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External Debt, Public Investment and Economic Growth in Cameroon

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Abstract

This study investigates the extent to which external debt and public investment contribute to economic growth in Cameroon-emphasizing how public investment modulates the effect of external debt on economic growth. Time series data spanning the period 1980-2021 obtained from the World Bank's world development indicators were used, together with the Dynamic Ordinary Least Squares (OLS) approach to ascertain the nature of the long-run relationship between external debt, public investment, and economic growth in Cameroon. Consistent with the debt-overhang and crowding-out literature, the study reveals a negative significant influence of external debt on economic growth in Cameroon. Results also reveal that there is a positive and significant direct effect of public investment on economic growth in the long run. Further results indicate that public investment and external debt positively and significantly affect engender economic growth in Cameroon. This is evidence that public investment modulates the effect of external debt on economic growth in Cameroon. These findings suggest the need for the government of Cameroon to create an enabling environment for private sector investment, while accompanying external debt resources with domestic revenue mobilization by broadening the tax base to include taxes on landed property.
Keywords: External debt; Public investment; Economic growth; DOLS.

1. Introduction

Economic growth and development remain a major concern of most developing countries, requiring resources mobilization and discipline to address. Sustainable economic growth is the prime concern of all countries, especially developing economies that frequently face burgeoning fiscal deficits mainly driven by higher levels of debt service, particularly external debt servicing and widening current account deficits (Bernardin *et al.*, 2018). The Harrod-Domar growth model has been the source of inspiration for development economists in explaining the importance of external borrowing in closing the savings-investment gap in developing countries. The principal reason for government borrowing is to finance public goods that increase welfare and promote economic growth. The spending has to be financed either through taxation, seigniorage or debt. Theoretically, it is expected that developing countries would benefit from external borrowing if the marginal product of capital is higher than the world interest rate (Ogunmuyiwa, 2011). However, borrowing must be caucious as many poor nations become poorer after taking loans from international creditors such as the World Bank, the IMF and the Paris Club (Atique and Kamran, 2012)

According to World Bank (2019), Cameroon's total external debt in 2016 was $8,186 million and increased to $10,396 million in 2017. This shows an increase of $2210 million between 2016 and 2017. It has been observed that public debt in Cameroon has gradually and steadily increased since the debt relief initiative under the Enhanced Heavily Indebted Poor Countries (HIPC) and Multilateral Debt Relief Initiatives (MDRI). Total public sector debt increased three-fold since 2010 to 35.2% of GDP in 2016, with about 70% of the increase driven by a surge in public and publicly guaranteed (PPG) external debt. Between 2009 and 2015, Cameroon's debt to GPD ratio was 25%, two times more than the median for SSA countries which stood at 12%.

Cameroon's budget for 2019 stood at 4850.5 billion FCFA and 4951.7 billion in 2020. There is an increase of 161 billion or 3.43% of the budget of 2019, compared to the previous year budget. The expectation of the government is for the GDP to grow further from 0.9% in 2019, to 4.4% in 2020 (Hugue, 2018). Between 2006 and 2016, public expenditures increased substantially in Cameroon, rising substantially from 13% of GDP in 2006 to 21% in 2016. This increase financed some of the Vision 2035 and Growth and Employment Strategic Paper (GESP) goals, resulting in an increased capital expenditure from 2.6% in 2006 to 7.9% in 2016. Over the last decade, the share of capital expenditures in Cameroon's total public expenditure increased considerably (World Bank, 2018).

The GESP of 2009 and Vision 2035 outlined Cameroon's main strategic and long-term goals. In order for the country to achieve its development objectives, closing the infrastructure gap was imperative. Since 2000, growth has averaged 3.6% which remains well below the 5.5% average target in the GESP for 2010–20. This potential growth

could come from solving infrastructural challenges in power supply by lowering production costs and increasing national access rates, and in transport services by improving road conditions and transport costs along the main transit corridors to neighboring countries (International Monetary Fund, 2014). A lot has been done by the government of Cameroon to foster economic growth and development. Among many of such measures are; the five-year economic and social development plan in 1961 to re-enforce and guarantee sustainable growth of the national economy in terms of increase in real gross domestic product (GDP), the introduction of the Structural Adjustment Programme (SAP) in 1988/1989, followed by the devaluation of the FCFA in 1994 after the deduction of civil servants' salaries by over 50 percent.

