IMPACT OF GOVERNMENT FISCAL POLICY ON ECONOMIC GROWH AND STABILITY

A dissertation submitted to the Office of the Dean, Faculty of Management in partial fulfillment of the Requirement for the Master's Degree

By

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CERTIFICATION OF AUTHORSHIP

I hereby corroborate that I have researched and submitted the final draft of dissertation entitled **"IMPACT OF GOVERNMENT FISCAL POLICY ON ECONOMIC GROWH AND STABILITY"**. The work of this dissertation has not been submitted previously for the purpose of conferral of any degree nor has it been proposed and presented as part of requirements for any other academic purposes. The assistance and cooperation that I have received during this research work has been acknowledged. In addition, I declared that all information sources and literature used are cited in the reference section of the dissertation.

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Lokendra Bahadur Bhandari

August, 2024

REPORT OF RESEARCH COMMITTEE

Mr. Lokendra Bahadur Bhandari has defended research proposal entitled **"IMPACT OF GOVERNMENT FISCAL POLICY ON ECONOMIC GROWH AND STABILITY"** successfully. The research committee has registered the dissertation for further progress. It is recommended to carry out the work as per suggestions and guidance of supervisor Joginder Goet and submit the thesis for evaluation and viva voce examination.

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APPROVAL SHEET

We have examined the dissertation entitled **"IMPACT OF GOVERNMENT FISCAL POLICY ON ECONOMIC GROWH AND STABILITY "** presented by Mr. Lokendra Bahadur Bhandari for the degree of Masters of Business Studies. We hereby certify that the dissertation is acceptable for the award of degree.

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ABBREVIATIONS

GDP	Gross Domestic Product
GE	Government Expenditure
FDI	Foreign Direct Investment
TR	Tax Revenue
BD	Budget Deficit
PD	Public Debt
SD	Standard Deviation
CV	Coefficient of Variation

ABSTRACT

This thesis explores the impact of government fiscal policy on economic growth and stability in Nepal, focusing on government expenditure, foreign direct investment (FDI), tax revenue, budget deficit, and public debt over the period from 2003/04 to 2022/23. Utilizing descriptive and causal-comparative research designs, the study applies descriptive statistics, correlation analysis, and regression analysis to assess the relationships between these fiscal variables and GDP. The analysis reveals a moderate positive correlation between government expenditure and GDP ($r = 0.581$, $p < 0.01$) and a strong positive correlation between tax revenue and GDP ($r = 0.700$, $p < 0.01$), indicating that higher government spending and tax revenues are associated with increased economic growth.

The regression analysis highlights that government expenditure has a marginally significant positive effect on GDP (coefficient = 0.232658, $p = 0.08641$), suggesting a potential but not strongly significant contribution to economic growth. In contrast, FDI and tax revenue do not show statistically significant effects on GDP, while the budget deficit also lacks a significant impact. Public debt is found to have a statistically significant negative effect on GDP (coefficient = -0.09929, $p = 0.046671$), indicating that higher levels of public debt are associated with lower economic growth.

Overall, the study underscores that government expenditure and public debt are significant factors influencing GDP growth in Nepal, while the effects of FDI, tax revenue, and the budget deficit are less pronounced. The findings emphasize the need for effective fiscal management and a balanced approach to spending and debt to support sustainable economic growth. Future research could further investigate the mechanisms through which these variables affect GDP and explore additional factors that may influence economic performance.

***Key words**: Fiscal Policy, Economic Growth, Government Expenditure, Foreign Direct Investment, Tax Revenue, Budget Deficit and Public debt.*

CHAPTER-I

INTRODUCTION

1.1 Background of the Study

The primary objective of fiscal policy is to stimulate economic and social growth by implementing policies that balance taxation, expenditure, and borrowing in a manner that promotes sustainable economic development and growth (Ocran, 2009). The principles of fiscal policy are rooted in the theories of John Maynard Keynes, who argued that adjustments in government revenue (taxes) and expenditure levels have significant impacts on inflation, employment, and overall economic activity.

