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PUBLIC DEBT AND ITS EFFECTS ON MONETARY AND FISCAL POLICY: CASE OF ALGERIA*Received 19 October 2025; accepted 06 November 2025; published 21 November 2025*

Abstract. *Public debt in Algeria has increased substantially in recent decades, raising concerns about its impact on macroeconomic policy. This study examines the effects of public debt on monetary policy, including money supply, bank credit, inflation, and on fiscal policy, such as government expenditures and total consumption, using a linear regression approach. Annual data from 1985 to 2024 are employed to estimate the elasticity of public debt with respect to broad money, aggregate consumption, inflation, and public expenditures. The results indicate that aggregate consumption significantly increases public debt, while higher public expenditures are associated with a reduction in debt, highlighting the importance of efficient and targeted fiscal policies. Broad money and inflation show weaker, statistically insignificant effects, suggesting that monetary factors play a less dominant role in driving debt dynamics. Overall, the findings underscore that managing public spending and consumption is crucial for debt sustainability, and coordinated fiscal and monetary measures are necessary to support long-term economic stability in Algeria.*

Keywords: *public debt, monetary policy, fiscal policy, government expenditure, inflation, money supply, ECM.*

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Introduction

Public debt has long been a central concern in economic thought, seen both as a potential driver of growth and stabilization and as a possible burden for future generations, threatening macroeconomic balance. It can stimulate economic activity, foster investment, and increase overall consumption, thereby shaping wealth creation and distribution (Chen et al., 2017).

Theoretical perspectives differ. Classical economists argue that if anticipated, public debt has minimal short-term effects, though they caution about long-term sustainability and its impact on private investment and future growth (Hilton, 2021). Keynesians, in contrast, emphasize its capacity to boost aggregate demand and support the economy during downturns (Aspromourgos et al., 2009). Both new classical and new Keynesian views highlight the risks of excessive debt, including higher interest rates, slower growth, and intergenerational burdens (Barro, 1974; Wagner, 2014).

Empirical research presents mixed effects of public debt on macroeconomics variables, mainly its impact on economics growth and fiscal (Ahlborn & Schweickert, 2017; Mayer et al., 2013). Research notes that, this ambiguity is especially pronounced in emerging economies with

limited fiscal space, where debt can either promote growth or hinder it, sometimes following complex nonlinear patterns.

In this research, we focus on the Algerian economy, that provide a relevant example of public debt dynamics and its impact on both monetary and fiscal policy outcomes. Between 1980 and 2005, the country faced high external debt due to falling oil prices, persistent budget deficits, and a lack of economic diversification, resulting in heavy reliance on international creditors. The 2006 oil boom allowed Algeria to repay its external debt early, demonstrating a strategic move toward financial independence. However, the 2014 oil price collapse triggered a new phase of debt accumulation, primarily domestic, to maintain sovereignty while financing rising deficits. Since 2015, Algeria's public debt-to-GDP ratio has steadily increased, raising questions about debt sustainability and its effects on future growth.

This study aims to investigate the effects of public debt on macroeconomic policy in Algeria, with a particular focus on both monetary and fiscal dimensions. Specifically, it examines how public debt interacts with monetary policy instruments, such as broad money and inflation fluctuations, as well as fiscal policy measures, including government expenditures and global consumption. The research seeks to answer the central question: How does public debt influence the formulation and effectiveness of monetary and fiscal policies in Algeria? By analysing annual data from 1985 to 2024 using a linear OLS (Ordinary Least Squares) regression framework, the study quantifies the magnitude and direction of these relationships, providing empirical evidence to inform policy decisions and strategies aimed at ensuring fiscal sustainability and macroeconomic stability.

By providing empirical evidence on the interactions between debt and policy instruments, this study offers insights for Algerian policymakers regarding the design of coordinated fiscal and monetary strategies. The results emphasize the importance of managing both the level and composition of public debt to support long-term economic stability and sustainable growth.

