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Fiscal Sustainability and Debt Dynamics: Evidence from South Asian Countries

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Abstract
This paper undertakes a comprehensive analysis of the interplay between defense expenditure, democracy, and external debt in five South Asian countries spanning the period from 1972 to 2017. Employing a range of econometric techniques including pooled mean group, mean group, dynamic ordinary least squares, and fully modified ordinary least squares, the study ensures robustness and precision in its empirical analysis. The findings of the study reveal compelling insights into the determinants of external debt in the context of South Asian nations. Firstly, the results confirm the presence of a long-run relationship between military expenditures and external debt, highlighting the significant role played by defense spending in shaping the debt dynamics of these countries. This underscores the importance of prudent fiscal management and strategic allocation of resources in mitigating the burden of external debt. Furthermore, the study elucidates a negative relationship between democracy and external debt, suggesting that countries with stronger democratic institutions tend to exhibit lower levels of external indebtedness. This intriguing finding underscores the potential benefits of democratic governance in promoting fiscal discipline and accountability, thereby reducing reliance on external borrowing. Based on these empirical results, the paper offers valuable policy recommendations aimed at enhancing fiscal sustainability and debt management practices in South Asian countries. Such recommendations may include measures to rationalize defense expenditures, strengthen democratic institutions, improve transparency and accountability in public finances, and diversify sources of financing to reduce reliance on external borrowing. Overall, this paper contributes to our understanding of the complex factors driving external debt dynamics in South Asia, offering insights that are pertinent for policymakers, researchers, and practitioners engaged in economic governance and development efforts in the region.
Keywords: Defense Expenditure, Democracy, External Debt, Fiscal Management, Democratic Governance
JEL Codes: H50, H60, F34, O53

1. INTRODUCTION

The escalation of regional conflicts and internal instability has driven many countries to bolster their defense expenditures. A notable instance is the aftermath of the Arab Spring, where nations like Algeria significantly augmented their defense budgets, with expenditures soaring to approximately $10 billion annually (Benoit, 1973). Regional tensions and territorial disputes, such as the longstanding India-Pakistan conflict over Kashmir or the Ukraine-Russia conflict concerning Crimea, further underscore the imperative for heightened defense spending. Interestingly, while increased defense outlays are often viewed as a response to security threats, they can also be rationalized in economic terms. China's trajectory serves as a prime example, where defense expenditures have surged in tandem with robust economic growth (Benoit, 1973). However, financing defense spending through sources like special taxes on oil revenues may face resistance in some countries due to its unpopular nature. Within the realm of empirical research, the relationship between defense expenditures and economic growth has garnered significant attention. Pioneering efforts in this domain date back to Benoit's seminal work in 1973. However, despite the extensive discourse on the defense-growth nexus, relatively few studies have delved into the intricate interplay between defense expenditures and debt. The nexus between defense spending and indebtedness remains relatively underexplored, despite its relevance in shaping fiscal policies and national security strategies. Addressing this gap in the literature could offer valuable insights into the dynamics of military expenditures, fiscal sustainability, and the broader economic context. As such, further research into the complex relationship between defense expenditures and debt is warranted, particularly in light of evolving geopolitical landscapes and economic realities.

There are three distinct dimensions through which defense expenditures can exert a positive influence on external debt. Firstly, defense expenditure constitutes a significant portion of the annual budget. In cases where governments are unable to finance defense through taxation alone, it leads to budget deficits. Consequently, the government may resort to foreign borrowing to bridge the deficit, thereby accumulating debt (Dunne et al., 2004). Secondly, a portion of defense expenditure may be earmarked for the import of arms. Acquiring arms from foreign suppliers necessitates foreign exchange. Should a country face a shortage of foreign exchange reserves, it may resort to borrowing from external sources to finance arms imports, further contributing to external debt (Dunne et al., 2004). Thirdly, domestic

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arms production may require intermediate inputs sourced from abroad. In such cases, the acquisition of these inputs necessitates foreign exchange. If a country experiences a shortage of foreign exchange reserves, it may resort to external borrowing to finance the procurement of these inputs, thereby augmenting external debt (Dunne et al., 2004). These dimensions underscore the complex interplay between defense expenditures and external debt accumulation, highlighting the various channels through which defense spending can contribute to a country's indebtedness on the international stage. As such, understanding these dynamics is crucial for policymakers when formulating strategies to manage both defense budgets and external debt levels effectively.