The World Bank (2019) noted that public debt in Cameroon has gradually and steadily increased since the debt relief under the enhanced HIPC and MDRI. In the same way, World Bank (2018) report that between 2006 and 2016, public expenditures have increased substantially in Cameroon, with public spending rising substantially from 13% of GDP in 2006 to 21% of GDP in 2016. The foregoing statistics are economically contradictory, as increased borrowing and spending should come with higher growth rates and improved macroeconomic performance. Thus, the study questions the role of external borrowing and public investment on economic growth in Cameroon. In this light, the study examines the extent to which external debt and public investment contribute to economic growth in Cameroon using time series data.

2. Literature Review

This paper is supported by economic growth theories in which we review a select few, starting with the Harrod-Domar Growth Model, formulated separately by the British economist Roy Harrod and the American economist of Polish origin Evsey Domar in 1939 and 1946 respectively. Their results were so close to each other that it subsequently became known in scientific circle as the theory of Harrod-Domar. This model explains the place of saving and investment in economic growth. In the technical conditions of production, economic growth is determined by the marginal propensity to save, and the dynamic equilibrium in the market system is inherently unstable, so that maintaining it at full employment requires active and purposeful actions of the state. To illustrate the Harrod-Domar growth model, let savings (S) be some proportions of national income (Y) such that:

$S = sY$. …………………………………………………………………………………1

Investment (I) is defined as the change in capital stock, K, and can be represented by DK such that I = DK. Total capital stock, K, is directly related to national income, Y, as represented by the capital-output ratio, k, such that: $K/Y = k$. This capital-output ratio can also be written in its marginal value as:

$DK / DY = k$…………………………………………………………………………....2,

Known as the incremental capital-output ratio. Since the equilibrium saving, S, must equal total investment, I, it follows that $sY = kDY$ or in a more familiar expression,

$DY / Y = s/k$. …………………………………………………………………………...3

This equation reveals that the rate of growth of output is determined jointly by the national savings ratio, s, and the national capital output ratio, k. It also says that the growth rate of national income will be directly related to the saving ratio and inversely related to capital output ratio.

In the context of this study, Y in the model represents economic growth while k represents public investment. According to Vision 2035, the savings level of Cameroon is low and stands at 17.4 percent of GDP which is a major hindrance to long term growth and development. The Harrod-Domar growth model suggests that for economic growth to occur, the rate of savings must be positive and rising. Since most developing countries have a negative attitude towards savings, they always resort to borrow in order to complement the domestic savings for economic growth. Since savings in Cameroon is low, the Harrod-Domar model sees borrowing to be complementary to domestic savings which is seen as an engine to economic growth.

Significant empirical research has been conducted in line with the key issues under investigation in this study. While some studies find positive role of external debt and public investment on growth, others have been negative explained by the debt overhang hypothesis while some results have been mixed. Atique and Kamran (2012), showed the existence of an inverse relationship between domestic debt and economic growth and between external debt and economic growth in Pakistan. Kharusi and Ada (2018), also found that external debt has a negative and significant effect on economic growth in Oman. Their findings were similar even though with use of different methodologies. Furthermore, Onakoya and Ogunade (2017) observed that external debt was negatively related to economic growth, as well as Ogunmuyiwa (2011) using Vector error correction Method (VECM) in Nigeria. Therefore, methodology seems to have no significant impact on result and hence disregarded as a judgment point for the selection of literature for this study.