Literature Review

The analysis of empirical contributions on public debt effects on both monetary and fiscal policies outcomes has highlighted several recurring themes in the study of the effects of public debt. Empirical studies on the relationship between public debt and economic growth reveal a nuanced and context-dependent picture. Public debt can positively affect long-term GDP growth, particularly when funds finance productive investments in some less-economically developed countries (Owusu-Nantwi & Erickson, 2016). Short-term dynamics, however, show bidirectional causality between debt and growth, emphasizing the interdependence of fiscal policy and economic performance (Egbetunde, 2012). These findings underscore the importance of disciplined debt management, prioritizing well-assessed and sustainable projects, while cautioning against excessive borrowing that may have adverse long-term effects (Reinhart & Rogoff, 2010; Hilton, 2021).

Comparative studies indicate that institutional quality and expenditure composition matter. In liberal economies, public debt often has neutral or positive effects on growth due to effective fiscal frameworks and targeted spending (Ahlborn & Schweickert, 2017). For OECD economies, research suggest a conventional negative correlation between public debt and economic growth (Panizza & Presbitero, 2014). High public debt can indirectly hinder labour market performance by increasing interest rate volatility and pro-cyclical wage fluctuations, reducing employment growth (Mayer et al., 2013). Collectively, these studies suggest that the impact of public debt is conditional on macroeconomic frameworks, debt composition, and governance quality, reinforcing the need for careful fiscal and monetary coordination.

The literature on the effects of public debt on fiscal policy highlights complex relationships, heavily dependent on debt levels, the composition of public spending, and institutional contexts. Several studies indicate that high debt levels can create multiple equilibria in the economy and trigger austerity policies, particularly during crises, which may hinder growth (Panizza & Presbitero, 2014). However, in certain financial contexts, supported by a diversified issuance of

government securities, a unique and stable equilibrium can emerge, allowing expansionary fiscal policy, for instance, to reduce consumption inequality (Dhital et al., 2021).

The composition of public expenditures is crucial: public investment promotes growth and improves debt sustainability, while excessive public consumption can reduce private savings and limit positive impacts on GDP (Ciaffi et al., 2024). Fiscal policies tend to be countercyclical when debt is low but can become procyclical beyond a specific threshold, creating “fiscal policy traps” where low output triggers high taxation, exacerbating stagnation (Camous & Gimber, 2018).

From monetary policy point of view, the literature indicates that the maturity structure of public debt directly affects consumption inequality. In an active monetary policy context, an increase in the money supply tends to exacerbate consumption disparities, particularly between agents transacting with cash and those using bank deposits (Dhital et al., 2021). This effect occurs regardless of the type of debt issuance, whether short- or long-term securities.

Furthermore, fiscal multipliers become non-monotonic under high debt: they may be high in the long run but low or negative in the short run, emphasizing the importance of fiscal rules, debt trajectory management, and institutional frameworks to preserve the stabilizing role of fiscal policy (Mayer et al., 2013; Combes et al., 2017). Finally, debt sustainability also depends on endogenous fiscal adjustments, where governments adapt their fiscal policies in response to rising debt, notably in African countries (Abubakar et al., 2025).

Overall, the effect of public debt on fiscal policy is conditional: it varies with debt levels, expenditure composition, institutional quality, and economic agents’ expectations, making budgetary planning complex and context-dependent.

Methods

Given that broad money and inflation represent the monetary policy dimensions, while aggregate consumption and public expenditures reflect the fiscal policy dimensions, this study aims to assess the impact of public debt on both monetary and fiscal policy in Algeria. To this end, we employ a linear regression model estimated using Ordinary Least Squares (OLS), based on annual data from 1985 to 2024 (40 observations). The dependent variable is the logarithm of public debt (LOGDEBT), and the explanatory variables are the logarithms of broad money (LOGBM), aggregate consumption (LOGCON), inflation (LOGINF), and public expenditures (LOGEXP).