Before the Great Depression of the 1930s, there was minimal government involvement in economic matters on a global scale. However, the years that followed, especially with the emergence of Keynesian economics, marked a shift towards recognizing the importance of aggregate demand, leading to increased government intervention to stabilize output and employment. This trend was particularly evident in developing countries, where governments began to play a more active role in reducing poverty and promoting economic growth and stability. These governments focused on correcting market inefficiencies and implementing measures to encourage investment and, in some cases, expand public sector production.

Fiscal policy is essential for promoting socio-economic activities and economic growth, particularly in developing countries (Jones, 1995; Mehrotra & Peltonen, 2005). However, despite policy efforts aimed at achieving high and sustainable economic growth, Nepal's economy remains trapped in a cycle of low growth. This raises important questions about whether public expenditure effectively accelerates economic growth. It is also crucial to evaluate the trade-offs between fiscal stability and achieving high levels of economic growth, as attaining both simultaneously may be challenging. In the context of Nepal, these issues have been largely unexplored, and theoretical literature presents mixed views on the relationship between fiscal policy and economic growth (Kharel, 2012).

Governments worldwide develop and implement policies concerning taxation and public spending, with the primary aim of accelerating economic and social development. There are two predominant perspectives on the role of government fiscal policy in fostering

economic growth and development. Keynesian and endogenous growth theories advocate that fiscal policy can be instrumental in promoting economic growth. In contrast, classical and neoclassical theories argue that governments, being inherently bureaucratic and inefficient, are more likely to impede rather than facilitate economic growth (Ocran, 2009).

The Solow-Swan neoclassical growth model (1956) posits that government policy has no long-term impact on economic growth. On the other hand, endogenous growth models acknowledge the influence of fiscal policy, recognizing that some fiscal measures may hinder economic growth, while others may support it (Barro, 1992). Traditional Keynesian economics suggests that public expenditure, including both capital and recurrent spending, positively contributes to economic growth and private investment. Keynesian theory argues that increased government expenditure boosts aggregate demand, leading to higher output, depending on the size and effectiveness of the expenditure multiplier. Conversely, the Ricardian Equivalence theory asserts that an increase in government spending, matched by an equivalent rise in private savings, has no significant impact on private investment and economic growth (Romer, 1989).

Empirical research by Kraay and Severn (2008) indicates that the impact of expansionary fiscal policy on economic growth is generally smaller in developing countries than in developed nations. However, these researchers also identify varying degrees of effectiveness of fiscal policy in the short and long term, influencing aggregate demand and output in developing countries.

The public budget, encompassing the budgets of central and local governments as well as social insurance, serves three primary functions: allocation, redistribution, and stabilization. These functions are closely interrelated (Buiter, 1990), but fiscal policy typically focuses on the stabilization function. Fiscal policy involves making decisions or setting rules regarding taxes and government spending to manage the economy's fluctuations and prevent high unemployment, inflation, or deflation (Samuelson, 1948). Fiscal policy outlines the government's sources of income, such as taxes, social insurance contributions, and the sale or disposal of public assets, and how this income will be allocated to various activities, including defense, education, and social and foreign policy. While fiscal policies are crafted by different levels of government, from local to central, the central government usually handles the stabilization function (Bénassy et al., 2010).

This study aims to provide insights into how fiscal policies have influenced economic growth in Nepal during the studied period. Both state and federal governments will gain a deeper understanding of the impact of fiscal policies on economic growth, enabling them to identify measures that could enhance growth. Additionally, academics and researchers will benefit from the theoretical and empirical evidence on the relationship between fiscal policies and economic growth and stability.

Numerous studies suggest that government spending may impede economic growth, particularly in developing countries like Nepal. This is because a significant portion of public funds is often allocated to non-productive areas such as defense and debt repayment, rather than to investments that foster development (Ul Husnain et al., 2011). Based on this, the research question for this study is: Does government expenditure, tax revenue, public debt, FDI, and gross capital formation affect economic growth in Nepal?

1.2 Problem Statement

Fiscal policy plays a crucial role in shaping government plans in Nepal. The levels of government spending, taxation, budget deficits, FDI, and public debt are largely influenced by the government's objectives and strategic plans. For instance, to achieve optimal economic growth, the government may increase its investment spending on infrastructure and provide subsidies to the private sector. Similarly, the government can address unemployment, stabilize the economy, and reduce poverty by implementing appropriate fiscal policy measures.