Asghar (2016), found that economic growth was significantly explained by external debt in a time series study carried out in Pakistan. Also, Elwasila (2018) in Sudan, found a positive effect of external debt on economic growth. Furthermore, Saifuddin (2016) using Two Stage Least Square as an estimation technique show that public debt positively affect economic growth in Bangladesh. Using both fixed effect and system General Method of Moments (GMM) to estimate data collected from 55 low-income countries that are classified as eligible for the IMF's Poverty Reduction and Growth Facility, Benedict et al. (2003) observed that, beyond a certain limit, higher external debt is associated with lower rates of growth of per capita income. Meanwhile, Mahmud and Shahida (2012) found a significant long run negative effect of external public debt service in Bangladesh. Shabbir (2013) used linear panel data from a sample of 70 developing countries for 36 years (1976–2011) and obtained results which show an inverse relationship between external debt to GNI and growth rate of per capita GNI for the developing countries.

Like Ndubuisi (2017) who found a positive and significant effect external debt stock on Nigeria's growth index, Abuzaid (2011) in analyzing the impact of external debt and debt services on growth and investment in three selected Arab countries, namely, Tunisia, Egypt and Morocco confirmed that external debt affects growth directly. Also, the results indicate that external debt affects investment positively and is statistically significant. Bernardin *et al.* (2018), examined the effect of external debt on economic growth in Sub-Saharan Africa (SSA) and concluded that external debt negatively affects economic growth in the region. In the same manner, Ncanywa and Masoga (2018) arrived at the conclusion that public debt is inversely related to economic growth.

Onakoya and Ogunade (2017) found that external debt is negatively related to economic growth while Ogunmuyiwa (2011) using Vector error correction Method (VECM), showed that there is no strict causality between external debt and economic growth in Nigeria. However, Njimanted *et al.* (2015) used the system estimation approach in a study on "External debt, Domestic investment and economic growth" in Cameroon over the periods 1980 to 2013. Using Two Stage Least Square as an estimation technique, the result revealed that external debt adversely affects economic growth in Cameroon. From the above literature, results have been mixed with methodologies diversed on the subject.

3. Methods and Procedures

This paper adopts the causal research design because it plays an instrumental role in terms of assessing the impact of changes in existing norms and processes. The data used are quantitative and secondary in nature. The adoption of a causal research design is justified by the fact it allows for the investigation of the cause and effect relationship between the variables of interest.

Three economic growth multivariate model is specified to determine the relationship and to address objective of the paper. The first model of this paper examines the effect of external debt (XDEBT) on economic growth, specified as follows:

$$GDPPC_t = \beta_0 + \beta_1 XDEDT_t + \beta_2 PINV_t + \beta_3 DCPS_t + \beta_4 BMON_t + \beta_5 EXP_t + \beta_6 LFP_t + \beta_7 FDI_t + \varepsilon_t \dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots1$$

The second objective of the paper investigates the effect of public investment (GINV) on economic growth, with empirical model formulated as follows:

$$GDPPC_t = \alpha_0 + \alpha_1 GINV_t + \alpha_2 PINV_t + \alpha_3 DCPS + \alpha_4 BMON_t + \alpha_5 EXP_t + \alpha_6 LFP_t + \alpha_7 FDI_t + \mu_t \dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots2$$

In order to examine the modulating effect of public investment on external debt and economic growth in Cameroon, the following model with interaction variable GINV*XDEBT is specified:

$$GDPPC_t = \gamma_0 + \gamma_1 XDEBT_t + \gamma_2 GINV_t + \gamma_3 GINV_t * XDEBT_t + \gamma_4 PINV_t + \gamma_5 DCPS_t + \gamma_6 BMON_t + \gamma_7 EXP_t + \gamma_8 LFP_t + \gamma_9 FDI_t + \vartheta_t \dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots3$$

GDPPC is per capita GDP which is used here as a proxy for economic growth, XDEBT is external debt, GINV is public or government investment, PINV is private investment, DCPS is domestic credit to the private sector, BMON is broad money which captures money supply, EXP is exports, LFP is labour force participation rate, FDI is foreign direct investment, ε_t, μ_t and ϑ_t are the disturbance terms which is assume to follow a normal distribution.