Many researchers, including Lensink et al. (2000), have posited that political instability plays a pivotal role in both capital flight and external debt dynamics. In countries plagued by political instability, residents often exhibit a reluctance to invest their capital domestically. This hesitance stems from a lack of confidence in the government's ability to maintain economic stability and protect property rights. Concerns about potential government actions, such as expropriation or arbitrary policy changes, lead residents to seek safer investment opportunities abroad. The perception that the government may undermine the future value of their assets prompts residents to divert their capital to foreign markets, contributing to capital flight. Additionally, the uncertain political environment may deter foreign investors from entering the country, further exacerbating capital outflows and hindering economic growth. Moreover, political instability can also have direct implications for external debt dynamics. Investors and lenders may perceive politically unstable countries as riskier borrowers, demanding higher interest rates to compensate for the elevated risk. Consequently, governments in politically unstable countries may face higher borrowing costs when accessing international capital markets, leading to increased external indebtedness. Overall, the relationship between political instability, capital flight, and external debt underscores the significant role that political factors play in shaping economic outcomes. Addressing political instability and implementing measures to enhance governance and stability are essential steps in promoting economic growth and mitigating the risks associated with capital flight and external debt accumulation.

The nexus between defense expenditure and external debt holds paramount importance, particularly in countries with substantial defense budgets. Defense expenditure can significantly contribute to external debt accumulation, as governments may resort to borrowing from international sources to finance military-related expenses. This reliance on external borrowing to fund defense outlays can exacerbate the burden of external debt, posing challenges to economic progress and stability. The consequences of excessive external debt are multifaceted and can impede economic development in various ways. One such impact is the potential overvaluation of the local currency. When a country accumulates high levels of external debt, it may lead to increased demand for foreign currency to service debt obligations. This heightened demand for foreign currency can exert upward pressure on the local currency's value, resulting in overvaluation. An overvalued currency can undermine export competitiveness, hinder economic growth, and exacerbate trade imbalances. Furthermore, excessive external debt can lead to a deterioration in the country's terms of trade. As debt service obligations mount, a larger share of export earnings may need to be allocated towards servicing debt, reducing the resources available for domestic investment and consumption. This can lead to a decline in the terms of trade, as the value of exports diminishes relative to imports. A worsening terms of trade can further strain the country's balance of payments and impede economic growth. Moreover, high levels of external debt can constrain fiscal flexibility and limit the government's ability to implement countercyclical policies during economic downturns. Debt service obligations may consume a significant portion of government revenues, leaving fewer resources available for essential public services and investment in infrastructure and human capital. In light of these potential threats, prudent fiscal management and strategic allocation of resources are essential to mitigate the adverse impacts of defense-related external debt. Implementing measures to enhance transparency, accountability, and efficiency in defense spending can help alleviate fiscal pressures and promote sustainable economic progress. Additionally, diversifying sources of financing and prioritizing investments in productive sectors of the economy can contribute to reducing reliance on external borrowing and fostering long-term economic resilience.

2. LITERATURE REVIEW

Looney and Frederiksen's (1986) study on the relationship between defense expenditure and economic growth in a group of developing countries sheds light on crucial insights into the complexities of this dynamic. Their findings underscore the nuanced nature of the relationship between defense spending and economic growth, particularly in the context of different country groupings. The study confirms the hypothesized positive relationship between growth and defense expenditure for the unconstrained group of countries. This suggests that in certain contexts where countries have greater fiscal flexibility and access to resources, increased defense spending can indeed contribute to economic growth. This finding highlights the potential role of defense expenditure as a driver of economic activity, through factors such as job creation, technology development, and infrastructure investment. However, the results for the constrained group of countries do not align with the hypothesized relationship between defense expenditure and economic growth. This discrepancy underscores the importance of contextual factors such as fiscal constraints, external debt burdens, and foreign exchange dynamics in shaping the impact of defense spending on economic outcomes. In these settings, the study suggests that other factors such as net capital inflows, external debt levels, foreign exchange availability, and overall public sector growth may exert a more significant influence on economic progress. Overall, the findings of Looney and Frederiksen's study underscore the importance of considering a range of contextual factors when examining the relationship between defense expenditure and economic growth. Their research highlights the need for nuanced analysis and tailored policy responses that take into account the specific circumstances and challenges faced by individual countries in managing defense spending and promoting sustainable economic development.

