EFFECTIVENESS OF DEBT INDICATORS ON PERFORMANCE OF SUB-SAHARAN AFRICAN ECONOMIES: A SELECTED REVIEW

Abubakar Sadiq Saleh (PhD)[1] and Umar Abbas Ibrahim (Ph.D)[2]

Department of Business Administration, Nile University of Nigeria, Abuja.

ABSTRACT: *Debt management strategy encompass much more than debts and how they were accumulated. Government debt management is the method of putting in place and effecting a strategy for transparently managing the government's debt with the main objective of meeting the government's financing needs; the costs and risks involved and any other debt management goals the government may have set. Such goals include evolving and preserving an efficient market for government securities. Many works thus tend to focus on debt and the crisis that ensued as a result but few or none of these works looked at the aspect of debt management that is required to guide the economic policy and decision makers in articulating far reaching decisions on how government should borrow and to what extent. In addition, questions such as the right source of finance and the maturity and composition of the instruments providing such are equally important in managing debt. These important aspects of debt management are crucial in managing government debts in the sub-Saharan Africa but conspicuously absent in both public and academic discussions in the region for some time. This work examines the relationship between the debt ratio of a country and the maturity of its debt; and between extent of indebtedness and the level of a country's capital market development. By use of the regression models and analysis this work attempted to determine the stated relationships.*

KEYWORDS: Debt Management, Debt Maturity, Debt Ratio, Sub-Saharan Africa

INTRODUCTION

The size and structure of the sub-Saharan African debt tend to follow a similar pattern with those recorded among other notable developing countries. The peculiar external source of the SSAs debt was however as a result of a number of factors. There are both endogenous and exogenous factors with the latter heavier in influencing the size as well as the structure of the borrowings over the last three decades. The endogenous factors were routine and included issues such as misallocation of funds, excessive military spending (Riddell, 1992) while the exogenous factors mainly included factors such as declining terms of trade as well as the prevalent droughts in the sub region. The fact that most of the sub-Saharan countries' economy is reliant heavily on commodity exports is a factor in the process of their indebtedness. According to Krumm (1985) transitory commodity price booms coupled with the ease of access to private financial and trade credits offered by the western credit institutions and the upsurge in expenditure among the exporting SSAs contributed substantially in the size and structure of the sub-Saharan debt. Although the trend has changed dramatically since the late 1990s these factors remain the shapers of the borrowing policy among governments in the sub-Saharan Africa.

For instance, the real stimulus to the expansion in the sub-Saharan African countries' external debt was the 1970s commodity export (oil) boom and bust in prices in the international market. These sudden fluctuations affected most sub-Saharan economies. The increases in commodity prices led various exporting countries to increase their government expenditure that there mostly financed by a renewed access to credits, but later on became saddled with excessive external debts due to a sudden fall in commodity prices which included crude oil. Cote d'ivoire, Ghana and Nigeria who were commodity and crude oil producing nations experienced increases in prices between 1973 to 75; 1973 to 1977; and 1974 to 1975 respectively. Countries affected by the sudden drop of their export prices responded by sharp increase in expenditures. External debt as a means of finance jumped in most of these countries. In Nigeria however recourse to external debt was not very substantial until in 1978.

The external factors that influenced the structure of the SSAs debts included the expanded access to external sources of lending's resulting from the rapid evolution of the international banking system especially after the post 1973 oil shocks where the banks played the vital role of recycling the substantial portion of the oil producing nations' surpluses. This led to the Euromarkets suddenly becoming an important source of financing for many sub-Saharan African countries'' governments who had hitherto never borrowed from it in the past (Krumm, 1985). Furthermore, most of the commercial banks' lending in the mid/late 1970s was linked to certain projects where the distinction between banks, suppliers and other credits were not clearly made. Export credit institutions also played a role in the huge size and external source of the debt in the SSA. This was where the export credit was directly extended through the official bilateral agencies that were officially guaranteed by export credit agencies, and the credits stood to be converted to official credit in the event of credits made falling into arrears or rescheduling. Public sector expenditure recorded increases as a result of expanded access to fresh avenues of raising funds as well as improvements in commodity prices for the sub-Saharan oil importers. Much of the contracted debt went into financing large public investment project that spanned a range of economic efficiency.

