Impact of Economic Freedom on External Debt: The Case of South Asia

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Abstract

The objective of this study is to empirically examine the relationship between economic freedom and external debt in South Asian countries using annual panel data from 2000 to 2023. Short- and long-run dynamics are investigated using panel unit root tests, Pedroni and Johansen cointegration techniques, and the panel ARDL model. The results indicate a significant adverse effect of economic freedom on external debt, showing that a one-unit increase in the Economic Freedom Index decreases external debt by approximately 7.94% in the long run, with a probability of 0.01. Descriptive statistics show that South Asian economies have a moderate level of economic freedom (average score 6.13) and that debt levels vary enormously from US$0.21 billion to US$647 billion, indicating sharp differences in debt sustainability. The ARDL results also indicate that the exchange rate depreciation coefficient (2.69, with a probability of less than 0.01) and corruption (coefficient 0.24, with a probability of less than 0.05) exacerbate external debt. Additionally, political stability has a weak negative impact, with a coefficient of -2.31 and a probability less than 0.10. Trade openness exhibits an effect, with a long-run coefficient p-value of 0, but it is insignificant in the short run. The error correction, with a coefficient of -0.316 and a significance level of 0.05, supports a long-run adjustment toward equilibrium. These results suggest that institutional quality and economic freedom play an important role in external debt management in South Asia.

Keywords: External Debt; Economic Freedom; South Asia; ARDL Model; Panel Data.

Introduction

The external debt has been a significant part of economic policies of low- and middle-income countries where it has been used to finance prosperity gap, finance large-scale projects and stabilize balance of payments; though in the short run it can provide macroeconomic improvements and allow government development, excess dependence of such borrowing could leave the economy vulnerable to the fluctuations in global interest rates and appreciating currencies as well as diminishing exports earnings, the fiscal space becomes constrained and unsustainable (Pattillo

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et al., 2011). Over the past few years, the concept of debt sustainability has shifted its focus to the institutional issues, and economic freedom, defined as the degree to which individuals and firms can make economic choices within a framework protecting property rights, enforcing contracts, and ensuring regulatory quality, fiscal prudence, open trade, and monetary stability, has taken center stage as a necessary component in promoting transparency, Accountability, and capacity to be resistant to shock (Gwartney & Lawson, 2003). In Pakistan, external debt has significantly contributed to instability, with an increasing share of new borrowing used to repay old debt at the expense of development and thus, more government revenues being used to meet repayment demands at the cost of welfare and other investments in growth-enhancing activities; and with world financial pressure increasing of interest rates, devaluation, and poor exports, the consequences are the increasing costs of servicing new debt rollovers and greater vulnerability. There is evidence that both short and long term debts serving burdens are not transitory instead are entrenched leading to the creation of the vicious cycle where rather than bringing growth, borrowing continues to bring fiscal crises and structural weaknesses leaving Pakistan in the dangerous circles of unsustainable debt accumulation which reduces economic stability and long term growth prospects by actually turning it into a development killer that limits sustainable development and growth (Arsh et al., 2024).

Based on the economic theories about institutions, those countries that display greater levels of economic freedom, which are characterised by the presence of secure property rights, reduced government intervention and open markets, can generate greater involvement of the privately owned sector and more economic activity, which ends up benefiting the Collection of taxes and improving the efficiency of public spending. Consequently, such economies tend to be fiscally responsible. They are less dependent on external financing to meet their demands. In contrast, nations with a low level of economic freedom are plagued by vices such as corruption, high regulations, and weak legal systems, which hinder their ability to generate revenue and lead to poor fiscal policies, ultimately increasing foreign borrowings (Hall & Lawson, 2014; North, 1990). In South Asia, economic institutional strength contributes to debt sustainability and resilience, as the freedom to invest and the reliability of law enforcement are important factors that attract foreign direct investment (FDI), which reduces dependency on state borrowing and leaves space within fiscal policy to fund productive development initiatives.

