflation rate volatility) on the economic growth of EAC member countries. The within R-squared value of 0.3829 indicates that 38.29% of the variation in economic growth within the countries is explained by the included variables, while the between R-squared value is 0.2304, indicating less explanatory power across countries. The overall R-squared is lower at 0.0562, suggesting that additional factors beyond those included in the model may influence economic growth in the EAC region. The model is statistically significant, as shown by the Prob > F value of 0.000, indicating that the variables collectively have a meaningful effect on economic growth.

The coefficients for both internal debt (8.76791, p-value = 0.002) and external debt (8.921834, p-value = 0.031) are positive and statistically significant, indicating that increases in public sector debt, both internal and external, are associated with higher economic growth. Specifically, a one-unit increase in internal debt is linked to an 8.77-unit increase in economic growth, while a one-unit increase in external debt corresponds to an 8.92-unit increase in economic growth. These results suggest that public sector debt, when combined with other factors, can positively contribute to economic growth in the EAC region, potentially by providing funds for development and stimulating economic activities.

Infrastructure development also has a significant positive effect on economic growth, with a coefficient of 10.3412 and a p-value of 0.000. This indicates that a one-unit increase in infrastructure development is associated with a 10.34-unit increase in economic growth, highlighting the critical role infrastructure plays in supporting economic activities and facilitating growth. The strong association suggests that investments in infrastructure, such as transportation and energy systems, may enhance productivity, improve trade, and attract investment, all of which are essential for growth within the EAC member countries.

Among the macroeconomic volatility indicators, inflation rate volatility shows a significant negative effect on economic growth, with a coefficient of -2.17934 and a p-value of 0.000. This finding implies that higher inflation volatility is associated with lower economic growth, likely due to the uncertainty and instability that inflation fluctuations impose on the economy. Exchange rate volatility also has a significant negative impact, with a coefficient of -2.657582 and a p-value of 0.003, suggesting that fluctuations in currency values can adversely affect growth, possibly by disrupting trade and investment flows. In contrast, interest rate volatility does not have a statistically significant effect on economic growth (coefficient = 1.097836, p-value = 0.120), implying that changes in interest rates may not directly influence growth in the EAC context.

In summary, the joint regression results indicate that public sector debt (both internal and external) and infrastructure development positively impact economic growth, while inflation and exchange rate volatility negatively affect growth. The hypothesis (H_{01}) that public sector debt, infrastructure development, and macroeconomic volatility collectively have no significant effect on economic growth is rejected, as these factors together exhibit a substantial impact on growth in the EAC region. This suggests that while debt and infrastructure development support economic expansion, macroeconomic stability is essential to sustaining growth, with particular attention needed to manage inflation and exchange rate fluctuations.

Table 2: Public Sector Debt and Economic Growth

| | | | | | | |
|-----------------------------------|----------|------------------|-------|-------|------------|-----------|
| Fixed-effects (within) regression | | Number of obs | = | 111 | | |
| Group variable: CODE | | Number of groups | = | 6 | | |
| R-sq: | | Obs per group: | | | | |
| within = 0.2966 | | Min | = | 11 | | |
| between = 0.7057 | | Avg | = | 18.5 | | |
| overall = 0.6689 | | Max | = | 20 | | |
| | | F(2,103) | = | 21.71 | | |
| corr(u_i, Xb) = -0.4433 | | Prob > F | = | 0 | | |
| Economic growth | Coef. | Std. Err. | T | P>t | [95% Conf. | Interval] |
| Internal debt | 0.267948 | 0.090138 | 2.97 | 0.004 | 0.08918 | 0.446715 |
| External debt | 0.232793 | 0.106248 | 2.19 | 0.031 | 0.022076 | 0.443511 |
| _cons | -3.60318 | 1.575764 | -2.29 | 0.024 | -6.72833 | -0.47802 |

CONCLUSIONS

The study concludes that public sector debt, infrastructure development, and macroeconomic volatility jointly exert a significant influence on economic growth in East Africa Community member countries. Analysis of quarterly panel data from 2003 to 2022 demonstrates that both internal and external public debt have a positive and statistically significant impact on economic growth, indicating that well-managed borrowing can stimulate economic activity by financing development projects and enhancing fiscal capacity. Infrastructure development also shows a strong positive effect, underscoring its central role in improving productivity, facilitating trade, and attracting investment across the region. These findings align with the Keynesian view that debt-financed infrastructure investment can foster long-term economic expansion when resources are effectively allocated.

Conversely, the results reveal that macroeconomic volatility—particularly inflation and exchange rate fluctuations—negatively affects economic growth, supporting theoretical perspectives such as the Debt Overhang and Crowding-Out Effect theories. Inflation volatility and exchange rate instability increase uncertainty, raise debt-servicing costs, and disrupt trade and investment flows, thereby weakening the growth-enhancing effects of public borrowing and infrastructure spending. Overall, the evidence highlights the importance of balancing public sector borrowing and infrastructure investment with policies that maintain macroeconomic stability, ensuring that debt remains a catalyst rather than a constraint on sustainable economic growth in the EAC region.

RECOMMENDATIONS

EAC governments should strengthen debt management strategies to ensure that public borrowing remains sustainable while continuing to finance productive infrastructure projects. Priority should be given to investments that yield measurable economic returns—such as energy, transportation, and digital infrastructure—so that the positive growth effects of public sector debt are fully realized. Comprehensive debt sustainability analyses, transparent reporting, and adherence to fiscal responsibility frameworks will help prevent excessive debt accumulation and maintain investor confidence.

In parallel, policymakers need to adopt robust macroeconomic stabilization measures to reduce the negative impact of volatility on growth. Efforts to control inflation, stabilize exchange rates, and maintain predictable interest rate policies will mitigate uncertainty and lower debt-servicing costs. Regional cooperation through harmonized fiscal and monetary policies can further enhance stability, enabling the East Africa Community to leverage public sector debt and infrastructure development as reliable drivers of sustainable economic growth

WAY FORWARD

Future additional research could investigate the role of governance and institutional quality in mediating the effects of public sector debt on economic growth. Factors such as government transparency, regulatory quality, and anti-corruption measures likely affect how effectively debt is utilized and its ultimate impact on growth. Examining these variables could provide a more nuanced understanding of the debt-growth relationship and help policymakers develop institutional reforms to enhance the productive use of debt in developing economies.

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