All variables are continuous and have been transformed into logarithmic form to correct for non-normality and to allow for elasticity interpretation. The choice of a linear regression model is justified by the continuous nature of the variables and the approximately normal distribution of their logarithmic transformations, which satisfy the classical OLS assumptions. This modelling strategy enables the estimation of the percentage change in public debt associated with a 1% change in each explanatory variable, holding other factors constant. Ultimately, it provides a comprehensive view of how macroeconomic factors interact with public debt and reveals the transmission mechanisms through which debt may affect monetary and fiscal dynamics in an emerging economy like Algeria.

Results

1. Analytical analysis of the used variables in the empirical model:

In this section we aim to analyse the evolution and variation of the Algerian public debt, inflation rates, and public expenditures in the studied period between 1985 and 2024. The graph in Figure 1 shows the evolution of Algeria’s public debt on a logarithmic scale, which highlights relative changes in debt rather than absolute levels. From 1985 to 1992, debt remained nearly constant around 1.87, suggesting stable debt management and a low net borrowing during this period. Between 1993 and 2005, debt gradually declined from 1.65 to 1.35, reflecting debt reduction through budgetary reforms, repayments, or restrictive economic policies. From 2006 to 2015, debt reached a low and fluctuating level around 0.88-1.10, indicating moderate instability likely linked to variations in public spending or investment. Between 2016 and 2021, debt rose steadily from 1.26 to 1.74, reflecting renewed borrowing and an increased government expenditures after a period of stabilization, with high dependence on domestic debt. In the most recent years,

2022-2024, debt stabilized around 1.66-1.68, with a slight decline in 2024, suggesting controlled borrowing and prudent fiscal policies.

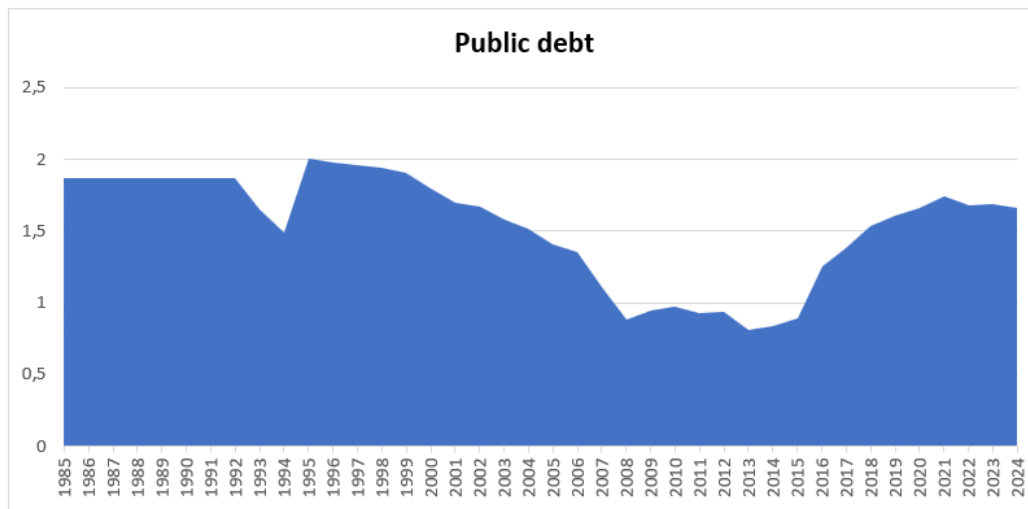


Figure 1. Public debt levels in Algeria 1985-2024

Data source: World of Bank

Overall, the logarithmic scale allows clear visualization of relative growth rates, showing a general downward trend until the mid-2000s followed by gradual recovery starting in 2016, with fluctuations likely reflecting major economic changes such as crises, reforms, oil price variations, or shifts in fiscal policy.