In comparison, the rampant weakness in institutional frameworks is a deterrent to the inflow of private capital and, ironically, drives the government back into the debt-financed cycle of consumption and rollovers instead of investing in growth. Empirical evidence indicates that since 2012, South Asia's external debt has nearly doubled, reaching US$418.6 billion in 2022, reflecting the lack of structural strength in fiscal discipline and domestic resource mobilisation. Pakistan, Sri Lanka, the Maldives, and Afghanistan are most at risk because their countries have poor debt management, a lack of export strength, and global financial weakness, which render debt rollovers more expensive and sustainability more difficult. It has worsened the region's debt situation, paired with the external shock of the COVID-19 pandemic and a rise in international interest rates, which has increased fiscal pressure in the region (Melecky, 2021). In the meantime, India and Bangladesh have achieved a relatively higher level of debt management and growth, with a market-oriented economy that, to some extent, has liberalised trade, which has increased their economic strength and reduced their dependence on debt.

In comparison, the situation remains problematic in Pakistan and Sri Lanka, where failures of governance and policy inconsistency expose them not only to external debts but also undermine their longer-term fiscal stability. The regional differences illustrate that the quality of institutions

is a critical determinant of how each country raises its external debt, when it is to be serviced, and how it is managed. Better institutions lead to greater transparency, investment, and resilience to external shocks. As the South Asian example demonstrates, sustainable management of the debt burden and long-term stability cannot exist without strengthening institutional frameworks, applying proper governance, and maintaining consistent policies that match economic freedom with fiscal responsibility (Farooq et al., 2024).

It is essential to study the link between economic freedom and external debt to know how much foreign borrowing affects a nation's freedom to decide and grow sustainably. Although global studies have addressed these matters, there are compelling reasons to focus specifically on South Asia. South Asian economies are experiencing a surge in external debt, which increases their risk of debt crises and makes it more challenging for them to improve their infrastructure, education, and health (Ale et al., 2023). Moreover, this vulnerability worsens in many countries because people save less of their earnings, budgets are usually in deficit, and funding large development projects is essential. Furthermore, the measures of economic freedom, governance quality, and regulation in South Asia determine how external debt affects economic development and the decisions made by policymakers. Having access to more economic freedom and strong institutions in a country enables the effective use of external financing and the avoidance of debt-related challenges. In contrast, weaker governance typically leads to poor growth and limited decision-making autonomy (Siddiqui & Malik, 2022). Compared to many advanced economies, South Asian nations face challenges such as geopolitical tensions, limited income, and multiple political systems, which impact the way debt influences their freedom.

This study both summarises previous research and provides unique insights for South Asia that can aid policymakers. The study aims to understand how economic freedom relates to external debt in the unique institutional and economic conditions of South Asia, and suggests solutions for sound financial policies, stability, and acceptable debt levels. These outcomes are crucial in understanding and addressing the specific debt issues and development challenges faced by South Asian nations.

Literature Review

The debt of other countries enables countries to invest in healthcare, education, and infrastructure, which are long-term developmental in nature, particularly when national savings are insufficient to meet the country's investment needs. Governments frequently use external borrowing to finance fiscal deficits and still afford necessary services. Concessional lending and foreign financing may be abused to complete projects that can improve productivity and growth (Akinci, 2024). As far as external debt can support the active life of the economy, it also presents countries with some weaknesses, such as unstable exchange rates and rising money service prices. This is where financial management comes in. The volume of money dissipated in debt service is likely to diminish the volume of financing for infrastructure, education, and healthcare, generating retrogressive development and inequality-enhancing debt waves, and setting the stage for stagnation and recessionary debt waves (Abbas, 2024). It all depends on the spending of the money, i.e. spending the money on infrastructure, energy, and innovation can help the economy grow by trade, investment and productivity, and instead make the situation worse by poor planning, corruption or misuse (i.e. consumption) without growth (Manasseh et al., 2022). Then, outside of debt, open government and good investment can only work when it can repay.

