

Permanent and Transitory Effect of Public Debt on Investment: Exploring the Role of Institutional Factors

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Abstract

This paper explores the permanent and transitory effect of public debt on investment in sub-Saharan Africa being a relatively high debt and low investment region. The paper also takes into account the role of institutional quality in examining the relationship between the variables. To achieve the study objectives, Mundlak's transformation method was employed to disentangle the effect of public debt into its transitory and permanent components. The findings of the study revealed that public debt exerts a positive permanent effect and negative transitory effect on total, public and private investments. However, when the quality of institutions is taken into account in modelling the relationship between the variables, the negative transitory effect of public debt on investment was neutralised. Improvement in institutional quality was also found to positively affect investment in the region.

Keywords: Public debt, Investment, Permanent, Transitory, Mundlak, Africa.

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