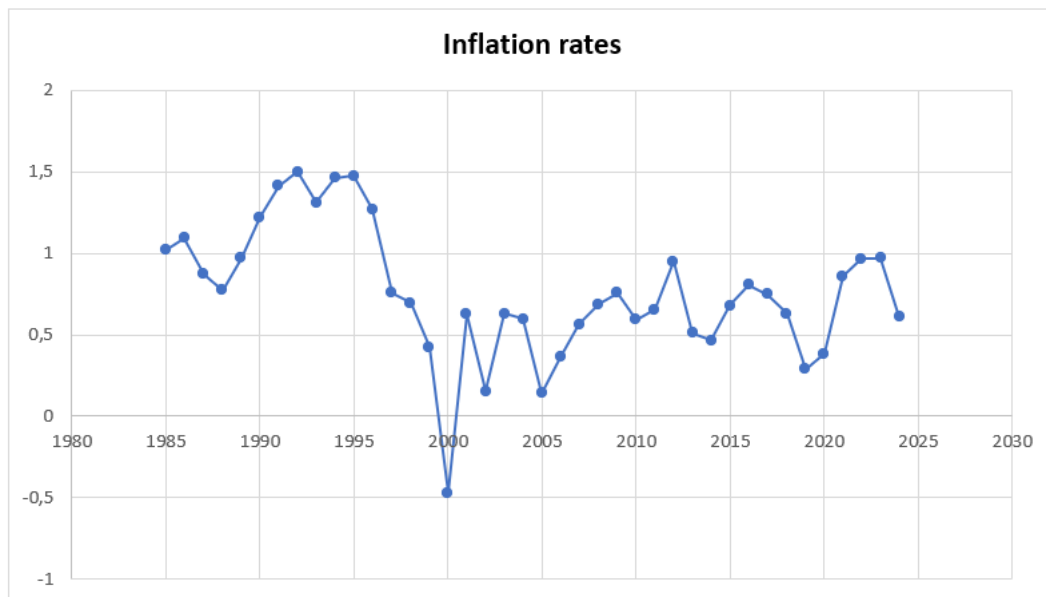


Figure 2. Inflation rates fluctuations in Algeria 1985-2024

Data source: World of Bank

Inflation, under certain conditions, can help reduce the real burden of public debt, thereby improving the primary balance. Political stability, in turn, strengthens institutional credibility and supports more effective fiscal policies (Abubakar et al., 2025). However, while inflation can theoretically ease debt repayment, this approach carries significant risks and uncertainties, particularly due to the growing share of debt held by foreign creditors and the potential for unexpected inflation surges (Aizenman & Marion, 2011). Niemann et al. (2013) demonstrate that, under a discretionary policy regime, governments have an incentive to generate surprise inflation to

reduce the real value of nominal public debt. This strategy creates a strong correlation between public debt and inflation.

Since public debt tends to be persistent reflecting a goal of smoothing fiscal distortions over time inflation also becomes persistent (Niemann et al., 2013). When households are informed about the actual level of public debt, which they generally underestimate, their inflation expectations rise especially when the information gap is large (Grigoli & Sandri, 2024). Unexpected increases in public debt lead to persistent rises in long-term inflation expectations in emerging market economies, but not in advanced ones (Brandao-Marques et al., 2023). These effects are particularly pronounced when debt levels and inflation are already high, and when a large share of sovereign debt is denominated in U.S. dollars. In contrast, countries with inflation-targeting regimes experience only mild effects (Brandao-Marques et al., 2023). Overall, higher debt levels followed with uncertainties and less information transparency may hinder efforts to control inflation in emerging markets characterized by dollarized debt and weaker monetary policy frameworks.

The graph in Figure 2 shows the evolution of Algeria's inflation over the period 1985-2024, highlighting relative changes in price levels from year to year. From 1985 to the early 1990s, inflation remained relatively stable, suggesting moderate price increases and controlled monetary conditions. Between the early 1990s and the early 2000s, inflation experienced fluctuations, with some sharp increases likely reflecting economic instability, structural adjustments, or shocks in the domestic and global economy. From the mid-2000s to 2015, inflation was more contained, showing periods of stabilization that may reflect improved monetary policy and fiscal management. Between 2016 and 2021, inflation rose moderately, possibly due to increased public spending and external price pressures. In the most recent years, 2022-2024, inflation showed relative stabilization, indicating some effectiveness of monetary policy measures. Overall, the graph highlights both short-term volatility and long-term trends in price changes, reflecting economic cycles, policy interventions, and external shocks affecting the Algerian economy.

