

Current Account Balance and Economic Growth: Interactions with Public Debt in Open Economies

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ABSTRACT

This conceptual article examines the interaction between current account balance, public debt, and economic growth within the context of open economies. While previous studies have widely explored the individual effects of public debt and external balances on growth performance, limited attention has been given to how these factors jointly shape long-term economic outcomes, particularly in economies with high trade openness and exposure to global financial conditions. This study develops an integrated conceptual framework that explains how current account positions influence the growth impact of public debt through multiple transmission channels, including external financing dependence, macroeconomic stability, fiscal space, and investor confidence. The article argues that persistent current account deficits may intensify the adverse growth effects of rising public debt by increasing vulnerability to capital flow volatility and external shocks, whereas sustained current account surpluses and strong external positions can reduce these risks and support more stable growth paths. By synthesizing insights from debt overhang theory, external sustainability frameworks, and open-economy macroeconomics, this paper contributes to a more comprehensive understanding of debt growth dynamics in globally integrated economies. The proposed conceptual model provides a foundation for future empirical research on the conditional effects of public debt on growth across different external balance regimes.

Keywords: Current account balance, public debt, economic growth, open economies, external sustainability, macroeconomic stability.

INTRODUCTION

Sustained economic growth in open economies increasingly depends on the interaction between fiscal conditions and external sector dynamics. Over recent decades, public debt has expanded significantly across both advanced and emerging economies as governments respond to financial crises, economic slowdowns, and development pressures. At the same time, many economies have experienced persistent current account imbalances, reflecting changing patterns of global integration and external financing. These developments have intensified concerns regarding macroeconomic stability, growth sustainability, and vulnerability to global financial disturbances (Reinhart & Rogoff, 2010; Chinn & Prasad, 2003; Catão & Milesi-Ferretti, 2018).

While public borrowing remains an essential instrument for stabilizing output and supporting development, rising debt levels generate increasing risks for long-term growth performance. Empirical evidence indicates that excessive public debt can restrict economic expansion by raising debt servicing costs, limiting fiscal flexibility, and increasing macroeconomic uncertainty (Checherita-Westphal & Rother, 2012; Panizza & Presbitero, 2014). More recent research further suggests that the growth impact of public debt is neither constant nor uniform across countries, but varies with institutional quality, debt structure, and macroeconomic conditions (Égert, 2015; Chudik, Mohaddes, Pesaran, & Raissi, 2017; Law, Ng, Kutan, & Law, 2021). However, existing explanations remain incomplete because external sector conditions are often treated as secondary considerations rather than fundamental components of the debt growth relationship.

The current account balance represents a critical indicator of an economy's external position and its reliance on foreign capital. Persistent deficits increase exposure to capital flow volatility, exchange rate pressures, and external financing constraints, thereby shaping the broader macroeconomic environment in which fiscal policy operates (Chinn & Prasad, 2003; Ghosh, Ostry, Kim, & Qureshi, 2018). Empirical observations indicate that economies with weak external positions tend to experience stronger macroeconomic instability and more pronounced growth slowdowns during periods of financial stress (Bussière, Schmidt, & Valla, 2018; Aizenman, Jinjarak, & Park, 2020; Kose, Ohnsorge, Sugawara, & Yu, 2022). Nevertheless, the role of current account balance in conditioning the growth effects of public debt has not been sufficiently conceptualized within existing theoretical frameworks.

In open economies, the interaction between public debt and external balances becomes particularly important. Debt-financed fiscal expansions often stimulate domestic absorption and import demand, contributing to wider current account deficits and reinforcing external vulnerabilities (Ghosh et al., 2018; Catão & Milesi-Ferretti, 2018). Such dynamics heighten exposure to exchange rate instability, capital flow reversals, and refinancing risks, which can weaken long-term growth prospects, especially in economies with high trade openness and financial integration (Frankel & Romer, 1999; Kose et al., 2022). Although previous studies acknowledge these linkages, the combined influence of public debt, current account balance, and trade openness on economic growth has rarely been integrated into a single conceptual framework.

Theoretical perspectives provide valuable guidance for understanding these interactions. Debt overhang theory emphasizes that excessive public debt discourages investment and productive activity through expectations of future fiscal adjustment (Krugman, 1988; Pattillo, Poirson, & Ricci, 2002), while crowding-out theory highlights how government borrowing can restrict private investment by increasing financing costs (Modigliani, 1961). These mechanisms are likely to operate more strongly in economies facing external financing constraints and volatile capital flows, suggesting that the growth consequences of public debt cannot be fully understood without explicit consideration of external balance conditions.

Despite extensive empirical investigation, significant conceptual gaps remain. Many existing studies rely on linear modeling approaches that obscure regime-dependent dynamics, while others employ broad cross-country datasets that mask country-specific external vulnerabilities (Panizza & Presbitero, 2014; Eberhardt & Presbitero, 2015; Chudik et al., 2017). Most importantly, limited theoretical work has systematically explained how current account balance conditions the transmission of public debt into growth outcomes in open economies.