The composition of government spending and taxation in Nepal is becoming increasingly complex, reflecting a broadening selection and combination of fiscal policy variables. This complexity requires careful identification and assessment of the impact of these variables on the economy, as well as their alignment with the government's overall objectives. Policymakers face the challenge of understanding the individual and collective impacts of these fiscal variables to ensure they effectively contribute to the desired outcomes. By understanding the effects of government spending, taxation, FDI, budget deficits, and public debt on the economy, we can better inform the redirection of fiscal policies to promote economic growth and development.

In Nepal, various studies have examined the impact of fiscal policy on economic growth and stability. For example, Phullel (2023) found that gross capital formation and public debt had a significant and positive effect on economic growth in South Asian countries, while tax revenue had a significant but negative effect. Government expenditure was found to have a positive but insignificant effect on economic growth. Upadhyaya and Pun (2023) concluded that there is no significant causal relationship between public debt and economic growth in Nepal. Kadel (2021) identified a long-run relationship between the budget deficit and economic growth, while Pokharel and Pokharel (2019) found a positive and significant relationship between GDP and FDI, suggesting that policymakers should focus on attracting more foreign direct investment. Mahara (2021) highlighted a significant long-run positive relationship between capital expenditure and economic growth. These findings offer valuable insights for policymakers.

The primary goal of this research is to investigate the impact of government fiscal policy on economic growth and stability. Consequently, the following research question has been developed. What is the position of government expenditure, foreign direct investment, tax revenue, deficit budget, public debt and economic growth and stability in Nepal?

1. Is there any relationship between government expenditure, foreign direct investment, tax revenue, deficit budget and public debt on economic growth and stability in Nepal?
2. Do government expenditure, foreign direct investment, tax revenue, deficit budget and public debt impact on economic growth and stability in Nepal?

1.3 Objectives of the Study

The general objective of the study is to assess the impact of the fiscal policy on economic growth and stability in Nepal for the period 2004-2023. The specific objectives are:

1. To assess the position of government expenditure, foreign direct investment, tax revenue, budget deficit, public debt, and economic growth and stability in Nepal.
2. To examine the relationship between government expenditure, foreign direct investment, tax revenue, deficit budget and public debt on economic growth and stability in Nepal.

3. To analyze the impact of government expenditure, foreign direct investment, tax revenue, deficit budget and public debt on economic growth and stability in Nepal.

1.4 Research Hypothesis

Based on review following alternative hypothesis will be drawn out.

H1: There is a significant effect of Tax revenue on economic growth and stability.

H2: There is a significant effect of Governments expenditure on economic growth and stability.

H3: There is a significant effect of public debt on economic growth and stability.

H4: There is a significant effect of deficit budget on economic growth and stability.

H5: There is a significant effect of FDI on economic growth and stability.

1.5 Rationale of the Study

This study is important because it highlights the critical role that well-designed government expenditure and tax policies play in fostering economic growth and stability in Nepal. While public spending and taxation are widely discussed topics in both developed and developing countries, Nepal has yet to fully capitalize on the potential benefits of fiscal policy to stimulate economic growth and stability. This research aims to fill this gap by providing empirical evidence specifically focused on the Nepalese context, thereby contributing to the existing literature on this topic with a particular emphasis on Nepal.

The study also seeks to assist policymakers in designing growth-oriented programs and implementing fiscal changes that enhance economic growth. The need for this type of knowledge in decision-making is of great importance, especially as one of the government's current priorities is to promote and sustain economic growth. Additionally, the study aims to provide insights into Nepal’s past fiscal experiences and explore the lessons that can be learned from previous economic performance.

One of the key factors extensively studied in the literature is the impact of government expenditure on economic growth. Several studies, such as Dangal and Gajurel (2021), have found a positive relationship between government expenditure and economic growth.

However, other research, including Makhoba et al. (2019), indicates a negative long-term relationship between government spending and economic growth.

Another significant factor examined in the literature is the impact of public debt on economic growth and stability. Some studies, such as Makhoba et al. (2019), have shown that public debt has a negative long-term relationship with economic growth. Conversely, other research, such as Shrestha (2023), suggests that both internal and external debt positively impact economic growth in Nepal in the short and long run.