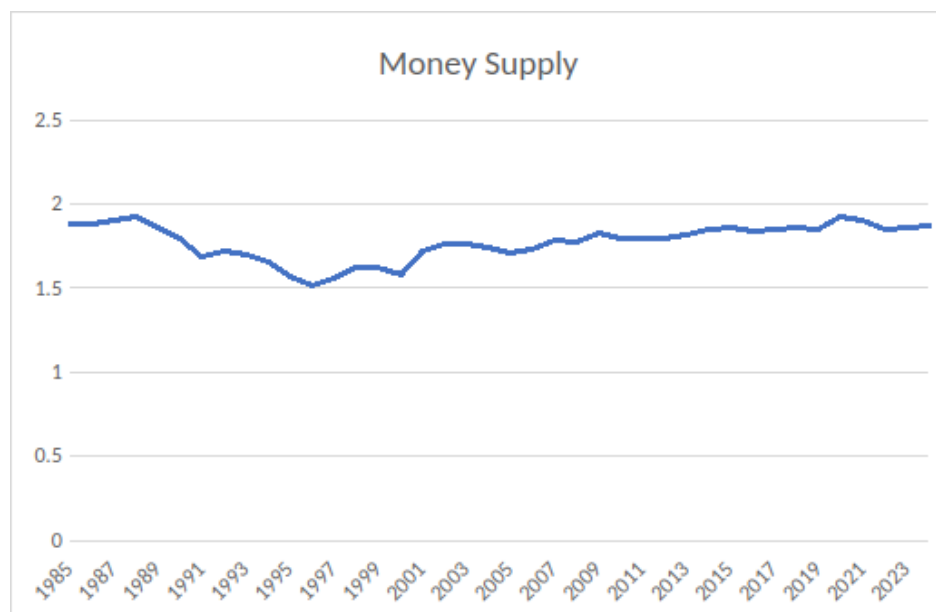


Figure 3. Total money supply in Algeria 1985-2024

Data source: World of Bank

Recent studies on the nexus between public debt and public expenditures; highlight a strong differentiated impact of public spending, government consumption, and public investment on public debt sustainability. Using robust identification methods based on unexpected fiscal shocks, Ciaffi et al. (2024) find that fiscal multipliers exceed one, indicating an expansive effect of public spending on GDP. When debt is low, fiscal policy tends to be countercyclical; however, once debt surpasses a certain threshold, it becomes procyclical (Ciaffi et al., 2024). This shift can lead to a self fulfilling

fiscal crises, or “fiscal policy traps”, where low output and high expected taxation reinforce each other (Camous & Gimber, 2018).

Public spending consistently promotes growth following classical view, while the effect of taxation varies it can either hinder or stimulate growth depending on whether taxes reduce or enhance productive public expenditure as suggested by Barro theory (1974). Overall, moderate taxation, and effective public spending, and a balanced debt structure are essential to sustain long term economic growth. However, public debt and public expenditures relationship is affected by external factors such as the level of corruption and the level of shadow economy. Corruption and public spending contribute to rising public debt through distinct channels, and that some categories of spending can even mitigate corruption’s harmful effects (Del Monte & Pennacchio, 2020).