In response to these limitations, this conceptual article develops an integrated framework that links public debt, current account balance, and economic growth within the context of open economies. The objective is to clarify the channels through which external balances shape the growth impact of fiscal policy and to provide a structured foundation for future empirical research. By unifying insights from debt overhang theory, open-economy macroeconomics, and nonlinear growth dynamics, this article contributes to a more coherent understanding of sustainable growth under conditions of increasing global integration.

LITERATURE REVIEW

Public Debt, Economic Growth, and External Conditions

The association between public debt and economic growth has long occupied a central position in macroeconomic research. Early empirical investigations suggest that excessive public borrowing may restrain economic performance through increased debt servicing costs, constrained fiscal space, and heightened macroeconomic uncertainty (Reinhart & Rogoff, 2010; Checherita-Westphal & Rother, 2012; Panizza & Presbitero, 2014). Subsequent studies advance this perspective by demonstrating that the debt growth relationship varies across institutional environments and debt structures, and cannot be adequately captured by linear specifications (Égert, 2015; Chudik, Mohaddes, Pesaran, & Raissi, 2017; Law, Ng, Kutan, & Law, 2021). Despite these contributions, the literature exhibits a notable limitation: insufficient integration of external sector conditions, particularly the role of current account balance, in explaining how public debt influences long-term growth. External variables are often included merely as auxiliary controls, thereby overlooking their fundamental role in shaping debt sustainability and growth outcomes.

Current Account Balance as a Conditioning Factor in Growth Performance

The current account balance serves as a key indicator of external sustainability and an economy's dependence on foreign capital. Persistent current account deficits reflect reliance on external financing, which increases vulnerability to abrupt capital reversals and global financial disturbances (Chinn & Prasad, 2003; Catão & Milesi-Ferretti, 2018; Ghosh, Ostry, Kim, & Qureshi, 2018). Empirical findings further indicate that economies with weak external positions tend to experience greater macroeconomic volatility and more severe growth contractions during periods of financial stress (Bussière, Schmidt, & Valla, 2018; Kose, Ohnsorge, Sugawara, & Yu, 2022; Aizenman, Jinjark, & Park, 2020). Nevertheless, much of this literature evaluates current account dynamics and growth performance independently of public debt developments. This fragmented approach limits understanding of how external imbalances condition the growth effects of rising public debt, especially in highly open economies.

Interaction Between Public Debt and Current Account Balance

An expanding body of research recognizes the interdependence between fiscal policy and external balances. Debt-financed fiscal expansions frequently stimulate domestic absorption and import demand, leading to wider current account deficits and reinforcing external imbalances (Ghosh et al., 2018; Catão & Milesi-Ferretti, 2018; Chudik et al., 2017). In open economies, this interaction intensifies exposure to capital flow volatility, exchange rate instability, and refinancing risks, thereby weakening growth prospects. Empirical evidence reported by Chudik et al. (2017), Law et al. (2021), and Égert (2015) suggests that high public debt exerts stronger adverse effects on growth when external financing constraints are binding. However, the heavy reliance on cross-country panel methodologies imposes homogeneity assumptions that conceal important country-specific adjustment mechanisms, limiting the policy relevance of these findings.

Open Economies, Trade Openness, and Debt Sustainability

Trade openness further shapes the relationship between public debt and current account balance. While greater trade integration enhances productivity and market access, it also amplifies sensitivity to global demand fluctuations and financial cycles (Frankel & Romer, 1999; Bussière et al., 2018; Kose et al., 2022). In highly open economies, adverse external shocks can rapidly deteriorate current account positions, elevate borrowing costs, and undermine debt sustainability. Empirical studies by Aizenman et al. (2020), Ghosh et al. (2018), and Kose et al. (2022) demonstrate that trade openness magnifies both growth opportunities and macroeconomic risks. Yet, existing research rarely integrates trade openness, current account balance, and public debt within a unified analytical framework, resulting in fragmented conclusions regarding their combined influence on long-term development.

Strengths, Weaknesses, and Research Gaps

The existing literature provides strong theoretical foundations through debt overhang and crowding-out frameworks (Krugman, 1988; Modigliani, 1961; Pattillo, Poirson, & Ricci, 2002) and offers robust empirical support for nonlinear debt growth relationships (Reinhart & Rogoff, 2010; Égert, 2015; Law et al., 2021). However, significant limitations persist. Many studies continue to employ linear modeling approaches that obscure regime-dependent dynamics, while others rely on large panel datasets that mask country-specific external vulnerabilities (Eberhardt & Presbitero, 2015; Panizza & Presbitero, 2014; Chudik et al., 2017). Moreover, the conditional role of current account balance in shaping the growth consequences of public debt remains underexplored, particularly for highly open economies.

These gaps highlight the necessity for further research that explicitly integrates public debt, current account balance, and economic growth within a coherent conceptual and empirical framework. Long-run country-specific analyses capable of capturing nonlinear, threshold, and asymmetric dynamics are essential for improving policy relevance and advancing understanding of sustainable growth strategies in globally integrated economies.