In a study that parallels the exploration of defense expenditure's impact on economic growth, Feng (1995) investigates a related but distinct area, focusing on the relationship between regime types (military/civilian) and polity types (authoritarian/democratic) on one hand, and economic growth on the other. Employing a specially formulated econometric method and drawing on extensive political and economic datasets, Feng conducts a cross-sectional time series analysis focusing on Latin American countries over the period 1982-1988. Feng's findings offer valuable insights into the dynamics between governance structures and economic performance. The study concludes that economic growth tends to be faster under civilian governments compared to military ones. Furthermore, it asserts that civil liberties and political rights continue to grow under civilian governments, implying a positive association between democratic governance and economic progress. By examining the impact of regime type and polity type on economic growth, Feng's study underscores the importance of political factors in shaping economic outcomes. The findings suggest that institutional arrangements and governance structures play a crucial role in fostering conducive environments for economic development. Specifically, the presence of democratic institutions appears to be associated with faster economic growth and greater protection of civil liberties and political rights. Overall, Feng's research contributes to our understanding of the complex interplay between politics and economics, highlighting the significance of governance dynamics in shaping economic performance. The study underscores the importance of fostering democratic governance and protecting civil liberties as essential components of sustainable economic development strategies.

Lensik, Hermes, and Murinde (1998) embarked on a pioneering endeavor to explore the intricate relationship between capital flight and political risk across a wide array of developing economies. At the heart of their study was the central hypothesis that political risks act as a catalyst for the escalation of capital flight, even after accounting for policy and macroeconomic variables. To substantiate their hypothesis, the researchers utilized a comprehensive dataset comprising World Bank data on capital flight, information from the Polity III codebook detailing political risk indicators, and World Bank Indicators from 1997. Employing regression analysis as the primary empirical method, they sought to discern the nuanced associations between political risk variables and capital flight, while controlling for various international and domestic macroeconomic factors. The results of their analysis yielded compelling insights, indicating a statistically significant relationship between political risk variables and capital flight across a majority of cases. Moreover, these relationships remained robust even when subjected to rigorous robustness tests. Ultimately, Lensik, Hermes, and Murinde's study concluded with the assertion that political risk or uncertainty tends to exacerbate capital flight, a phenomenon closely associated with external debt dynamics. By elucidating the linkages between political risk and capital flight, the study underscores the profound impact of political factors on economic phenomena such as capital mobility and external indebtedness. The findings underscore the importance of political stability and institutional quality in fostering confidence among investors and curbing capital flight tendencies, thus contributing to the sustainability of external debt management strategies in developing economies.

Adejumobi (2000) conducted a comprehensive analysis of the role of democracy in promoting economic development within the context of African countries grappling with dictatorship. The findings and discussions within the study shed light on the intertwined relationship between development and democracy, positing them as twin elements crucial for the prosperity of African nations. The study underscores the importance of a nuanced understanding of democracy, moving beyond mere adherence to abstract political rights and periodic elections. Instead, democracy is conceptualized as a system wherein the rule of law and constitutionalism are firmly institutionalized, ensuring the protection of economic, social, and political rights. Moreover, genuine democracy entails active citizen participation in decision-making processes beyond the confines of electoral activities. Highlighting the missing links in the relationship between democracy and economic growth, the study identifies several critical factors. These include the character of the state, the nature of economic policies pursued, and external pressures such as debt burdens and the impact of globalization on investment and trade in less developed countries. By delineating these crucial dimensions, Adejumobi's study underscores the multifaceted nature of democracy and its implications for economic development in Africa. It emphasizes the need for comprehensive reforms that go beyond electoral processes to address broader governance challenges and promote inclusive growth. Ultimately, the study contributes valuable insights to the ongoing discourse on the nexus between democracy, governance, and economic development in the African context.

Smyth and Narayan (2009) conducted a comprehensive study to investigate the intricate relationship between defense expenditure and external debt, with a particular focus on the impact of income and defense expenditure on external debt dynamics. Their analysis centered on six Middle Eastern countries—Oman, Yemen, Syria, Jordan, Bahrain, and Iran—spanning the period from 1988 to 2002. Employing a panel data analysis approach, which encompassed a panel cointegration framework and panel unit root techniques, the researchers sought to unravel the nuanced dynamics underlying the defense expenditure-external debt nexus. The findings of the study yielded valuable insights into the long-term and short-term relationships between defense expenditure and external debt. In the long run, the study identified an elastic relationship between external debt and defense expenditure, suggesting that changes in defense spending have a substantial and lasting impact on the accumulation of external debt. However, in the short run, the relationship was characterized as inelastic, indicating that changes in defense expenditure have a less pronounced and immediate effect on external debt dynamics. One noteworthy finding of the study was the quantification of the impact of defense expenditure on external debt. Specifically, the researchers observed a 1.1% to 1.6% appreciation in external debt for every 1% increase in defense expenditure. This empirical evidence underscores the significance of defense spending as a driver of external debt accumulation in the Middle Eastern context. Overall, Smyth and Narayan's study contributes valuable insights into the complex interplay between defense expenditure and external debt dynamics in Middle Eastern countries. By shedding light on the elasticity of the relationship between these variables and quantifying their impact, the research provides policymakers and practitioners with valuable information for informed decision-making in fiscal and defense planning.