Other equally important factors that affected the size of the SSA borrowings include shocks as a result of the global economic recessions of the early 1980s. This contributed to a decline in export earnings among the commodity exporting countries in the SSA. This development not only led to a fall in the terms of trade, but the pressure on the current account by these factors led to the expansion of the external debt in the SSA. In a departure from this view, Greene (1989), see the problem of external debt among the SSAs largely as a result of governments' actions, in particular the accumulation of external debt for the purpose of development projects.

In the sub-Saharan Africa, the new institutional approach in the area of public debt management was readily adopted. For example, as early as the year 2000, Nigeria had established a separate debt management office with the objective of carrying out an effective management of Nigeria's debt for development and economic growth. Beside Nigeria however, majority of the countries in the sub-Saharan Africa e.g. Ghana, Cameroun and Uganda, continue to have their apex banks and Ministries of Finance as the case may be to handle issues concerning debt and its management. But the term debt management tend to be applied loosely especially among the few sub-Saharan African countries where independent debt management offices happen to exist. Thus, given all the recent developments in debt management, issues related to cost of borrowing or the risks inherent in the process of government debt tend not to be prioritised. However, the bureaucratic red-tape-ism which

hinges on corruption and mismanagement remained entrenched and eventually with the dysfunctional institution's management is as dictated by the executive. Improved debt management amongst the SSAs notwithstanding, substantial portion of their borrowings were externally sourced. For instance, by the turn of the 1990s the sub-Saharan Africa found itself engulfed in debt crisis which culminated into a clamour for debt relief. Because the sub-Saharan Africa lacked a developed capital market there was so much reliance on external debt sources mainly from the multi-national financial institutions such as the IMF, the World Bank and ADB; and from the lending bodies e.g. the Paris and the London clubs.

LITERATURE

Interest Element on External Debt

The interest element on external debt of sub-Saharan African countries has been a major factor in the current size of the debt portfolio. While there have been arguments against the exorbitant interest charged on some of the facilities granted Africa, interest continued to increase at an accelerated rate over the years. For instance, international real interest rates jumped from lower and sometimes negative rates in 1970s to over 8 per cent in the beginning of the 1980s. It has been argued by Schmitt (2000), that in reality the LDCs are only rid of their external debt burden after they have been charged interest twice. The World Bank statistics elaborated on over 16 consecutive years for 133 countries affected. The work portrayed the double interest payment within the imperfect system of the international settlement witnessed currently. All interest was shown to be first settled by the residents who bear the principal external debt; and additionally, by their country's international reserves. This process had led to the excessive size of external debt among most of the sub-Saharan African countries. International real rates of interest charged on loans which had very low and at some points negative in the 1970s suddenly recorded an exponential rise in the beginning of the 1980s to a figure as high as 81 per cent. This development changed the status of the sub-Saharan Africa's external debt status and had a serious negative effect on their economies and ability to pay. As a result interest service by the SSAs stood at a high 31 per cent of total exports of goods and services 1978 (Krumm, 1985), and by the year 1983 interest paid by the indebted nations of the sub-Saharan African had reached 91 per cent of total exports.

Debt Management in Sub-Saharan Africa

Countries in the Sub-Saharan Africa were found to rely more on external debts in comparison to their developed counterparts. Relatively SSA countries tend to find it difficult to issue larger amounts of longer-term, local currency debts than their rich counterparts. This the lesser developed economies cannot appropriately do even in their domestic markets (Alfaro & Kanczuk, 2009). It has been argued that excessive debt that is dominated in the foreign currencies and short-term liabilities may have the repercussion of unnecessarily exposing the borrowing economy to vulnerabilities in the form of for instance changes in market sentiments, sudden stops and rollover risks. Two measures are promoted to tackle this situation: The strategy of extending the debt maturity and the other has to do with indexing debts.