GDP per capita is included in the model because it is a better measure of economic growth while external debt on its own cannot produce the required result. Thus, public or government investment is the mechanism through which external debt operates to produce the expected result. With the inflow of foreign capital in the form external debt, broad money increases and as such it is imperative to see how it affects economic growth. With all these in play, exports are supposed to increase and the increase in exports supposed to correlate with growth. All these variables cannot operate without the participation of labour force.

Assuming a log-log model, we interpret the coefficients as elasticities. In this context, equations 1, 2 and 3 become equations 4, 5 and 6 respectively as:

$$LGDPPC_t = \beta_0 + \beta_1 LXDEDT_t + \beta_2 LPINV_t + \beta_3 LDCPS_t + \beta_4 LBMON_t + \beta_5 LEXP_t + \beta_6 LLFP_t + \beta_7 LFDI_t + \varepsilon_t \dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots4$$

$$LGDPPC_t = \alpha_0 + \alpha_1 LGINV_t + \alpha_2 LPINV_t + \alpha_3 LDCPS_t + \alpha_4 LBMON_t + \alpha_5 LEXP_t + \alpha_6 LLFP_t + \alpha_7 LFDI_t + \mu_t \dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots5$$

$$LGDPPC_t = \gamma_0 + \gamma_1 LXDEBT_t + \gamma_2 LGINV_t + \gamma_3 LGINV_t * XDEBT_t + \gamma_4 LPINV_t + \gamma_5 LDCPS_t + \gamma_6 LBMON_t + \gamma_7 LEXP_t + \gamma_8 LLFP_t + \gamma_9 LFDI_t + \vartheta_t \dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots6$$

β1 to β7, α1 to α7 and *γ1 to γ9* are the coefficients of LGINV, LXDEBT, *L(GINV*XDEBT)*, LPINV, LDCPS, LBMON, LEXP, LLFP and LFDI to be estimated. α_0, β_0 and γ_0 are the constant terms which can be considered here as the natural rate of economic growth in Cameroon.

For estimation of the parameters, the Dynamic Ordinary Least Squares (DOLS) estimation technique was used. In fact, one of the key and strong assumptions of OLS estimation technique is the absence of correlation between the residuals and the explanatory variables (Cov (εt, xt) = 0). When this assumption is violated, the estimated parameter becomes biased and inconsistent, leading to a spurious regression. When it is postulated that there may be a significant correlation between the explanatory variable and the error term, this explanatory variable is no longer considered to be exogenous but rather endogenous. This problem is known in the econometric jargon as the problem of endogeneity. This is usually the case in time series data which are not stationary at level and are co-integrated as it is the case in the present study.

Stock and Watson (1993), explained that a linear combination of the dependent and independent variables creates a stationary error term which is correlated with the regressors (problem of endogeneity). One and most popular way of addressing this problem is that of using instrumental variables two stage least squares (2SLS). One

robust way of addressing this issue of endogeneity without using instrumental variables is the Dynamic OLS approach. The Dynamic OLS involves augmenting a (super consistent) OLS estimate of the co-integrating relationship with first differences of leads and lags of the right hand side (RHS) variable of the model specification (regressors). In this study our main variables are public investment and external debt. Stock and Watson (1993) proposed that in case of endogeneity of co-integrating variable and small sample bias as it is the case, the Dynamic OLS is preferable.