METHODOLOGY

Research Design

This study adopts a conceptual research design aimed at developing an integrated analytical framework to explain the interaction between current account balance, public debt, and economic growth in open economies. Rather than conducting new empirical estimation, the methodology is grounded in systematic synthesis and theoretical integration of established macroeconomic literature. Conceptual analysis is appropriate for this study because existing empirical research on public debt and growth remains fragmented, particularly in its treatment of external sector conditions and regime-dependent dynamics (Panizza & Presbitero, 2014; Eberhardt & Presbitero, 2015; Chudik, Mohaddes, Pesaran, & Raissi, 2017).

The conceptual approach allows the study to reorganize existing knowledge into a coherent framework that explicitly links fiscal conditions with external balance dynamics and growth outcomes. This method follows established practice in macroeconomic theory development, where conceptual models are constructed by integrating theoretical propositions and empirical regularities from prior research (Reinhart & Rogoff, 2010; Égert, 2015; Law, Ng, Kutan, & Law, 2021).

Analytical Framework Development

The conceptual framework is constructed through three structured stages. First, core theoretical mechanisms are identified from debt overhang theory and crowding-out theory, which explain how high public debt can reduce investment, weaken productivity growth, and limit long-run economic performance (Krugman, 1988; Modigliani, 1961; Pattillo, Poirson, & Ricci, 2002). These mechanisms provide the primary transmission channels linking public debt to growth.

Second, external sector dynamics are incorporated by integrating insights from the literature on current account sustainability and external vulnerability. Persistent current account deficits are interpreted as indicators of dependence on foreign financing and exposure to capital flow volatility, which can amplify macroeconomic instability and constrain fiscal policy effectiveness (Chinn & Prasad, 2003; Catão & Milesi-Ferretti, 2018; Ghosh, Ostry, Kim, & Qureshi, 2018). This stage establishes current account balance as a conditioning variable that shapes the strength and direction of debt growth effects.

Third, the framework explicitly incorporates trade openness as a moderating factor. Trade integration is recognized as both a source of productivity gains and a channel through which external shocks and global financial cycles are transmitted to domestic economies (Frankel & Romer, 1999; Bussière, Schmidt, & Valla, 2018; Kose, Ohnsorge, Sugawara, & Yu, 2022). The interaction of trade openness with current account balance and public debt completes the structural representation of growth dynamics in open economies.

Conceptual Propositions

Based on the integrated framework, the study formulates a set of analytical propositions that guide future empirical testing. The first proposition states that the growth impact of public debt is conditional upon a country's external position, with weaker current account balances intensifying the adverse effects of rising public debt (Chudik et al., 2017; Égert, 2015; Law et al., 2021). The second proposition suggests that economies with persistent current account deficits experience stronger macroeconomic volatility and growth instability when public debt is high, due to heightened exposure to external financing constraints and capital flow reversals (Bussière et al., 2018; Aizenman, Jinjark, & Park, 2020; Kose et al., 2022). The third proposition proposes that trade openness magnifies both the opportunities and risks associated with public debt, strengthening growth potential under stable external conditions but increasing vulnerability when external imbalances and debt levels rise simultaneously (Frankel & Romer, 1999; Ghosh et al., 2018; Kose et al., 2022). These propositions provide a structured basis for future empirical research and allow systematic evaluation of the conditional relationships identified in the conceptual framework.

Methodological Rigor and Contribution

The rigor of this methodology lies in its systematic integration of well-established theoretical perspectives and empirical findings into a unified conceptual structure. By organizing existing evidence into clearly defined mechanisms and propositions, the study addresses important limitations of prior research, particularly the fragmented treatment of fiscal and external sector dynamics (Panizza & Presbitero, 2014; Eberhardt & Presbitero, 2015). The framework also accommodates nonlinear and regime-dependent relationships that are frequently emphasized in recent empirical studies but remain insufficiently formalized at the conceptual level (Reinhart & Rogoff, 2010; Égert, 2015; Chudik et al., 2017). Through this approach, the methodology establishes a coherent foundation for subsequent empirical investigation and contributes to improved understanding of sustainable growth processes in globally integrated economies.

CONCLUSION

This conceptual study clarifies the complex relationship between current account balance, public debt, and economic growth in open economies by presenting an integrated analytical framework. The discussion demonstrates that the growth effects of public debt cannot be properly understood without explicit consideration of external sector conditions. Persistent current account deficits amplify fiscal vulnerabilities by increasing dependence on foreign financing, exposing economies to capital flow volatility, and reducing policy flexibility, which together weaken long-term growth prospects. In contrast, stable external positions and sustained surpluses provide greater resilience against external shocks and allow public borrowing to support development more effectively. The interaction with trade openness further reinforces these dynamics, as deeper global integration magnifies both the potential gains from fiscal expansion and the risks arising from external instability.

The framework developed in this study offers a coherent structure for understanding how fiscal policy outcomes are shaped by external balance conditions and financial openness. By highlighting nonlinear, conditional, and regime-dependent mechanisms, the analysis advances conceptual understanding beyond traditional linear perspectives and supports more nuanced interpretations of debt sustainability and growth performance. These insights create a foundation for future empirical research and policy design focused on promoting sustainable growth in highly integrated global environments, where fiscal decisions and external positions are closely interconnected.

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