The latter is directly connected to the dimension of economic freedom, i.e., personal choice, secure property rights, free exchange, and limited government intervention, which fosters a supportive

environment for innovation, efficiency, and long-term prosperity (Markosyan et al., 2023). To achieve productivity that is beneficial to society, economic freedom enables people and companies to produce, innovate, and compete. However, a high standard of institutions, legal defence, and government restraint is of minor importance in the production and distribution of resources (Gwartney & Lawson, 2003). The more effective economic freedom within a specific country and the quality of its institutions, the more growth it has, the more it can attract investment and the better the outlook in the long term, the more the government intervenes in the affairs of the economy, the higher the costs of doing business and the less developed are the individual enterprises, empirically proven. The policy makers who want to realise a sustainable, prosperous economy must, thus, minimise barriers to entrepreneurship, improve institutions and uphold property rights in such a way that external debt and internal reserves can contribute a significant portion towards the maintenance of economic growth, which is sustainable (De Haan & Sturm, 2000).

The increasing debt has become a significant drag on the GDP growth of countries like Burundi, Tanzania, and Kenya, as borrowing has not been used to generate productive investment but to augment the debt service burden, replace domestic investment, and cripple economic performance. Burundi is the country that suffers the most due to its weak institutions as well as political instabilities, with Tanzania and Kenya performing poorly in terms of corruption and inefficiencies, resulting in a waste of borrowed money, compared to Uganda, whose productivity is not a very good result, due to better functioning governance and prudent investment in infrastructure and social services. The gaps indicate that only with good policies, good institutions, and proper investment planning can debt be employed as a development tool. Similarly, Magnini and Vojnovic (2024) confirm in a similar study that a one-point increase in Economic Freedom Index (EFI) decreases the level of external debt by 1.7 to 7.3 percent, noting that the presence of clear regulations, free property rights, free markets, and limited government involvement in the industry pushes the performance of the private sector, investment and fiscal sustainability, and minimizes the level of foreign borrowings (Tile et al., 2024). Unless smoothly utilised as a factor of production, excess external debt has an inverse relationship with GDP growth, as excessive debt servicing dilutes revenue to fund education, health, and infrastructure, leading to macroeconomic imbalances and a lack of investor confidence (Mohsin et al., 2021). Trade openness is, however, positive in nature, as it attracts foreign direct investment, which in turn leads to inflows of capital, technology, skills, and market access. This boosts productivity, employment, and growth, attracting further inflows of trade and FDI that lead to a virtuous cycle of development. To perpetuate this loop, liberal trade policies, investment-friendly legislation, and infrastructural initiatives come into play. Consequently, strategic trade and institutional strength are the primary sources of long-term economic growth (Dhiyaulhaq et al., 2023).

Several studies have been conducted to investigate the impact of economic and socio-political factors on external debt, as noted by Ozler and Tabellini (1991). In their attempt to assess the relationship between debt and economic freedom in CEE countries, Mura and Donath (2023) conclude that an increase in government debt levels is associated with a decrease in economic freedom. Magnini and Vojnovic (2024) analysed the effect of the quality of economic institutions, as measured by the Economic Freedom Index, on the level of public debt in various countries. Bui (2018) evaluates the contribution of public debt in the Asia-Pacific region to financial development, demonstrating that public sector borrowing limits private sector borrowing, thereby hindering financial development. This study aims to examine the impact of economic freedom on external debt, with a focus on South Asia. The literature that remains has explored how economic

freedom affects Turkish public debt between 1990 and 2022 using the ARDL approach, to determine the short- and long-term relationships between the two variables. Most past research works do not demonstrate how economic freedom affects external debt, particularly for countries that rely heavily on external funding. In contrast to other studies, this research will address the gap by examining the impact of economic freedom on external debt in the context of South Asia.

