

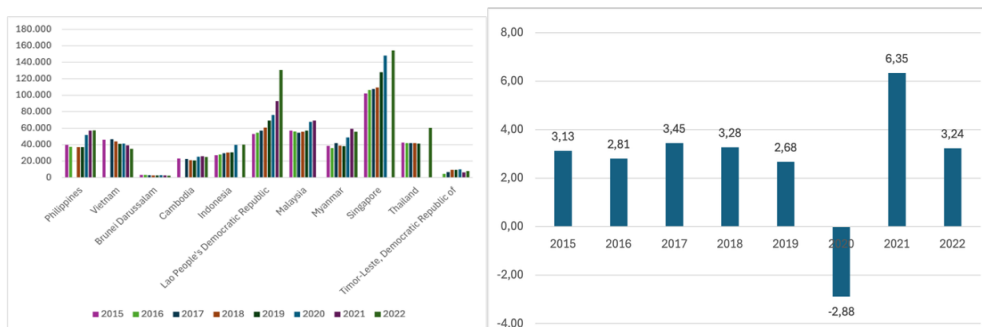
CHAPTER I

INTRODUCTION

1.1 Background of Research

The term “sovereign debt” refers to when a national government borrows money in order to fund its operations when tax and other revenue are insufficient to pay for public expenditures (Eaton C Fernandez, 1995) . This debt is typically raised through the issuance of bonds or by securing loans, either from domestic sources or international lenders. Sovereign debt comes in two primary forms, external debt, which is obtained from foreign creditors and typically denominated in foreign currencies like the euro or the US dollar, and domestic debt, which is financed domestically and denominated in local currencies. Governments borrow for various reasons, such as finance infrastructure projects, covering budget deficits, boost the economy during recessions, or deal with crises like pandemics or natural disasters.

Borrowing can be advantageous, however if it funds long-term economic growth but taking on too much debt can be dangerous. Excessive debt levels, especially if they are dominated in foreign currencies, can result in higher interest payments, less government investment in other important areas, and possibly a debt crisis or default. The fiscal deficit that risks sustainable economic growth is one major issue with sovereign debt in ASEAN nations. Marimuthu et al., (2021) stress that a dangerous fiscal situation is indicated by the behavior of government income, rising interest rates, and high amounts of outstanding debt.



a. Gross Debt General Government (% of GDP) ASEAN b. Global GDP Growth

Figure 1. 1 Gross Debt General Government (% of GDP) ASEAN and Global GDP Growth from 2015 to 2022

Source: Data processed, 2025

The two pictures above show the correlation between the amount of government debt in ASEAN countries and the growth of the world economic growth from 2015 to 2022. Global economic growth during the same period appears in the right chart, while the gross debt of the government as a percentage of GDP across different ASEAN countries is shown in the left chart. Global GDP growth was comparatively steady between 2015 and 2019, averaging between 2,7 percent and 3,4 percent. The majority of ASEAN countries' levels of external debt were either stable or gradually rising during this time. However, the COVID-19 pandemic's start in 2020 caused a serious global economic downturn, with growth falling to -2,88 percent. As a result, many governments' debt-to-GDP ratios noticeably increased as they dramatically increased public spending to support businesses, manage the health crisis, and provide social assistance.

Countries like Singapore and Lao PDR, which had some of the highest debt levels by 2021, are prime examples of this trend. The global economy recovered well in 2021, growing at a rate of 6,35 percent, but as fiscal stimulus and recovery assistance persisted government debt levels stayed high overall. Even though global growth slowed to 3,24 percent by 2022, the majority of countries debt levels had not decreased to their pre-pandemic levels due to continuous economic pressures and weak fiscal condition. Overall, there is a significant correlation, governments borrowed more money during the global economic downturn of 2020, and even

after the economy recovered, the legacy of high debt keeps happening because of ongoing fiscal difficulties and only a slow economic normalization.

Based on the figure above it shows the correlation of sovereign debt and economic growth supporting the debt overhang hypothesis states that anticipated debt service cost will deter additional foreign and domestic investment if there is a chance that the nation's future government debt will exceed its capacity to repay it (Yusuf C Mohd, 2021). According to the debt overhang theory, excessive borrowing results in high debt, debt traps, and a slowdown in economic growth. Macroeconomic factors like inflation, interest rates, unemployment, money supply, and exchange rates may all be impacted by government debt (Murungi C Okiro, 2018). When funds are used as efficiently as possible, external debt does not always turn into a burden (Adegbite et al, 2008).