Arezki and Bruckner (2011) conducted a noteworthy study examining the effects of revenue windfalls resulting from booms in international commodity prices on external debt dynamics. Their research delved into the nuanced relationship between commodity price fluctuations, political regimes (democracies vs. autocracies), and the management of external debt. The key findings of the study unveiled intriguing insights into how different political regimes respond to revenue windfalls and their implications for external debt dynamics. In democracies, a rise in international prices of exported goods led to a significant decrease in external debt levels. This suggests that democratic governments tend to utilize revenue windfalls judiciously, potentially allocating surplus funds towards debt repayment or other debt-reducing measures. Conversely, in autocracies, no significant reduction in external debt was observed despite revenue windfalls from commodity price booms. This indicates a less prudent approach to managing windfall revenues, potentially leading to increased spending or less disciplined fiscal management practices. Furthermore, the study revealed contrasting trends in the risk of default on debt between democracies and autocracies in the context of commodity price booms. In democracies, the risk of default decreased significantly, reflecting the effective management of windfall revenues and improved fiscal stability. However, in autocracies, the risk of default on debt increased significantly, suggesting a higher susceptibility to fiscal mismanagement or misuse of windfall revenues. The study underscores the complex interplay between commodity price dynamics, political regimes, and external debt management. By highlighting the divergent responses of democracies and autocracies to revenue windfalls, the research offers valuable insights into the factors shaping fiscal policy and debt sustainability in different governance contexts. Such insights are crucial for policymakers and practitioners seeking to navigate the challenges of managing external debt amidst volatile commodity markets and political uncertainties.

In a separate research endeavor, Paleologou (2012) examined the impact of defense expenditure on the level of general government debt across 25 European Union countries over the period 1996-2009. Employing a panel data analysis methodology, the study utilized a dynamic GMM panel model (Generalized Method of Moments) to estimate the relationship between defense spending and government debt. The findings of the study revealed a significant positive impact of defense expenditures on general government debt across the European Union countries under investigation. This suggests that higher defense spending contributes to the accumulation of government debt, highlighting the fiscal implications of military expenditure in the European context.

In a related study, Ahmad (2012) delved into the relationship between external debt, defense expenditure, and economic performance in Sub-Saharan African countries. Utilizing a dataset encompassing 25 countries over the period 1998-2007, the research focused on examining the long-run elasticities between national output, external debt, and defense expenditure. The empirical results of Ahmad's study yielded noteworthy insights, indicating that a 1% increase in national output was associated with an average decrease of 1.52% in external debt. This underscores the importance of economic growth in mitigating external debt burdens in Sub-Saharan Africa. Furthermore, the findings underscored the importance of fiscal responsibility and rational spending practices, particularly advocating for reductions in defense expenditures to alleviate debt pressures and foster sustainable economic development. Overall, both studies contribute valuable insights into the complex dynamics between defense expenditure, government debt, and economic performance in different regional contexts. By shedding light on the fiscal implications of defense spending and offering policy recommendations for debt management and economic growth, these studies provide valuable guidance for policymakers and practitioners striving to navigate the challenges of fiscal sustainability and economic development.

Zaman, Shah, Khan, and Ahmad (2012) undertook a comprehensive analysis to discern the relationship between real military expenditure (RME), the level of economic activity (RGNP), and real external debt (RED). Employing the Johansen multivariate cointegration framework, the study aimed to unravel the dynamic interactions between these variables using time series data spanning the period from 1980 to 2008. The research delved into both short-term dynamics and long-term impacts of changes in RME and RGNP on real external debt (RED) within the context of Pakistan. By employing rigorous statistical techniques, the study sought to elucidate the nuanced relationship between defense expenditure, economic activity, and external debt. The findings of the study revealed compelling insights into the behavior of real external debt concerning defense expenditure and economic activity. In the long run, the study identified an elastic behavior of external debt with respect to defense expenditure, suggesting that changes in defense spending exert a significant and lasting impact on the accumulation of external debt over time. However, in the short run, the effect of defense expenditure on external debt was found to be statistically insignificant, indicating that changes in defense spending have a less immediate and pronounced impact on external debt dynamics. Overall, Zaman, Shah, Khan, and Ahmad's study contributes valuable insights into the complex relationship between defense expenditure, economic activity, and external debt in Pakistan. By shedding light on the long-term implications of defense spending on external debt accumulation, the research offers valuable guidance for policymakers and practitioners seeking to navigate the challenges of fiscal sustainability and debt management in Pakistan's context.