The effect of tax revenue on economic growth and stability has also been studied, with some research, like Phullel (2023), indicating a significant but negative effect on economic growth. However, other studies, such as Kharel (2021), report that tax revenue positively and significantly affects GDP.

The relationship between FDI and economic growth and stability has similarly been the focus of numerous studies. While some research has found a positive and significant relationship between GDP and FDI, other studies, such as Khanal (2022), have confirmed no short-run relationship or unidirectional causal link between FDI and economic growth in Nepal.

Lastly, the impact of the budget deficit on economic growth and stability has been examined, with findings like those of Kadel (2021) indicating a significant long-term relationship between the budget deficit and GDP. However, other studies, such as Nayab (2015), show that the budget deficit positively impacts economic growth.

1.6 Limitations of the Study

One of the common challenges encountered in research, especially in developing nations like Nepal, is the scarcity of reliable data. Due to the lack of comprehensive datasets from a single source, researchers often have to gather information from multiple outlets, which can lead to inconsistencies. This situation often necessitates the use of a relatively limited sample size for analysis.

While the model used in this study demonstrated accurate specification and significant predictive capabilities, the study does not claim that fiscal policies alone can drive economic growth. It is clear that when fiscal measures are combined with other strategies,

their prudent application holds considerable potential for accelerating economic growth in Nepal.

Studying the impact of government spending on economic growth and stability is challenging because the real-world context is highly complex. Although the study examines critical factors such as government spending, taxation, foreign investment, debt, budget deficits, and the broader economy, it may not fully capture the interactions between these variables. Additionally, the study might overlook unexpected events or external factors that could influence how government policies affect the economy. Moreover, obtaining high-quality data is particularly challenging in countries like Nepal. These challenges suggest that the study's findings may have limited generalizability and should be applied cautiously in policy-making.

CHAPTER-II

LITERATURE REVIEW

This chapter delves into the essential definitions, concepts, and theories that explore the impact of fiscal policy on economic growth. It also reviews several empirical studies that have investigated the influence of various fiscal policy variables on economic growth.

2.1 Conceptual Review

Economic growth

Economic growth can be understood as the enhancement of a nation's capacity to produce goods and services that satisfy the desires of its population (Peterson, 1988). Similarly, Todaro and Smith (2003) described economic growth as the continuous process through which the economy's productive capacity increases over time, leading to rising levels of national output and income. According to Gillis et al. (1987), economic growth also refers to an increase in national or per-capita income and production, where per-capita income is measured by dividing the gross national product (GNP)—the total value of all goods and services produced within a country in a year—by the population.

However, Kuznets (1974) argued that economic growth should not be narrowly defined by changes in output or income levels alone but should also encompass significant structural transformations and corresponding social and institutional changes necessary to sustain increases in output or income. He defined economic growth as the long-term rise in a country's capacity to provide an increasingly diverse range of economic goods to its population, driven by technological advancements and the necessary institutional and ideological adjustments.

According to Bowden (1992), a nation's economic growth depends largely on the development and organization of a more efficient labor force (including better utilization of labor, education, attitudes, and skills) and the accumulation of better capital (such as constructing power plants, factories, and acquiring or importing advanced machinery and equipment). Traditionally, economic growth has three main components: capital accumulation, labor force growth, and technological improvements. Capital accumulation involves increasing the stock of capital in an economy, labor force growth generally occurs

as the population increases, and technological improvements involve the application of new scientific knowledge through inventions and innovations in both physical and human capital.

In academic literature, the terms "economic growth" and "economic development" are often used interchangeably, but it is crucial to distinguish between the two because they represent different concepts. Economic growth typically refers to an increase in output, whereas economic development involves a broader process that includes significant changes in social structures, popular attitudes, and national institutions, as well as the acceleration of economic growth, reduction of inequality, and eradication of absolute poverty (Todaro, 1992). Therefore, economic growth can be considered a component of economic development.

