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PUBLIC DEBT AND ECONOMIC GROWTH: DOES THE COMPOSITION OF GOVERNMENT BORROWING MATTER MORE THAN ITS SIZE?

Botirova Diyora Furqat qizi
diyorabotirova1234@gmail.com
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Abstract: Public debt is often discussed as if its size alone determines whether it helps or harms an economy. This article argues that the purpose, productivity and financing conditions of borrowing are equally important. Debt used for well-selected infrastructure, education, health and research can raise productivity and future tax revenues; borrowing that mainly supports recurring expenditure without lasting economic benefits can leave future taxpayers with repayment obligations but few new resources. However, even productive projects can become harmful when they are poorly planned, overpriced, delayed or financed at unsustainable interest rates. Drawing on international research and proposing a country-panel research design, the article explains the channels linking debt, public investment and real GDP per capita growth. It concludes that governments should assess both debt sustainability and the quality of spending, rather than rely on a single debt-to-GDP threshold.
Keywords: public debt, economic growth, public investment, fiscal sustainability, government expenditure, productivity.

Governments borrow to respond to crises, build infrastructure and provide public services. Borrowing can spread the cost of long-lived assets across the generations that benefit from them. Yet debt also creates future interest and repayment obligations. When these costs rise, governments may have less room to finance schools, hospitals, transport, climate adaptation or other priorities. The policy challenge is therefore not simply to ask whether public debt is high, but to ask what the borrowed money achieves and whether the economy can service the resulting obligations.The question is especially relevant in a period of elevated global public debt and borrowing costs. The International Monetary Fund's October 2025 Fiscal Monitor emphasizes that shifting spending toward infrastructure, education, health and research and development—and improving spending efficiency—can support long-run output without necessarily increasing total expenditure (IMF, 2025). This suggests that the composition and quality of spending deserve close attention alongside the headline debt ratio.

This article addresses the question: Does public debt affect economic growth differently depending on whether borrowed funds finance productive investment or current expenditure? Its central argument is conditional: the growth effect depends on the economic return of spending, the efficiency of public institutions, the cost and currency of borrowing, and the country's initial fiscal position. Debt is neither automatically beneficial nor automatically damaging.

First, productive public investment can raise the economy's capacity to produce. Reliable roads and electricity reduce business costs; ports and digital networks connect firms to markets; schools and vocational training strengthen human capital; preventive healthcare improves workforce participation; and research can encourage innovation. These benefits may increase private investment and productivity over several years. If a project generates broad economic returns, it may also expand the future tax base, making debt easier to repay.

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Second, public borrowing can support demand during recessions. When households and firms cut spending, temporary government expenditure may prevent a deeper downturn and protect employment and productive capacity. This stabilizing role is strongest when resources are underused and the spending is timely. It is weaker when the economy is already operating near capacity, where extra demand may mainly raise prices or imports.

Third, borrowing has costs. Interest payments use public revenue that could otherwise fund services or investment. If lenders perceive greater risk, they may demand higher interest rates. Higher rates can increase the cost of borrowing for private firms and households, reducing private investment—a process known as crowding out. Foreign-currency debt also exposes a government to exchange-rate risk: a depreciation can increase the domestic-currency value of repayments.

Finally, the debt-to-GDP ratio depends on more than new borrowing. It is affected by the interest rate, economic growth, the primary budget balance and exchange-rate movements. If debt grows faster than the economy's capacity to generate income and revenue, the ratio can rise even when some public spending is useful. Conversely, growth-enhancing investment can improve debt dynamics, provided that its returns are realistic and arrive in time.

Public investment and current expenditure serve different purposes, although the distinction is not absolute. Investment commonly creates or improves assets—such as transport infrastructure, water systems, schools or digital networks—whose benefits may last for years. Current expenditure includes wages, maintenance, transfers, subsidies and day-to-day services. Some current spending, including teachers' salaries, essential medicines and maintenance, is vital to making public assets productive. The relevant distinction is therefore not simply 'investment good, consumption bad'; it is whether spending produces durable social and economic value relative to its cost.

Research supports this nuanced view. Berg and colleagues (2012) show in a macroeconomic model that well-executed, high-return public investment can increase output and consumption and may partly pay for itself over time, but financing and adjustment challenges can be substantial. The World Bank's Global Economic Prospects (2024) reports that public investment tends to have stronger effects where fiscal sustainability concerns are lower and investment is more efficiently managed; in highly indebted settings, the growth impact may be weak. The IMF (2025) likewise emphasizes that reallocating spending toward high-value functions and closing efficiency gaps can raise output. Borrowing for recurring costs may still be justified during emergencies or when it protects human capital. But if governments repeatedly borrow to cover expenditure that does not raise future productive capacity or deliver clear social benefits, debt service can accumulate without a matching increase in future revenue. Conversely, a poorly chosen capital project—an underused airport, an overpriced road or a facility without trained staff—can create debt without delivering the expected return. Project selection, procurement, maintenance and transparency are essential.

The evidence suggests that governments should manage debt as a portfolio of obligations linked to the quality of public choices. Before borrowing, they should publish a clear project appraisal, estimate construction and lifetime maintenance costs, assess environmental and social impacts, and test whether expected benefits remain plausible under lower-growth or higher-interest scenarios. Competitive procurement, independent audits and public reporting can reduce waste. Debt-management strategies should also consider maturity, currency composition, interest-rate exposure and the risk of refinancing large amounts at once. Where fiscal pressures require adjustment, indiscriminate cuts to investment may damage long-term growth. A more effective approach is to

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protect high-return projects and essential services while reviewing low-impact subsidies, poorly targeted transfers and inefficient programmes. This does not mean that every investment should be protected: projects with weak evidence of benefits should be redesigned or cancelled. Governments also need realistic revenue plans so that debt repayment does not crowd out future priorities.

In conclusion, the composition of government borrowing can matter as much as—and sometimes more than—its headline size for long-run economic performance. Productive, efficiently managed investment can expand capacity and support future revenue, while expensive or ineffective borrowing can constrain growth and fiscal stability. Nevertheless, no spending category guarantees success: outcomes depend on project quality, institutions, financing conditions and the country's ability to manage risk. The most useful question is not 'How much debt is too much?' in isolation, but 'What public value does each borrowed unit create, and can the resulting obligations be repaid without undermining future development?'

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