The results of the current research support the existing literature, indicating that the level of economic freedom has a significant impact on the level of external debt in South Asia. Greater economic freedom, in the form of secure property rights, open institutions, free trade, and reduced government intervention, is associated with lower dependency on external borrowing. This finding aligns with the Institutional Quality Hypothesis, which holds that institutional strength enhances fiscal discipline, curbs corruption, and ensures that resources are distributed productively rather than squandered. Similarly, this is also in line with the Debt Overhang Theory, which argues that high levels of external debt will deter investment and growth unless nations have viable governance and policy structures that can ensure investor confidence. Conversely, external borrowing increases in the economies of weak institutions and those with low economic freedom, due to the stifling of domestic investment in the private sector, low tax revenues, and the use of debt to fund government expenditures. Hence, the findings suggest that structural changes to enhance economic freedom, the rule of law, and an investment-friendly environment can help South Asia minimise its reliance on foreign debt. The analysis, in accordance with the theory and previous empirical research, highlights the fact that economic freedom is not only a growth determinant but also a key tool for maintaining external debt levels at sustainable levels.

Methodology

This paper utilised panel data to analyse how economic freedom affects external debt in the South Asian region. Balanced panel datasets were analysed for a subset of selected countries between 2000 and 2023. To achieve consistent results, the study first performed diagnostic tests, including unit root tests, to avoid biased estimations. Having determined the order of integration, the research then applied panel cointegration tests and the Autoregressive Distributed Lag (ARDL) model to estimate both short-run and long-term coefficients. Such approaches are paramount in producing both consistent and supportive results.

The variables included in this study are external debt (ED), economic freedom (EF), trade openness (TO), exchange rate (ER), corruption control (CC), and political stability (PS). Data for these variables has been collected from credible sources such as the World Bank's World Development Indicators (WDI), the International Monetary Fund (IMF), and the Heritage Foundation's Economic Freedom Index. A detailed description of variables and their sources is provided in Table 1.

The unit root tests were used to determine whether the variables are non-stationary or not. The existence of unit roots implies non-stationarity, which may lead to spurious regressions if not corrected. It is hence essential to test the stationarity of each variable before going to cointegration analysis or long-term prediction. To do this, two panel unit root tests were used: the Im, Pesaran, and Shin (IPS) test and the Levin, Lin, and Chu (LLC) test. Since the data appeared to be integrated of order one, panel cointegration tests were implemented to determine the existence of long-run equilibrium relationships among the variables, including the Johansen-Fisher test and the Pedroni residual-based tests.

Finally, the study employed the panel ARDL model to estimate both short-run and long-run dynamics. This model is particularly robust for analysing panel data because it accommodates

variables with different levels of integration and effectively handles endogeneity and autocorrelation problems. By applying the ARDL model, the study provides more accurate and reliable estimates of the relationship between economic freedom and external debt. From the literature, the following baseline model has been constructed:

$$\ln ED_{it} = \alpha_o + \beta_1 lnEF_{it} + \beta_2 lnTO_{it} + \beta_3 lnCC_{it} + \beta_4 lnCC_{it} + \beta_5 lnPS_{it} + \varepsilon_{it} \quad (1)$$

The equation represents a log-linear panel data model to examine the determinants of external debt (ED) across countries over time. Here, ED_{it} is the external debt for country i at time t. β_s represent the coefficients of the respective variables, α_o is the constant term, and ε_{it} is the error term.

Table 1: Variable Description

Variable	Variables Abbreviation	Definition of Variables	Unit	Source
Dependent Variable				
External Debt	(ED)	Total External Debt refers to debt paid for in currency, goods or services to foreign creditors.	Current US$ (Billions)	World Bank (2024)
Independent Variable				
Economic Freedom	(EF)	This reflects the level of economic freedom in a nation.	Range (1-10)	Fraser Institute (2024)
Control Variables				
Trade Openness	(TO)	Trade openness (Export+Import)/GDP	Constant US $	World Bank (2024)
Corruption	(CC)	The corruption is taking advantage of public office for private gain.	Control of corruption: Estimate	World Bank (2024)
Exchange Rate	(ER)	Local currency units in relation to another country's currency.	Local currency per US dollar.	World Bank (2024)
Political Stability	(PS)	Political stability represents the probability of encountering political unrest or violent conditions such as terrorism.	Indicator (ranging from approximately -2.5 to 2.5)	World Bank (2024)