Fiscal Policy

Fiscal policy refers to the use of government expenditures and taxation to influence macroeconomic outcomes. Virtually all economic activities are directly or indirectly impacted by government fiscal policies. Fiscal policy serves several essential functions necessary for the smooth operation of the economy. The three main functions, often discussed, include:

First, the government's fiscal activities play a crucial role in correcting market failures and promoting efficiency. The government achieves this by distributing and allocating budgetary spending and taxes in a manner that fosters efficiency while serving society's best interests.

Second, changes in government expenditures and taxes affect macroeconomic variables within the economy, and fiscal policy instruments can be adjusted to stabilize the economy. However, these instruments are inherently volatile and can also contribute to macroeconomic fluctuations.

Lastly, through its fiscal policies, the government aims to reduce income disparities between households and regions by implementing progressive taxes, providing subsidies, etc. In summary, fiscal policy allows the government to promote macroeconomic stability and economic growth while encouraging efficiency and equity.

To fully comprehend the role of fiscal policy, it is necessary to consider the government’s budget and its implications for the economy. The government budget, or simply the budget,

is a plan for spending funds and generating revenue through taxation, fees, and other means, with the possibility of borrowing if necessary (Hyman, 1994). Government spending encompasses all budgetary outlays, including recurrent expenditures like civil service salaries, maintenance, military costs, interest payments, and subsidies for public enterprise losses, as well as capital expenditures like the construction of infrastructure, such as roads, schools, and the purchase of non-military equipment (Gillis et al., 1987).

In Nepal, government expenditures are categorized into capital expenditures and recurrent expenditures. Capital expenditures cover spending on items with long-term utility, such as buildings, bridges, roads, schools, dams, electricity, and healthcare. Recurrent expenditures are those incurred at regular intervals or within a particular year, including wages and salaries, interest payments on loans, defense expenses, and government consumption.

On the revenue side, government income is classified into tax and non-tax revenue. Taxes are the most important revenue source for the government in Nepal. They are paid by the public to enable the government to fund certain expenses in the common interest of society, without providing any direct benefit to the taxpayer in return. Tax revenue is used to finance investments in infrastructure, education, health, agriculture, and other areas, yielding social and economic benefits for the country. By expanding opportunities and benefits for the population, taxes play a vital role in promoting economic growth and development. Taxes are further divided into direct and indirect taxes: direct taxes are levied on individuals, corporations, and property, while indirect taxes are imposed on goods and services. Non-tax revenue includes fees, fines, penalties, gifts, royalties, loans, grants, sales of government property, and profits from government enterprises.

The difference between total government expenditures and revenues is known as the budget balance. Three scenarios can arise concerning the relationship between government expenditures and revenues: a balanced budget occurs when revenues equal expenditures, a budget surplus occurs when revenues exceed expenditures, and a budget deficit occurs when expenditures exceed revenues.

2.2 Theoretical Review

Barro (1997) highlights that various theories have been developed to analyze how fiscal policy can be utilized to achieve economic growth. Each theory offers different

perspectives and conclusions regarding the impact of fiscal policy on economic growth. This section focuses on three primary theories: the Neoclassical, Keynesian, and Ricardian equivalence approaches.

Keyne's Theory

John Maynard Keynes (often referred to as Lord Keynes) introduced a groundbreaking theoretical framework on fiscal policy in 1936, during a period of severe global economic distress resulting from the Great Depression of 1929. The unemployment rate exceeded 22%, and the gap between actual and potential output widened significantly in both Europe and the United States (Barro, 1997). In this economic context, Keynes proposed that to revive the economy, governments should increase their spending and reduce taxation levels. Notably, Keynes identified gross domestic product (GDP) as being determined by aggregate demand in the short run. He argued that economic recessions or depressions were primarily due to declining demand relative to the economy's productive capacity, and that the solution lay in stimulating demand. Blinder and Solow (2005) support this view, suggesting that increased consumption positively impacts the economy.

At that time, Keynes's ideas were considered unorthodox, as the prevailing belief was that market forces alone would restore economic equilibrium without government intervention. However, Keynes contended that even with sufficient productive capacity, an economy could suffer from high unemployment if aggregate demand was inadequate. According to Keynesian thought, insufficient demand leads to poor business performance and declining profits, prompting firms to reduce production and lay off workers. This situation creates a vicious cycle of declining demand, falling profits, and rising unemployment (Fazzari et al., 1998). Keynes further argued that monetary policy would be ineffective in lifting an economy out of a depression because interest rates, already near zero during such periods, would be caught in a liquidity trap (Hassett & Hubbard, 2002).