Public debts should be indexed in situations where that issues a nominal debt is faced with no option but to monetize as a result of pressure put on by a self-fulfilling expectation of a private sector. Debts are indexed against perceived inflationary trend. According to Giavazzi and Pagano (1989), when bond holders begin to fear that government may resort to monetisation there is the tendency for them to demand for higher interest rates. The process may persist until such a time the government would rather respond by the anticipated monetisation than go for the alternative offered by monetisation. The option of debt indexation saves the government from inevitable monetisation as well as the public driver to demand for monetisation. Indexing debt in lesser developed countries in the sub-Saharan Africa may however be difficult if not impossible. Because the stock markets in the SSAs are not effective enough for major adjustments and decisions such indexation this important aspect of debt management can actually affect the ability to adopt certain strategies especially those concerned with debt indexation, inflation and taxation. Yartey and Adjasi (2007), noted that critiques of the stock market in the SSAs argued that the markets were not performing quite efficiently and as a result the African states might not find it feasible to promote stock markets especially with the huge amounts involved. But as a result of the progressive development of financial markets both domestic and external among more advanced economies; the overall internationalisation of the markets; the development and introduction of various financial products which in turn allows for riskier and larger financial investments; and the evolvement and rising role of new actors in the financial markets particularly institutional investors; the derive towards the establishment of stock markets in many African countries recorded an increase in last decade. Furthermore, the manner with which the advanced economies utilise the level of development of their financial trade and exchange services to their advantage in the world trade organisation (WTO) actually encouraged the development of the capital markets in Africa. The development influenced the establishment of stock markets in Africa and the process of liberalisation of capital assets was also linked to that. It is however expected that a developed and vibrant stock market in Africa will go a long way to boost the domestic savings and in turn trigger a rise in the quantity and quality of investments. Impliedly the issue of debt overhang which is said to be excessive and accumulated sovereign borrowing that impede on domestic investments (Elbadawi, Ndulu, & Ndung'u, 1997) in an economy. More importantly however, stock markets are believed to serve as an important factor enhancing the smooth operation of the domestic financial system in general and the capital market in particular (Kenny & Moss, 1998). Stock markets development has the potentials of promoting the growth in domestic economic revival especially as it encourages increased investments. It has been argued that stock market prices fail to reflect the actual underlying fundamentals especially where speculations result into fluctuations in the market (Binswanger, 1999). Prices are however said to be determined through the process of discounting the expected future cash flows and in accordance to the stock market approach the process is expected to reflect all the available information about the fundamentals. This translates into making the stock market to develop its own speculative growth dynamics, which in itself could be guided by irrational behaviour. But Bhide (1993) noted that stock market liquidity has the tendency of negatively influencing corporate governance because a very liquid stock market could push investors into ambitious irrational speculations.

METHODOLOGY

This work adopts the quantitative approach to research. Data was however collected from both the primary and secondary sources. Due to the nature of the subject under investigation the appropriate data are secondary and cross-country in form. The form of data selection is based on the availability and suitability as a substance in answering the stated research questions. Data collected took the secondary form except for situations where certain confirmations are needed as well as to make up for the case of missing data that is rampant in the developing economies. A comprehensive data base on debt can readily be found in the government financial statistics of the IMF's International Financial Statistics and the World Bank's World Development Indicators. And given the research questions outlined in the introductory part of this work the model is developed accordingly. In this respect four different relationships have been designed to tackle each of the research questions. For instance, the research question referring to debt management strategy and economic growth warranted for setting up of a causal relationship between the indicator of debt management against that of economic growth to make up for the first model. The second model observed relationship between debt and economic growth; extent of indebtedness (debt ratio) to debt maturity; and debt ratio to market capitalization to give us the impact of capital market development on borrowing. Similarly, the model includes another relationship representing the choice of source of debt instrument.

Model Specification

Debt Ratio on Debt Composition and Maturity

A good measure of debt management as discussed above are the indicators contained in the World Bank-IMF debt management performance assessment (DeMPA) tools are adopted as potential source to quantify the variable of debt management especially for those periods where the country performance institution assessment index (CPIA) was not readily available. Accordingly, our model assumes a functional relationship between a country's debt ratio and the key explanatory variables of debt management (DeM) here represented by country performance institution index (CPIAdt), Note however, a priori theory does not give the exact structure of the function. Thus, in this study, different specifications of the model will be tested and estimated. Based on the review of literature, models are specified for economic growth and debt management. The aim of the model is to verify the impact of sovereign debt management, on the overall country's level of indebtedness.

(i) Specifically, level of indebtedness (dtgdp) is taken to be a function of sovereign debt management (DeM).