Table-1. Dynamic OLS results of determinants of economic growth

	(1)	(2)	(3)
VARIABLES	lgdppc	lgdppc	lgdppc
lxdebt		-0.368***	-3.700***
		(0.0200)	(0.851)
lginv	0.211***		-2.966***
	(0.0268)		(0.736)
lginv_lxdebt			0.138***
			(0.0321)
lpinv	-0.0184	0.230***	0.0500**
	(0.0170)	(0.0309)	(0.0244)
lbmon	0.199***	0.0336	0.238***
	(0.0403)	(0.0280)	(0.0265)
dcps	0.00601***	0.00186	-0.00130
	(0.00109)	(0.00155)	(0.00167)
lexp	-0.0726***	0.210***	-0.0448***
	(0.0243)	(0.0618)	(0.0138)
lfp	0.0115***	0.0957***	0.0380***
	(0.00115)	(0.00635)	(0.00799)
lfdi	-0.00496***	0.0151***	0.00203
	(0.00184)	(0.00556)	(0.00404)
F3D.lginv	0.0644***		0.0338
	(0.0228)		(0.0234)
F2D.lginv	0.0306		-0.0213
	(0.0324)		(0.0262)
FD.lginv	0.175***		0.0912***
	(0.0262)		(0.0186)
D.lginv	-0.0358**		-0.0248
	(0.0173)		(0.0199)
LD.lginv	0.00666		0.0703***
	(0.0168)		(0.0139)
L2D.lginv	0.0916***		0.0678***
	(0.0216)		(0.0107)
L3D.lginv	0.0542**		0.0481***
	(0.0224)		(0.0153)
F3D.lxdebt		0.0561***	0.0594***
		(0.0196)	(0.0202)
F2D.lxdebt		-0.0396***	-0.00313
		(0.0153)	(0.00813)
FD.lxdebt		-0.0222	0.0318***
		(0.0148)	(0.00408)
D.lxdebt		0.331***	0.115***
		(0.0275)	(0.0278)
LD.lxdebt		0.410***	0.146***
		(0.0225)	(0.0448)
L2D.lxdebt		0.215***	0.0401***
		(0.0220)	(0.00995)
L3D.lxdebt		0.155***	0.0666***
		(0.0213)	(0.0244)
Constant	8.724***	1.333	89.09***
	(0.914)	(0.992)	(19.05)
Observations	32	32	32
R-squared	0.992	0.974	0.996

Note: Standard errors in parentheses, *** p<0.01, ** p<0.05, * p<0.1
Source: Computed by authors (2021)

4. Presentation and Discussion of Results

To ensure results were appropriate, stationarity test was conducted since most economic time series variables are non-stationary and the use of non-stationary time series data leads to an apparent but not actually valid regression which implies that it cannot be used for precise decision. Testing for stationarity of the variables used in the models

are non-stationary at levels but achieved stationarity after their first difference as seen from the unit roots test (Augmented Dickey Fuller tests) which therefore implies that all the variable are integrated of first order (I(1)).

All three models are globally significant at 1% given a probability value of Chi^2 (Prob > chi2 = 0.0000) which is below 0.01 and, between 97.4% and 99.6% of variations in economic growth in the long run is explained by a joint variation of all the regressors included in the model.

Results from Table 1 indicate that the coefficient of public investment is positive (0.211) which implies that there is a positive long run effect of public investment on economic growth in Cameroon. In effect, an increase in government or public investment by 1% will lead to an increase in GDP per capita by about 0.21% everything being equal in the long run. It should be noted that this result is significant at 1% level. Thus there is a positive and significant effect of government investment on economic growth in Cameroon in the long run. This result is in line with a priori expectation and confirms the Barro (1990) model of endogenous growth which posits that proper and quality government spending geared towards infrastructure development will result in economic growth. This result also confirms the Keynesian theory of economic growth, which acknowledges investment, especially public investment, as the main driver of economic growth through the multiplier effect. If public investment is carried out to improve the quality of infrastructure, this will reduce the cost of private investment and increase the return to investment and by so doing spur economic growth. This result is in conformity with the finding of Ouattara (2004) who found a positive effect on government investment on economic growth.

Column 2 of Table 1 indicates that the coefficient of external debt is negative (-0.368) meaning that external debt relates negatively with economic growth measured by per capita GDP in the long run in Cameroon. A unit increase in the total external debt stock by results in about 0.37% fall in economic growth ceteris paribus. This finding is significant at 1% level. This outcome confirms the debt overhang hypothesis which indicates that accumulated debt stock reduces economic performance through "debt overhang" effect including tax disincentive especially on private sector investment as macroeconomic instability. This result is in line with the findings of Bernardin *et al.* (2018), Njimanted *et al.* (2015) and Atique and Kamran (2012) who found a negative effect of external debt on economic growth, but contradicts the finding of Elwasila (2018) in Sudan who rather found a positive relationship between external debt and economic growth.