To address these economic challenges, Keynes advocated for running a fiscal deficit. He argued that increased government spending would not only directly boost demand but would also trigger a ripple effect, leading to further demand from suppliers and workers whose incomes would rise as a result of government expenditure (Saleh, 2003). Saleh (2003) also noted that Keynesians believe that cutting taxes would increase disposable income for consumers, thereby stimulating demand.

The Keynesian general model of the macroeconomy demonstrates that better economic outcomes can be achieved by applying the aforementioned strategies, including running fiscal deficits. One key result of this model is the multiplier effect of changes in government taxation and spending. By reducing taxes and increasing government spending, national income initially rises by the amount of the deficit, and the Keynesian multiplier further amplifies this effect (Steytler & Powell, 2010).

The Keynesian multiplier suggests that if government expenditure increases by a certain amount, the national income will eventually increase by more than that amount due to the multiplier effect. Thus, the necessary increase in fiscal deficit does not need to match the existing output gap directly; instead, it can be sufficient to cover the gap when considering the multiplier's secondary effects. This also implies that stimulating consumption and national income should lead to increased investment, known as the investment accelerator (Gaber, 2010). Ultimately, the fiscal deficit would enhance capacity utilization and smooth out the business cycle.

Keynesianism operates under several assumptions. One is the existence of surplus production capacity and unemployed labor. Another is that a large portion of the population faces liquidity constraints (Dwivedi, 2010). The first assumption implies underutilization of capacity and a negative output gap in the economy. The second assumption suggests that people can quickly increase their demand in response to short-term tax cuts or increased government spending. When an economy operates below its potential, Keynesians argue that implementing fiscal deficits is an ideal strategy for stabilizing economic growth (Fatas & Mihov, 2009).

Neoclassical Theory

The neoclassical theory posits that fiscal deficits negatively impact economic growth. This view was notably advanced by Diamond (1965), who conducted a seminal study supporting the neoclassical perspective. The central argument is that fiscal deficits lead to higher interest rates, which in turn hinder capital accumulation. This theory has been further developed by several scholars, including Taylor (2009).

The neoclassical argument is closely aligned with the analysis of the IS-LM model, which suggests that output expansion resulting from a fiscal deficit increases the demand for

money. If the money supply is fixed, this increased demand drives up interest rates, leading to a reduction in capital accumulation, particularly in private investment. As a consequence, this decrease in investment counteracts the Keynesian multiplier effect, ultimately lowering overall output (Taylor, 2009).

Like the Keynesian theory, the neoclassical approach is based on certain assumptions. It assumes that consumers are rational, forward-looking, and have access to capital markets. Given these assumptions, it is argued that consumers are unlikely to significantly increase their consumption in response to higher government spending or tax cuts. Therefore, fiscal deficits may not effectively stimulate economic activity. Bernheim (1989) argues that under these assumptions, fiscal deficits have little to no effect on interest rates, consumption, or private investment.

According to neoclassical theory, the preferred solution for smoothing business cycles is to allow market forces to operate freely what is often referred to as the "invisible hand" rather than relying on government intervention through fiscal deficits. Bernheim (1989) and Taylor (2009) emphasize that the self-adjustment of wages and prices can help restore an economy to its optimal equilibrium. The theory suggests that if a negative output gap arises due to a departure from equilibrium, market forces will drive wages down and reduce production costs for suppliers. This reduction in costs would lead to increased output, thereby closing the output gap without the need for government intervention.

Endogenous Growth Models.

The neoclassical growth model, despite incorporating endogenous saving rates, falls short in addressing the intricate relationship between long-term economic growth and macroeconomic policy. Recent endogenous growth models offer a more nuanced analysis of this relationship, focusing on the interactions between government budgetary policies and economic growth (Barro, 1990; Jones & Manuelli, 1990; King & Rebelo, 1990; Rebelo, 1991; Turnovsky, 1996, 1999, 2000, 2004). These models explore both first-best and second-best fiscal policies.