In his 2013 study, Bittencourt aimed to discern the primary determinants of external debt and government in South American countries. The research focused on all nine South American nations that underwent re-democratization over the past three decades, utilizing data spanning from 1970 to 2007. The study yielded insightful findings regarding the factors influencing external debt dynamics in the South American region. Notably, economic growth emerged as a key determinant, demonstrating its significant capacity to reduce debt levels across the studied countries. This underscores the crucial role of fostering an economic environment conducive to prosperity and growth in managing external debt effectively. Moreover, Bittencourt's research shed light on the nuanced nature of the relationship between external debt and various socio-economic factors. While factors such as inequality, inflation, and constraints on other variables are often considered pertinent in the South American context, the study found that their impact on external debt and government was not as clear-cut or as expected. This suggests the need for a more nuanced understanding of the complex dynamics at play in shaping external debt trajectories in the region. This study contributes valuable insights into the determinants of external debt and government in South American countries. By highlighting the significance of economic growth and the complex interplay of various socio-economic factors, the research offers valuable guidance for policymakers and practitioners seeking to navigate the challenges of managing external debt and promoting sustainable economic development in the region.

3. METHODOLOGY

Economic growth emerged as a key determinant, demonstrating its significant capacity to reduce debt levels across the studied countries (Bittencourt, 2013). This underscores the crucial role of fostering an economic environment conducive to prosperity and growth in managing external debt effectively. Moreover, Bittencourt's research shed light on the nuanced nature of the relationship between external debt and various socio-economic factors (Bittencourt, 2013). The model to be estimated is as follows:

ED=f(DE, PL)

ED = External debt stocks (% of GNI)

DE= Defense expenditure (% of GNI)

PL = PolityIV score

4. EMPIRICAL ANALYSIS

The table presents the results of unit root tests for different variables using various statistical methods. These tests are essential for determining the stationarity of time series data, which is crucial for many econometric analyses. For the variable ED (presumably representing Economic Development), the Levin, Lin, and Chu test statistic is -1.3459, indicating a lack of statistical significance at conventional levels. However, after differencing (ΔED), the test statistic becomes -5.01, which is highly significant at the 1% level. This suggests that ΔED is stationary, implying that the variable may exhibit a stable behavior over time after removing any trend or seasonality. Similarly, for the variable DE (possibly representing Domestic Economy), the initial test statistic is -3.010, significant at the 1% level. After differencing (ΔDE), the test statistic becomes -5.5096, again highly significant at the 1% level. This indicates that ΔDE is stationary, suggesting a stable behavior over time. The variable PL (likely representing Price Level) exhibits mixed results across different tests. The Levin, Lin, and Chu test yield a statistic of 1.7277, which is not statistically significant. However, both the Im, Pesaran, and Shin W-stat and Maddala and Wu-PP-Fisher $\chi 2$ tests show significant results for the differenced series (ΔPL), with test statistics of -1.6430 and 50.01, respectively. This suggests that ΔPL is stationary, indicating a stable price level over time. The results of these unit root tests provide important insights into the stationarity properties of the variables under consideration, helping ensure the validity of subsequent econometric analyses and model specifications.

Table 1: Unit Root Tests

	ED	ΔED	DE	ΔDE	PL	ΔPL
	Statistic	Statistic	Statistic	Statistic	Statistic	Statistic
Levin, Lin and Chu	-1.3459^{*}	-5.01^{***}	-3.010^{***}	-5.5096^{***}	1.7277	1.5713
Im, Pesaran and Shin W-stat	-0.7936	-6.09^{***}	-1.5954^{*}	-4.8121^{***}	-1.6430^{*}	-8.1603^{***}
Maddala and Wu-ADF-Fisher χ^2	10.7261	57.08^{***}	15.7550	43.4924^{***}	15.5222	72.455^{***}
Maddala and Wu-PP-Fisher χ^2	10.2497	113.4^{***}	19.6416^{**}	57.3010^{***}	50.01^{***}	89.634^{***}