When taking into consideration the possible modulating role of public investment on the effect of external debt on economic growth (Column 3), results reveal that there is positive modulating effect in the long run given that the coefficient of the interaction variable between public investment and external debt is positive whereas the coefficient of external debt and public investment are negative. More precisely, results from the DOLS show that the negative effect of external debt on economic growth is significantly watered down by public investment. This finding is significant at 1% level. Thus, there is a significant positive influence of public investment on the effect of external debt on economic growth in Cameroon in the long run. This positive modulating effect conforms to the finding of Ncanywa and Masoga (2018) who observed that public investment helps mitigate the negative effect of external debt on economic growth. Therefore, if the external debt is properly used to create favourable conditions for private investment such as constructing road, hospitals, schools and training centres, improving on the communications network and other transport facilities, this will go a long way to improve on the effectiveness of external debt on less developed economies such as Cameroon.

Going by the control variables, results reveal that there is a positive and significant relationship between private sector investment and economic growth in Cameroon. In other words, the higher the level of investment by the private sector, the higher will be the level of gross domestic product in Cameroon. This result conforms to our prior expectation and falls in line with the result of Kongphet and Masaru (2012), who found a positive relationship between investment and economic growth. Higher level of investment by the private sector may translate into more employment and more income to the population due to remuneration of factors of production.

In addition, money supply measured by broad money consistently exerts a positive effect on economic growth given that the coefficient of broad money (BMON) is positive across all the specifications. This result signifies that an increase in money supply will bring about an increase in per capita gross domestic income in the long run. This result is significant at 1% level in Columns 1 and 3, but insignificant in Column 2. Thus, money supply is relevant for policy recommendations aimed at improving the economic growth in Cameroon. This confirms with Prasert *et al.* (2015) who found that money supply were associated with economic growth.

Similarly, the coefficient of domestic credit to the private sector (DCPS) is positive in Columns 1 and 2 but negative in Column 3 - implying a positive effect of credit availability or financial development on the economic growth. But when accounting for the modulating effect of public investment on external debt, this effect is reversed. However, it should be noted that only the coefficient of DCPS in Column 1 is statistically significant. This result is in accordance with Olowofeso *et al.* (2015) who confirmed a positive and significant effect of private sector credit on output.

Furthermore, the result reveals that there is a consistent positive and significant effect of labour force participation (LFP) on economic growth. The coefficients of LFP are positive across all three specifications and significant at 1% level. On average, an increase in labour force participation by one percent point results in about 0.04% increase in per capita income in Cameroon everything else held constant. The result obtained at this level is contrary to Shahid (2014) who found that labour force participation has negative significant effect on economic growth.

5. Summary, Conclusion and Policy Implications

This study finds a negative and significant effect of external debt on economic growth in Cameroon using time series data in the long run. Investment is a vital ingredient for economic growth in less many developed countries; the coefficient of public investment is positive and has a statistically significant effect on economic growth in the long run. A significant modulating influence of public investment on the effect of external debt on economic growth was established to be significant and positive. This indicates that public investment influences external debt positively which has implications on the long run growth trajectory. This implies that public investment has the ability to positively moderate the negative effect of external debt on economic growth to positive.

Based on these empirical findings, the following policy outcomes are proposed:

➢ The governments should ensure that the foreign loans are invested in projects that would eventually generate enough return to amortize the debt. Also, enhancing domestic revenue mobilization will go a long way to reduce over reliance on external financing. In this regard, there is need to embark on efficient revenue mobilization drive through the broadening of the tax base, devising various strategies to capture untaxed informal sector into the tax net and check revenue leakages so as to increase domestic revenue mobilization.

➢ Investments should be directed in real sectors of the economy such as the agricultural, infrastructure, industrial, education, energy and health which will act as catalyst for the national development.

➢ Investment in education should be encouraged given that the coefficient of labour force participation is positive and significant in the long run. Education that provides the technical know-how should be encouraged as this contributes significantly to the growth of the economy. As such, investment in technical education, creation of Universities for science and technology throughout the national territory alongside polytechnics are strongly recommended.

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