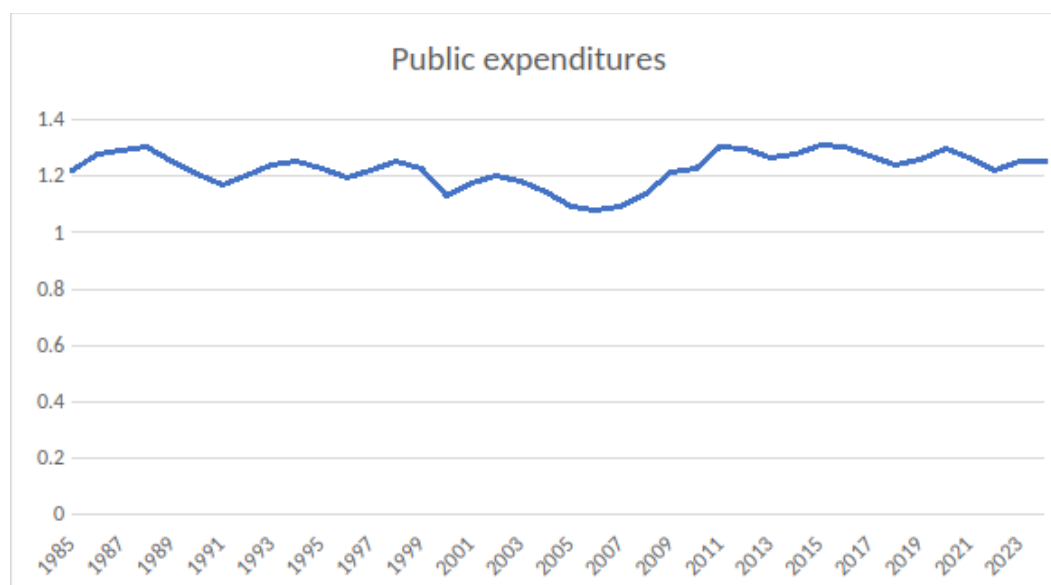


Figure 4. Public expenditures levels in Algeria 1985-2024

Data source: World of Bank

Overall, this highlights that corruption is not limited to developing economies and can substantially undermine fiscal stability in advanced ones; strengthening anti-corruption measures is therefore a key policy tool to curb public debt and enhance the effectiveness of institutional fiscal controls (Del Monte & Pennacchio, 2020).

The graph in Figure 04 shows the evolution of Algeria’s public expenditures on a logarithmic scale, which highlights relative changes over time. From 1985 to the early 1990s, public expenditures remained relatively stable, suggesting consistent government spending policies during this period. Between the early 1990s and the early 2000s, public expenditures experienced moderate fluctuations, reflecting adjustments in fiscal policy or responses to economic challenges. From the mid-2000s to 2015, public spending gradually increased, indicating an expansionary fiscal stance or an increased investment levels in public services and infrastructure. Between 2016 and 2020, public expenditures remained relatively high, followed by a slight decline in 2021-2022, reflecting fiscal consolidation or responses to external economic pressures. In the most recent years, 2023-2024, spending stabilized around similar levels, suggesting controlled public expenditures. Overall, the logarithmic scale allows a clear view of relative growth rates, showing periods of moderate increase and stability in Algeria’s public spending over the past four decades.

2. Data source:

We used annual data from 1985 to 2024 (40 observations) on the following variables:

- Public debt (LOGDEBT) – logarithm of total public debt in Algeria;
- Broad Money (LOGBM) – logarithm of broad money in Algeria;
- Consumption (LOGCON) – logarithm of broad money in Algeria;
- Inflation (LOGINF) – logarithm of annual inflation rate in Algeria;

- Public expenditures (LOGEXP) – logarithm of total public expenditures in Algeria.

All data were obtained from (World Bank, IMF) and transformed to natural logarithms to reduce skewness and allow interpretation in terms of percentage changes.