Results and Discussion

In the initial step, descriptive variables were estimated to know about the kind and co-distribution of the data. The confirmatory analysis used the Im, Pesaran & Shin (IPS) and Levin, Lin and Chu (LLC) panel unit root test. The order of integration of the variables was established using the two tests at both the level and the first difference. Pedroni residual based test and Johansen Fisher panel cointegration test were then used to test on the presence of a long-run equilibrium relationship among the variables. Lastly, the cause and the strength of the relationships were tested using Panel Autoregressive Distributed Lag (ARDL) technique which has presented both short and long-run estimates.

Table 2: Im-Pesaran-Shin (IPS) Unit Root Test Results (Individual intercept and trend)

Variables	At Level		At First difference		Conclusion
	Statistic	Prob.	Statistic	Prob.	
LCRP	-0.92	0.18	-3.29*	<0.01	I (1)
LEF	0.06	0.52	-2.38*	<0.01	I (1)
LEXC	1.97	0.98	-4.12*	<0.01	I (1)
LPS	0.17	0.43	-3.54*	<0.01	I (1)
LTO	2.42	0.99	-4.24*	<0.01	I (1)

* Significant at 1% level (0.01)

According to the results of the IPS unit root test in Table 2, all variables, LCRP, LEF, LEXC, LPS and LTO, are found to be non-stationary at its level form as the test statistics and probability values are above five percent significance. The IPS value of LCRP would be -0.92 with probability 0.18 and LEF would be 0.06 with probability 0.52. Similarly, we also find that LEXC, LPS and LTO demonstrate values and probabilities that verify non-stationarity. At the first difference, however, all variables are stationary since the test statistics are significant at the one percent level with a probability of 0.01. It implies that the series are intertwined of order one, as is typical of macroeconomic and financial time series.

Table 3: Im-Pesaran-Shin (IPS) Unit Root Test Results (Intercept)

Variables	At Level		At First difference		Conclusion
	Statistic	Prob.	Statistic	Prob.	
LCRP	-1.25	0.11	-4.09*	<0.01	I (1)
LEF	-0.64	0.26	-2.36*	<0.01	I (1)
LEXC	6.64	1.00	-4.07*	<0.01	I (1)
LPS	0.06	0.52	-4.67*	<0.01	I (1)
LTO	5.32	1.00	-4.51*	<0.01	I (1)

* Significant at 1% level (0.01)

The unit root test, which uses the IPS unit root statistics, and a single intercept specification all show that all the variables are non-stationary at their level form, since the test statistic is statistically insignificant. This implies that the series have unit roots and are stochastic. However, when the difference is as large as the first one, all the variables demonstrate highly significant results and reject the null hypothesis at the one percent level. This confirms that the variables are stationary on first differencing and are of order one integrated. The similarity in the outcomes across the specifications will help the econometric basis of the panel cointegration analysis to test the existence of a long-run equilibrium relationship.

Table 4: The Levin, Lin, and Chu (LLC) Unit Root Test (Individual intercept and trend)

Variables	At Level		At First difference		Conclusion
	Statistic	Prob.	Statistic	Prob.	
LCRP	-0.34	0.37	-4.91*	< 0.01	I (1)
LEF	0.26	0.60	-2.75*	<0.01	I (1)
LEXC	1.18	0.89	-4.15*	<0.01	I (1)
LPS	-0.90	0.18	-7.69*	<0.01	I (1)
LTO	-0.88	0.19	-5.53*	<0.01	I (1)

* Significant at 1% level (0.01)

Table 4 indicates that all variables LCRP, LEF, LEXC, LPS and LTO are not at their level form since the probability values of all their test statistics are greater than 0.05. To illustrate, LCRP records -0.34 with probability of 0.37, and LEF and LEXC also have an insignificant result. But at the first difference, all variables will be stationary with large negative statistics and highly significant probabilities at the 1 percent level. An example is LCRP -4.91, LEF -2.75 and LPS -7.69. These findings verify the order one intercept-trend specification of the series is integrated.