External debt can promote sustainable economic growth when used effectively, such as for projects that improve infrastructure, agriculture, or exports (Adebusola et al, 2007). There is more than the "burden" that taxpayers bear when they create their checks when the government raises the tax rates in order to supply the money needed to pay off the higher debt level (Phelps, 2022). The risk that a government might not be able to refinance its current debt obligation (roll them over into the new debt) when they become due is known as sovereign debt roll-over risk (Amato et al, 2024). If a country can fulfil all of its present and future payment obligations without making unrealistically significant changes to its revenue and expenditure balance or restructuring its debt in the event of default, then that nation's debt is considered sustainable (Oyadeyi et al, 2024). Additionally, governments are motivated to create connections between domestic financial institutions and sovereign debt that boost their current borrowing capacity, even as they guarantee future governments will incur any cost of distress and make net repayment (Acharya C Rajan, 2013). The well-known reputational argument is one of the earliest justifications for sovereign obligations to be repaid, nations decide to pay back their debts because the country anticipated to borrow more money in the future (Amador, 2008).

A large amount of sovereign debt may result in increased risk premiums, which would make borrowing more costly for governments and possibly discourage private investment (Broner et al, 2013), some research showing that economic downturns in one sovereign can have a significant impact on others within a spatial network through interconnected debt markets (Muteba Mwanba C Manguzvane, 2020). Additionally, when debt levels are high, it is more important than ever to coordinate fiscal and monetary policy because any changes could affect macroeconomic stability and sovereign risk perception in a volatile environment (Bonan C Lukkezen, 2013).

Countries are more likely to maintain macroeconomic stability if they successfully manage their debt while making sure it promotes economic growth (Bianchi C Sosa Padilla, 2020). In summary, the complex interaction and policy initiative is reflective in the relationship among sovereign debt, and economic growth to macroeconomic stability. A high debt payment load reduces private investment and raises anticipated future taxes on the private sector. Debt servicing uses up resources that could have been used to finance investment. Furthermore, if policy myopia sets in and quick-yielding projects are prioritized over longer-term, higher-valued investments, debt overhang can worsen economic performance by influencing the quality of investment (Sen et al, 2007). A nation's economic growth is negatively impacted by debt overhang due to its negative impact on investment and policy. Furthermore, the primary way that excessive debt affects economic growth is by having a negative impact on the accumulation of physical capital (Pattillo et al., 2004).

The author aims to analyze the relationship between sovereign debt and economic growth in 7 (Cambodia, Indonesia, Lao PDR, Myanmar, Philippines, Thailand, Timor Leste, and Vietnam) ASEAN countries, focusing on how sovereign debt influences the overall stability and performance of national economies. Titled "Debt and Macroeconomic Variables: The Relationship Between Sovereign Debt and Economic Growth in ASEAN Countries", the study adopts a purposive sampling method to select the countries under observation. This paper

uses annual data between 1992 and 2022, capture multiple economic cycles including regional development as well as global financial crisis. The primary aims to establish the extent to which differences economic development between these countries associated with their levels of sovereign debt. This previously neglected area of research is expected to contribute to the current literature of scholar through a regional analysis. Decision-makers will also get practical knowledge on controlling sovereign debt without compromising economic stability through the insights derived. By identifying trends, patterns, and potential risk, this study aims to support more macroeconomic policy development within the ASEAN region.

1.2 Problem Identification

Based on the background earlier, the relationship between sovereign debt and economic growth remains an important topic to discuss. Some studies show that sovereign debt can support economic growth and other studies have the opposite result, there are also studies that find inconsistent or mixed results. These differences show that the connection between sovereign debt and growth is still unclear and worth further research, because of this, this research aims to better understand the nature of this relationship by examining home sovereign debt and economic growth in different ASEAN countries. Therefore, the formulation of the research problem can be explained as follows:

- a. What is the impact of sovereign debt on economic growth on 7 (Cambodia, Indonesia, Lao PDR, Myanmar, Philippine, Thailand, and Vietnam) ASEAN countries?
- b. What is the relationship between sovereign debt and economic growth in the short term and long term in 7 (Cambodia, Indonesia, Lao PDR, Myanmar, Philippine, Thailand, and Vietnam) ASEAN countries?

1.3 Research Objective

The following point can be used to characterize the research objective in connection with the background and problem formulation mentioned above:

- a. To see the impact of sovereign debt on economic growth in 7 (Cambodia, Indonesia, Lao PDR, Myanmar, Philippine, Thailand, and Vietnam) ASEAN countries.
- b. To see is the relationship between sovereign debt and economic growth in the short term and long term in 7 (Cambodia, Indonesia, Lao PDR, Myanmar, Philippine, Thailand, and Vietnam) ASEAN countries.

1.4 Research Benefit

1. To improve knowledge of the short- and long-term connections between debt structure, macroeconomic factors, and economic growth in ASEAN nations in order to advance academic understanding, especially in the areas of macroeconomics, development economics, and public finance.
2. To expand empirical research on the relationship between debt and growth by using the Panel Autoregressive Distributed Lag (ARDL) approach, which captures a common long-run equilibrium while allowing for heterogeneous short-run dynamics across nations, particularly in the context of developing economies with a variety of structural features.
3. To provide the academic literature on public debt composition by explicitly distinguishing between external debt, government debt, and external debt service, thereby providing empirical evidence that the impact of debt on economic growth is not homogeneous and depends critically on the type of debt and its transmission mechanisms.