3. Estimation Equation:

$$LOGDEBT = \beta_1 + \beta_2 LOGBM + \beta_3 LOGCON + \beta_4 LOGINF + \beta_5 LOGEXP \quad (1)$$

4. Substituted Coefficients:

Table 1. Estimation results

Dependent Variable: LOGDEBT

Method: Least Squares

Sample: 1985-2024

Included observations: 40

Significance level: 5%

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-3.944212	0.984953	-4.004467	0.0003
LOGBM	0.175593	0.361372	0.485905	0.6301
LOGCON	5.272759	0.566125	9.313768	0.0000
LOGINF	0.109183	0.099275	1.099809	0.2789
LOGEXP	-3.549492	0.762929	-4.652451	0.0000

Source: Authors' calculations

5. Interpretation of Results:

The regression estimates the impact of broad money (LOGBM), aggregate consumption (LOGCON), inflation (LOGINF) and public expenditures (LOGEXP) on public debt (LOGDEBT) using logarithmic transformations. In this specification, coefficients can be interpreted as elasticities. A coefficient of 0.1 implies that a 1% increase in the explanatory variable leads, ceteris paribus, to a 0.1% change in public debt.

Constant (C = -3.944, p < 0.001)

- The negative constant indicates that when all explanatory variables are at their reference level (log = 1), the expected level of public debt in logarithms is negative.
- While the constant has limited direct economic interpretation, it is statistically significant, supporting the overall model specification.

Broad Money (LOGBM = 0.176, p = 0.63)

- The positive coefficient suggests that increases in broad money tend to raise public debt. This effect is not statistically significant at conventional levels ($p > 0.05$).
- This indicates that, in the Algerian context, variations in broad money do not appear to have a clear or immediate effect on public debt.

Aggregate Consumption (LOGCON = 5.273, p < 0.001)

- The coefficient is positive and highly significant, indicating that a 1% increase in consumption is associated with a 5.27% increase in public debt.
- This highlights a strong relationship between domestic demand and government borrowing: higher consumption, likely financed by public debt, leads to a substantial increase in debt levels.

Inflation (LOGINF = 0.109, p = 0.28)

- The coefficient is positive but not statistically significant, suggesting no clear relationship between the inflation level and public debt in this model.
- Inflation does not appear to be a major determinant of public debt in Algeria over the period studied.

Public Expenditures (LOGEXP = -3.549, p < 0.001)

- The coefficient is negative and significant, indicating that a 1% increase in the overall public expenditures is associated with a 3.55% reduction in public debt.
- Although this result may appear counterintuitive, it could reflect a situation where higher or better targeted public spending reduces the need for additional borrowing, or where increased expenditures are accompanied by budgetary adjustments that limit debt accumulation.

6. Model Fit and Diagnostics:

Table 2. Model fit results

Significance level : 5%	
R-squared	0.761096
Adjusted R-squared	0.733792
F-statistic	27.87555
Prob(F-statistic)	0.000000

Source: Authors' calculations

• The adjusted R^2 of 0.734 indicates that 73.4% of the variation in public debt is explained by the model, which is high for macroeconomic data.

• The F-statistic (27.88, $p < 0.001$) confirms the overall significance of the model.

The analysis shows that aggregate consumption is the main driver of public debt in Algeria, with a strong and significant positive effect. In contrast, public expenditures exhibit a negative and significant effect, suggesting that increased spending may be associated with better debt management, possibly through budgetary adjustments. Broad money and inflation do not appear to be statistically significant determinants of public debt in this model. The model explains approximately 73% of the variance in public debt, although potential autocorrelation in the residuals warrants caution when interpreting the significance of the coefficients.

Discussion

The analysis shows that aggregate consumption is the main driver of public debt in Algeria, with a strong positive effect. Public expenditures exhibit a negative and significant impact, suggesting potential efficiency gains or compensatory fiscal adjustments. Broad money and inflation are not statistically significant determinants in this model. While the model explains a substantial portion of debt variation, caution is warranted due to autocorrelation in the residuals, which may affect inference reliability. This suggests that increases in domestic demand are closely associated with higher government borrowing, highlighting the role of public debt as a mechanism to finance consumption-driven fiscal pressures.