Table 5: The Levin, Lin, and Chu (LLC) Unit Root Test Results (Intercept)

Variables	At Level		At First difference		Conclusion
	Statistic	Prob.	Statistic	Prob.	
LCRP	-1.38	0.08	-5.40*	<0.01	I (1)
LEF	0.58	0.72	-4.25*	<0.01	I (1)
LEXC	4.87	1.00	-3.02*	<0.01	I (1)
LPS	-0.43	0.33	-9.67*	<0.01	I (1)
LTO	3.51	0.99	-5.20*	<0.01	I (1)

* Significant at 1% level (0.01)

According to the IPS unit root test with an intercept-only specification represented in table 5, all the variables are non-stationary at their level form because the probability values have values exceeding the 5 percent level of significance. As an example, LCRP records -1.38 with probability 0.08, whereas the result of LEF and LTO are insignificant, as well. This means that these fluctuations in these variables do not revert to a certain point, they are long term. Nonetheless, when there is the first difference, all the variables indicate extremely significant negative values with p-values of 0.01, indicating stationarity. These results confirm that LCRP, LEF, LEXC, LPS and LTO are integrated one after another, and the conformity of IPS specifications adds to the reason to use the panel cointegration analysis to test the long-run relationships.

Table 2 through Table 5 results of the IPS unit root test reveal that the non-stationary level form of all the variables, i.e. LCRP, LEF, LEXC, LPS and LTO, are found at a probability value exceeding five percent, which implies the existence of unit roots. At first all the variables become stationary with very significant values at the one per cent level, which supports the claim that they are of order one integrated. The fact that such results are consistent with the intercept-only and intercept-with-trend specifications makes them reliable and gives valid reasons to use panel cointegration methods to find out the long-run relationship between the variables.

Table 6: Johansen Fisher Cointegration Test

Hypothesized No. of CE(s)	Fisher Stat. * (from trace test)	Prob.	Fisher Stat. * (from max-eigen test)	Prob
None	286.2	0.01	289.8	0.01
At most 1*	150.9	0.01	78.19	0.01
At most 2*	84.46	0.01	50.69	0.01
At most 3*	42.35	0.01	24.73	0.01
At most 4**	25.13	0.01	17.37	0.07
At most 5	15.60	0.11	14.15	0.17
At most 6	12.06	0.28	12.06	0.28

Note: * and ** represent at level 1% and 10% respectively

The Johansen Fisher Panel Cointegration Test indicates that for the hypotheses of None, At most 1, and At most 2, the p-value is 0.01, leading to the rejection of the null hypothesis and confirming the presence of at least one cointegrating vector. For higher hypotheses, the p-values increase, showing weaker evidence against the null. Overall, the results confirm that the variables are cointegrated, implying long-run equilibrium relationships. This supports their suitability for dynamic modeling and policy analysis.

Table 7: Long Run and Short Run Results of ARDL

Variables	Coefficient	Std. Error	t-Statistics	Prob.*
Long Run Equation				
LEF	(-) 7.9434	2.088902	3.8026	0.0004
LEXRTE	2.690801	0.31493	8.475146	0.0000
LPS	(-) 2.307026	1.172666	(-) 1.96335	0.0526
LCRP	0.23814	0.1128	2.1098	0.0483
LTO	9.77200	3.885575	2.53439	0.012
Short Run Equation				
LTO	- 0.205541	0.3316	-0.61972	0.5366
LEXRTE	-0.21010	0.14185	-1.481121	0.1411
LEF	-0.41948	0.236099	-1.776704	0.082
LPS	0.080512	0.083437	0.964944	0.336
LCRP	0.036027	0.06785	0.53092	0.596
COINTEQ01	(-)0.31564	0.015664	2.0144	0.0387