(ii) The general framework of the functional form is expressed as:

(iii) $Y = f$ (DeM)

(iv) DeM = GOVED + CORMAC + BORFINA + CASHFLM + OPRX + DTRR + GOVDEC+ AUTH

(v) (Each one of these debt management indicators are scored in the various sections of the administered questionnaire. See appendix I)

(vi) $DTGDP = f(GOVED + CORMAC + BORFINA + CASHFLM + OPRX + DTRR + GOVDEC + AUTH) + MCAPGDP + STDT + LTDT + \mu_t \ldots$ (1)

Where DTGDP is the ratio of debt to gross domestic product representing extent of indebtedness; GOVED stands for government and strategy development, CORMAC is coordination with macro policies, BORFINA stands for borrowing and related financing activities, CASHFLM is cash flow forecasting and cash balance management, OPRX is operational risk management and DTRR stands for debt records and reporting.

The models are given as follows;

(vii) $DTGDPX_t = \beta_1 + \beta_2(DeM)_t + \beta_3(MCAPGDP)t + \beta_4(STDT)t + \beta_5(LTDT)t + \beta_6 \log(DTFGV)t + \mu_t$ ………………………(2)

(viii)   But DEM = CPIA

(ix)   The specification of the model is:

(x) $\Delta GDPX_t = \beta_1 + \beta_2\Delta(CPIA)_t + \Delta\beta_3\Delta(MCAPGDP)t + \beta_4\Delta(STDT)t + \beta_5\Delta(LTDT)t + \log\Delta\beta_6(DTFGV)t + \mu_t$ ………………………(3)

(xi)   Accordingly, the a priori expectations are:

(xii) $\beta_1 > 0, \beta_2 < 0, \beta_3 < 0, \beta_4 > 0, \beta_5 < 0$

(xiii) $\beta_t s$ = coefficients

(xiv) β_1 = cons tan t (intercept)

(xv) μ_t = error term

Furthermore, in order to allow for some dynamisation of the relationship so that long term relationships can be assessed; we will equally estimate the relation given below:

β_1 is to take care of the constant variable, $\beta_{2,}$ is the coefficient of debt management which is expected to be less than zero because it is negatively related to extent of government indebtedness or debt ratio, β_3 is the coefficient capital market development which expected to be positively related to debt ratio, β_4 which is the coefficient of short term debt is expected to be positively related to debt ratio, β_5 is the coefficient of long term debt and is expected to be negatively correlated with debt ratio; and β_6 is the coefficient of debt forgiveness or relief and is expected to be negatively correlated with a country's extent of indebtedness.

$DTGDP = f(M2GDP + MCAPGDP + LTDT + STDT + CPIA + \varepsilon)$

Where:

DTGDP = Debt to GDP ratio

M2GDP = Broad money to GDP ratio as a measure of development of the stock market. Ratio is expected to be positively correlated to extent of government debt ratio. Broad money ratio is also a measure of the condition of the capital market.

LTDT = Long term government debt would result in a more stable policy and ultimately could lower the rate of government borrowing and hence will be negatively correlated with the debt ratio.

STDT = Short term government debt is supposed to be positively correlated with debt ratio. Short term debt is known to be aggravating decline in investments and as a result debt overhang. It is therefore negatively related to growth.

CPIAdt = this is directly related to the debt ratio and should be positive. The CPIAdt, represent the country performance institution assessment index of debt management. This variable is an extension of the variable defining debt management (DEM) explained earlier in the chapter. CPIAdt is therefore a combination of the two. It involved a unity between the scores obtained from the country wide debt management performance assessment (DeMPA) process and the scores obtained from the country performance institution assessment in debt management.

ε = Error term

The above equation represents our second model. The model looks at the explanatory power of the variables ratio of broad money to gross domestic product (M2GDP), ratio of market capitalisation to gross domestic product (MCAPGDP), long term debt (LTDT), short term debt (STDT), and CPIAdt. The ratios of broad money and market capitalisation to gross domestic product were variables that were used to measure the extent of the development of a country's capital market, a development that plays a pivotal role in a nation's effective debt management process as well as efficient sourcing of funding in the domestic markets. The variables of long-term debt (LTDT) and that of the short-term debt (STDT) were included precisely to help determine the choice in the composition of debt open to the policy makers as represented by debt managers. Here we study the relationship that could exist between long term borrowings as against a short term one. The model was however unable to reflect on choice between domestic and external debts as a source of funding. This was as a result of the dearth of data on domestic debt among the sampled countries. Where the data was available it was just for a fraction of the specified period covered by the work. The data though was relatively inadequate was presented and discussed extensively in subsequent chapters.