In contrast, public expenditures show a significant negative relationship with debt, implying that more efficient or targeted spending may help contain borrowing needs. Broad money and inflation, however, do not appear to significantly influence public debt in the Algerian context, suggesting that monetary expansion and price-level fluctuations have limited direct impact on debt dynamics over the study period. These findings provide valuable insights into the interaction between public debt and macroeconomic policy. The positive link between consumption and debt underscores the potential tension between stimulating domestic demand and maintaining fiscal sustainability, while the negative association with expenditures suggests that prudent fiscal management can partially offset the debt burden.

The visual analysis of the time series complements these findings. Public debt remained relatively stable in the late 1980s and early 1990s, declined during the 1990s and early 2000s, and then experienced a gradual increase from 2016 onwards. Public expenditures followed a similar trend, with gradual growth in the 2000s and stabilization in recent years. Inflation, meanwhile, displayed short-term volatility with periods of stabilization, suggesting that monetary policy has been somewhat effective in controlling price levels, even as debt levels evolved.

Overall, the study indicates that fiscal policy, through investment management, plays a key role in influencing public debt, while monetary factors such as inflation have a smaller and less consistent effect. These results imply that policies aimed at promoting investment and controlling spending can be effective tools for managing debt, while careful monitoring of inflation is necessary to prevent indirect pressure on public finances.

Conclusion

This study examined the impact of public debt on monetary and fiscal policy in Algeria over the period 1985-2024, focusing on the roles of broad money, aggregate consumption, inflation, and public expenditures. The empirical results indicate that aggregate consumption is the main driver of public debt, with a strong and statistically significant positive effect, highlighting the close link between domestic demand and government borrowing. In contrast, public expenditures exhibit a negative and significant effect, suggesting that efficient or well-targeted fiscal spending can help contain debt levels, possibly through compensatory budgetary adjustments. Broad money and inflation, however, do not appear to be significant determinants of public debt in Algeria, indicating that monetary factors play a less dominant role in shaping debt dynamics over the studied period.

These findings reinforce the notion that fiscal policy is central to debt sustainability, while monetary policy has a more limited direct influence. The visual and time-series analysis of public debt, expenditures, inflation, and money supply further supports these conclusions, showing periods of relative stability, decline, and gradual recovery in debt levels, largely reflecting fiscal management and domestic economic conditions.

Overall, the results suggest that prudent fiscal management through targeted public spending and careful monitoring of consumption patterns is essential for maintaining debt sustainability in Algeria, while coordinated monetary measures can support macroeconomic stability indirectly. Policy implications include prioritizing investment-oriented expenditures, controlling domestic consumption pressures, and maintaining transparent debt management frameworks to mitigate long-term fiscal risks.

Despite providing valuable insights into the determinants of public debt in Algeria, this study has several limitations that should be acknowledged.

First, the analysis is based on annual time-series data with only 40 observations (1985-2024), which restricts the statistical power of the estimations and may not fully capture short-term fluctuations or structural breaks in the Algerian economy. Expanding the dataset to include quarterly or semi-annual data could enhance precision and allow for dynamic modelling approaches such as Vector Autoregression (VAR) or Error Correction Models (ECM).

Second, the study employs a linear regression model, which assumes constant elasticities and symmetric relationships among variables. However, the impact of fiscal and monetary variables on public debt may be nonlinear or regime-dependent, particularly during periods of economic crisis, oil price shocks, or policy reforms. Future research could apply nonlinear models, threshold regressions, or structural break tests to better capture such dynamics.

Third, while the study focuses on key macroeconomic variables: broad money, consumption, inflation, and public expenditures; it does not account for other potentially important factors such as interest rates, exchange rates, fiscal deficits, institutional quality, or external debt composition. Incorporating these dimensions could provide a more comprehensive view of debt dynamics and policy interactions.

Finally, the study is country-specific and therefore its findings may not be generalizable beyond the Algerian context. Comparative studies including other developing or oil-dependent economies could help assess whether similar patterns hold under different institutional or economic conditions.

Future research could thus extend this work by integrating broader datasets, exploring nonlinear effects, and examining the interaction between fiscal discipline, governance quality, and macroeconomic stability in shaping public debt trajectories.

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