The regression findings reveal that the negative effect of economic freedom on external debt is negative and highly significant with a coefficient of -7.9434, implying that, the higher the economic freedom, the lower the debt liability in South Asia. The exchange rate has a significant and positive coefficient of 2.6908, i.e., the depreciation of currency raises external debt. The coefficient is negative at -2.3070, weakly significant at 10 percent thus more stable governments will reduce dependence on external borrowing. The impact of corruption, a coefficient of 0.2381, is positive and significant, meaning that an increase in corruption increases external debt. There is also a positive effect of trade openness with a coefficient of 9.7720 meaning that increased trade integration promotes increased external borrowing. In general, the results indicate that institutional quality, macroeconomic stability, and openness have a strong influence on the dynamics of external debts in the region.

The results of the short-run regression indicate that external debt is not significantly affected by most explanatory variables. Trade openness, exchange rate, political stability and corruption have very low coefficients, and only economic freedom has weak significance at the 10 percent level. This implies that short-term dynamics cannot explain fluctuations in external debt to a large extent. Nonetheless, the error correction term is negative and statistically significant, with a coefficient of -0.3156, which ascertains that an average of 31.6 percent of the disequilibrium is corrected every period. This observation brings home the fact that there are negligible short-run effects, but there is apparent long-run equilibrium adjustment.

Table 8: Normality Jarque-Bera Test Result	
Jarque-Bera	2.918770
Probability	0.232379

The value of JB statistics is 2.918770, and the probability is 0.232379. Since the p-value is larger than the significance level of 0.05, we would not reject the null hypothesis of the Jarque-Bera test. This outcome means that the assumption of normality cannot be rejected.

As a result, the residuals of the model can be treated as nearly normally distributed, which justifies the validity of further statistical inference and reinforces the robustness of the econometric findings suggested by this paper. The normality of residuals also indicates the adequacy of the estimated ARDL model and its suitability for providing practical policy implications.

Conclusion

This paper aimed to empirically examine the predictors of external debt in South Asian economies, focusing on economic freedom, exchange rate, political stability, corruption, and trade openness, based on panel data from 2000 to 2023. Our ARDL testing results, assisted with unit root and cointegration tests, indicate that all variables are strongly related in the long run. It was observed that economic power reduces extensive debt at the 1% level, which suggests that the stronger the institutions, the rule of law, and the quality of their regulations, the less they depend on external borrowing. On the other hand, it was found that exchange rate depreciation and corruption significantly increase debt burdens, exposing debt sustainability to macroeconomic instability and poor governance. The influence of political stability on the control of external debt was negative but small, indicating that stable governments are better equipped to manage external debt, and that trade openness, although positively related to growth, amplifies the impact of low competitiveness on external borrowing. The short-run outcome revealed weaker effects, although the error correction term was necessary to indicate a rapid adjustment to the long-run equilibrium. Taken together, these results support the debt overhang theory and the institutional quality model, highlighting the importance of structural changes as a key to achieving sustainable debt management.

Based on these findings, some policy recommendations are promoted. Governments must focus on institutional reforms to raise the level of economic freedom by enhancing the quality of institutional frameworks through increased regulatory effectiveness, protection of property rights, and improved transparency. Inclusive governance, credible elections and consistent policies should also be encouraged to promote political stability, which will allow long-term planning. Anti-corruption measures should be stringent to prevent fiscal leakages. Exchange rates should be moderated, and adequate foreign reserves should be maintained to curb currency fluctuations and rising debt service bills. Openness to trade must be weighed against export diversification and support for domestic industries to prevent the accumulation of debts through trade deficits. Lastly, the South Asian nations need to work together within the region, as managing debts collectively, sharing experiences, and establishing regional financial safety nets may lead to increased resilience against external shocks. This demonstrates that sustainable debt management in South Asia extends beyond growth rates in the region to encompass institutional reforms, macroeconomic stability, and cooperative regional policies.

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