The table presents the results of cointegration analysis with ED (presumably Economic Development) as the dependent variable, employing three different estimation techniques: Mean Group (MG), Dynamic Fixed Effects (DFE), and Pooled Mean Group (PMG). In the long-run parameters section, the coefficient estimates and associated p-values for the variables DE (Domestic Economy) and PL (Price Level) are reported. For DE, the coefficient estimates are -1.7909 (MG), 0.2133 (DFE), and 0.8110 (PMG), with corresponding p-values of 0.206, 0.440, and 0.004, respectively. These coefficients indicate the long-term relationship between Economic Development and Domestic Economy. Similarly, for PL, the coefficients vary across the estimation techniques, with associated p-values suggesting different levels of significance. The table also provides information on the average convergence parameter (Error Correction Term, φi), which measures the speed of adjustment towards equilibrium following a shock to the system. The φi estimates are -0.0714 (MG), -0.1020 (DFE), and -0.0724 (PMG), with corresponding p-values indicating the statistical significance of these parameters. In the short-run parameters section, the table reports the coefficient estimates and associated p-values for the first differences (Δ) of DE and PL. These coefficients represent the short-term impact of changes in Domestic Economy and Price Level on Economic Development. The p-values provide insights into the significance of these relationships. Additionally, intercept terms are included in the analysis, representing the constant term in the regression models. The coefficients and p-values for the intercept terms are reported for each estimation technique. The table presents comprehensive results of cointegration analysis, offering insights into the long-run and short-run relationships between Economic Development, Domestic Economy, and Price Level, as well as the speed of adjustment towards equilibrium in response to shocks.

Table 2: Cointegration Results with ED as dependent variable

	Mean Group (MG)		Dynamic Fixed Effects (DFE)		Pooled Mean Group(PMG)	
	Coefficient	p-value	Coefficient	p-value	Coefficient	p-value
			Long Run Parameters			
DE	-1.7909 (-1.27)	0.206	0.2133 (0.77)	0.440	0.8110 (2.91)	0.004
PL	-0.1188 (-0.38)	0.705	-0.0605 (-1.03)	0.303	-0.1552 (-1.80)	0.071
			Average Convergence Parameter			
Error Correction Term (φ_i)	-0.0714 (-2.70)	0.007	-0.1020 (-3.57)	0.000	-0.0724 (-2.03)	0.042
			Short Run Parameters			
ΔDE	-0.1169 (-1.18)	0.239	-0.0848 (-0.83)	0.405	-0.1274 (-0.96)	0.337
ΔPL	-0.0803 (-1.32)	0.188	0.0252 (7.29)	0.000	-0.0972 (-1.39)	0.165
Intercept	0.2893 (0.92)	0.360	0.0274 (0.90)	0.366	0.0398 (0.68)	0.494

Note: In parenthesis, z statistics are given.

5. CONCLUSIONS

The study examines the interplay between defense expenditures, democracy, and external debt using data from five South Asian countries spanning the period from 1972 to 2017. The findings reveal intriguing relationships among these variables, offering valuable insights for policymakers. Firstly, the study uncovers a positive relationship between defense expenditures and external debt in the long run. This suggests that higher defense spending tends to be associated with increased external debt levels over time. Conversely, a negative relationship is observed between democracy and external debt, indicating that stronger democratic institutions are linked to lower levels of external indebtedness. This finding aligns with existing research highlighting the role of democracy in promoting fiscal responsibility and debt management. In light of these findings, policymakers are urged to prioritize efforts to strengthen democratic governance, recognizing its potential to mitigate external debt burdens. By fostering transparency, accountability, and effective governance mechanisms, policymakers can create an environment conducive to fiscal discipline and debt sustainability. Furthermore, the study underscores the importance of addressing defense expenditures as a means to reduce external debt. The findings suggest that South Asian countries stand to benefit from curbing defense spending, potentially leading to lower levels of external indebtedness. This highlights the need for strategic allocation of resources and prudent fiscal management practices to achieve debt sustainability objectives. In conclusion, the study offers valuable guidance for policymakers in South Asian countries, emphasizing the importance of strengthening democracy and reevaluating defense spending priorities to mitigate external debt risks and foster long-term economic stability and growth. By implementing targeted reforms and adopting sound fiscal policies, policymakers can work towards achieving sustainable debt management and promoting overall economic prosperity in the region.

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