Hypothesis

Null hypothesis (H_0): Debt management does have a significant influence on economic growth of a country.

Alternative hypothesis (H_1): Debt management has no significant influence on the economic growth of a country.

Null hypothesis (H_0): There is a relationship that exists between the extent of debt and the maturity of debt

Alternative hypothesis (H₁): There is no relationship that exists between the extent of debt and the debt maturity;

ANALYSIS AND FINDINGS

Debt Ratio; Debt Composition and Debt Maturity

The model examines the relationship that exist between extent of indebtedness and the choice of debt; the effectiveness of debt management strategy; and whether the level of capital market development could impact on the level of indebtedness (debt ratio). Here we consider a dependent variable, debt ratio (edtgdp), against a range of predictors; the variable of debt management (cpiadt), ratio of broad money to gross domestic product (m2gdp), measuring capital market effectiveness, variable representing long term debt (ltdt, and another for short term debt (stdt). These variables would help to explain the two-phenomenon stated above. A choice between domestic and external debt would have enriched our findings, but due to the lack of data on domestic debt in most of the sub-Saharan Africa, particularly the sampled countries with the exception of South Africa. However, the data on domestic debt for South Africa was available for a little over a decade, a far cry behind a trend covering three decades (1980 – 2012).

Table 1: Multiple Regression

Column1	Column2	Column3	Column4	Column5	Column6	Column7
	R2	B	B	SE	CI 95%	(B)
Model	0.952***					
M2gdp		-0.018**	-1.10E+18	1.40E+18	0,000	0,000
Lngtdbt		1.375****	6.00E+11	1.60E+10	0,000	0,000
Stmdbt		-0.705*	-5.20E+11	2.60E+10	-20.085	-4.176
Cpiadbt		0.093***	6.90E+20	1.70E+20	1.189	586.75

*Statistical significance: *p < 0.001; **p > 0.005; ***p < 0.001; ****p < 0.001*

Table summarises the results from our multiple regression process for the model. Multiple regressions were performed to investigate the ability of an effective capital market, choice of the debt structure and maturity, the government's debt management strategy to predict levels of government indebtedness. All preliminary analyses were conducted to ensure no violation of the assumptions of normality, linearity and homoscedasticity. Furthermore, the correlations between the predictor variables included in the study were equally examined. Correlations were however found to be high between the variable of ratio short term debt to total debt (stmdbt) and that of debt management strategy (cpiadbt) with a recorded r = 0.070; and a p > 0.05 (see Table 1). This made the problem of multi-collinearity very likely in the model. The variable measuring the impact of the capital market (m2dgp) was recorded to be positively correlated with the dependent variable, with however a p − value > 0.050. This situation further threw our model into a problem. All other predictors were however statistically correlated with the debt ratio or level of government's indebtedness. But as a

result of the issue of multi-collinearity which arose with respect to the two variables identified above as well as m2gdp, we review our model data and consider the stepwise regression analysis. By this all insignificant variables or predictors would be eliminated leaving those most relevant for our analysis.

Since there was no apriori hypotheses made that would determine the order of entry of the predictor variables, a direct method was employed for the multiple regression analysis. The four independent variables put together were able to explain 95.2 per cent variance in the level of indebtedness of the countries sampled in the model, (F $(4,302) = 559.199$, P < 0.0005). However only three of the four predictors turned out to be statistically significant with ratio of long term debt to total debt (lngtdbt) recording a higher Beta value ($\beta = 1.375$, p < 0.001), more than the debt management index (cpiadbt) recording a positive but insignificant Beta value ($\beta = 0.093$, p < 0.001); and the ratio of short term debt to total debt (stmdbt) recording a negative but significant relationship with a Beta value ($\beta = -0.705$, P < 0.001). The fourth variable, ratio of broad money to gross domestic product (m2gdp), measuring the impact of capital market development on the level of indebtedness was found to be statistically insignificant and irrelevant in the model with a negative Beta value ($\beta = -0.018$, p > 0.05).

