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The role of deficit and debt in financing growth in West Africa

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Abstract

Empirical literature on debt–growth nexus and deficit–growth nexus indicate that government debt and fiscal deficit could have negative effects on economic growth after a certain threshold level. However, the impacts of debt and deficit on economic growth via the financial sector have not been thoroughly explored. Thus, this study examines the effects of debt and deficit on finance–growth nexus in West African region. It employs empirical strategies that account for various economic and econometrics issues. Evidence from the study reveals that the impact of financial development on growth varies with the levels of debt and deficit. Specifically, the marginal effects of financial development on growth turn negative when debt and deficit exceed the threshold levels of 48.6% and –13.5% of GDP, respectively. The implication of this study is that the financial sector is one of the channels through which debt and deficit exert their influences on economic growth. Thus, an increase in financial development would not produce the desirable long-run economic benefits unless it is accompanied by a reduction in government debt and fiscal deficit. Based on the findings, the study makes some policy recommendations.

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