This Study comparatively analyzes the impact of external debt on economic growth of Pakistan and Malaysia from 1970 to 2010. In order to examine the linear and non linear impact of debt on economic growth, the New Classical Growth Model is used by incorporating debt indicators like debt to GDP, debt servicing to GDP and debt servicing to exports and some macroeconomic variables including, growth rate of exports (^Exp/Exp), growth rate of Investment stock (GCAP), investment to output ratio (RGFI/RGDP) and Terms of Trade (TOT). The Econometric technique of Ordinary Least Square (OLS) is used in order to estimate the models.

The results of the study show the non- linear impact of external debt on economic growth of Pakistan and Malaysia. On the other hand, the macroeconomic variables like growth rate of exports, growth rate of investment (Gross investment) and Investment to GDP (Domestic resources) have shown positive and significant impact on economic growth rate of both countries. This indicates that these macroeconomic variables are playing their important role for enhancing the economic growth. The negative and significant impact of debt to GDP and debt servicing to exports ratio with investment output ratio confirms the Debt Overhang and Liquidity Constraint Hypothesis for Pakistan and Malaysia. But overall results for Malaysia are better than Pakistan which shows the better allocation and management of debt.

The study suggests some policy implication for Pakistan for better management of debt, through coordination in macroeconomic policies, reduction in fiscal deficit and current account deficit, proper allocation and management of debt and by enhancing the role of private sector.