Does Debt Management as a Strategy Impact on the Economic Growth of an Economy?

In an attempt to answer the research question stated above we introduced the second model which relate debt ratio (edtgdp) to a number of variables; the debt management index (cpiadbt), ratio of short term debt to total debt (stmdbt), ratio of long term debt to total debt (lngtdbt), the ratio of market capitalisation to gross domestic product (mcapgdp), measuring the impact of the capital market development in a country, and dbtfgvl[2] measuring the impact of debt relief or forgiveness. We saw that both short- and long-term debts tend to attract market risks that could lead to higher interest rates which in turn could push the debt service ratio higher. Short term debts in addition tend to incur higher administrative costs as a result of frequent roll overs (Christensen, 2004). The two variables were however expected to relate positively with the debt ratio

Short term debt is supposed to relate positively with a country's level of indebtedness or debt ratio. And the same expectation applies to long term debt. That is, the higher the borrowing the higher the debt to gross domestic product ratio. The same positive relationship was expected of the variable measuring the level of development of the capital market and debt forgiveness or relief. The debt relief initiative had as its major objective the reduction of the external debts of severely indebted countries (Freytag & Pehnelt, 2009). Thus, it was expected that any debt relief should relate negatively to a country's debt ratio.

Debt Management Related to Indebtedness

The four variables in the model discussed in the preceding section were to be answered by way of accepting or rejecting a number of formulated hypothesis. These hypotheses which were already presented in chapter four. For the purpose of resolving the questions contained in these tentative scientific statements we proceed by representing them in the order they appeared in the model. The following is a presentation of the hypotheses contained in our model.

H_0: Debt management does have a significant influence on economic growth of a country.

To accept or reject the above hypotheses we proceed to our regression result we refer back to our regression results. Debt management index was represented by the country performance institutional assessment index on debt (cpiadbt) in the model as an explanatory variable. Our model whose variables combined to explain 69.9 per cent change in the dependent variable or the ratio of debt to gross domestic product. In the model the index of debt management (cpiadbt) recorded a standardized Beta value of 0.158, indicating a positive correlation with the debt ratio. The independent variable was expected to rise by 15.8 per cent with every 1 standard deviation change in the independent variable; in this case cpiadbt. This implied that our null hypothesis need not be rejected and thus debt management tend to influence higher ratio. But this assertion is conditional on the level of the debt ratio, because we saw also that at higher debt ratios economic growth became negative. This result could also be interpreted as the debt index or debt management would only be effective at lower debt levels but becomes irrelevant at higher levels of debt.

Debt Maturity and the Level of Indebtedness

Here we look at how the choice of type of debt and its maturity would affect a country's debt situation. For this purpose, we refer to our long-formulated hypotheses and check our regression analysis results to take a decision. According our hypotheses is stated as follows:

H_0: There is a relationship that exists between the extent of debt and the maturity of debt

Short- and long-term debts tend to constitute the major, in some instances, only choice in government borrowing. And as a result, the two types of debt determine the maturity of debt especially in most African countries whose capital markets were not adequately developed. Thus, to test the hypotheses whether a relationship exists between the extent of debt and the maturity of debt we included the two variables as independent variables regressed against the debt ratios.

Thus, checking the model coefficient table, we saw that the variables recorded a standardized Beta values of 1.865 for the short-term debt and -1.026 for long term debt respectively. By implication debt ratio would be altered by up 186.5 per cent with a single standard deviation movement in the short-term figure. Similarly, debt ratio would decline by 102.6 with 1 standard deviation change in the value of long-term debt. These values indicate that short term is positively correlated to a country's debt ratio, thereby implying the higher governments incur short term debts the higher or worse their debt conditions becomes. Long term debts were however found to be negatively correlated to a country's debt ratio. By implication the longer the debt the lesser the risks of debt crisis perhaps as a result of reduced frequency of debt servicing, lower interest rates and handling costs (Christensen, 2004).

CONCLUSION

From the foregoing and by making reference to our hypotheses we can promptly go on to assert that there tend to exist a relationship between a country's extent of indebtedness, its choice of debt instruments, debt maturity and economic growth. Thus, the composition of a country's debt and by extension its debt management strategy significantly affects its economic growth.

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