In a decentralized economy framework with endogenous growth, government finances are sourced from various taxes. The equilibrium growth rate in this model is determined by maximizing the representative agent’s lifetime utility, subject to constraints from after-tax

resources and profit-maximizing behavior of firms. Given that public expenditures and taxation create externalities, the optimal choices for consumption and savings are not Pareto efficient and thus represent a second-best solution. Studies in this domain focus on identifying second-best fiscal policies, which are designed to maximize social welfare within the constraints of a decentralized economy.

Conversely, in a centrally planned economy, a social planner controls all economic resources and seeks to maximize overall social welfare, or the aggregated lifetime utility of the population. The growth rate in such a model is not distorted, representing a first-best solution. Fiscal policies that achieve this first-best outcome are termed first-best fiscal policies.

Among these endogenous growth models, King and Rebelo (1990) explored a calibrated economy where government tax revenues are used exclusively for lump-sum transfers. Barro (1990) differentiated between two scenarios: one where government spending solely enhances productivity and another where it improves both productivity and utility. This study includes public services as inputs in the production function, illustrating how public services contribute positively to economic growth, while higher tax rates have a distortionary effect that can impede growth. Typically, smaller government sizes have a growth-enhancing effect, whereas larger sizes can be growth-retarding. The study found that maximizing welfare for a Cobb-Douglas production function aligns with maximizing the growth rate. Whether using proportional income tax or lump-sum tax, growth remains balanced without transitional dynamics. Government use of proportional income taxes to finance productive spending (excluding public services) leads to higher growth rates in a decentralized economy.

Turnovsky's contributions in this field are significant, analyzing various fiscal policy rules within closed and open economy frameworks with fixed labor supply. He addresses an infinitely lived representative household and examines how different fiscal policy shocks affect endogenous growth rates (Turnovsky, 1996, 1999, 2000, 2004). The studies suggest that fiscal policy measures replicating the first-best solution in a decentralized economy are optimal. Turnovsky also explores how investing in foreign assets allows differential equilibrium growth rates for consumption and capital in an open economy with fixed labor supply. In closed or open economies with inelastic labor supply, fiscal policy changes have minimal impact on restoring equilibrium or maintaining balanced growth. His research

indicates that productive government expenditure and capital tax rate changes influence steady-state growth rates in closed economies, but these effects vary in open economies with fixed labor supply. For small, anti-autarkic economies with elastic labor supply, fiscal policy changes have limited long-term impact on capital and output growth rates.

2.3 Empirical Review

Many empirical researches have been carried out to identify the impact of government fiscal policy on economic growth and stability in various nations. Several studies conducted over various time frames. Below, several recent studies on the impact of government fiscal policy on economic growth and stability have been evaluated.

Gara et al. (2024) studied the analysis of social variables such as government spending, income from taxes, public debt, government effectiveness, fiscal freedom, rule of law index, and corruption in economic growth. They analyzed these factors using different statistical methods (OLS, OLS Robust fixed and random effects models, and GMM (Generalized Method of Moments)) and found that fiscal policies generally helped boost economic growth in these countries. Additionally, factors such as government effectiveness, rule of law, and corruption also played significant roles. The findings suggested for policymakers in the region to focus on implementing strong fiscal policies to encourage economic growth.

Aisyah et al. (2024) analyzed the impact of aggregate government spending using library data collection methods and found a close relationship between fiscal policy and economic growth in Indonesia.

Leghari (2023) investigated the role of economic governance in the partnership between public expenditure, private investment, and economic development using Johansen cointegration, error correction test, and Impulse Response Function methods. The study's results indicated that fiscal instruments and economic development in Pakistan had a significant long-term and short-term relationship. Furthermore, the impulse response indicated that when direct taxes were higher than GDP, both productive and unproductive expenses grew. Some unproductive investments were also found to have paved the path for economic development.

Al-Kasasbeh (2023) analyzed the research conducted on fiscal policies and economic growth, noting three tools of fiscal policy: government expenditure, taxation, and debt. The study used a theoretical and empirical review method and found that the effect of fiscal policy on economic growth was not constant. It varied depending on heterogeneous factors such as the research methodology used, the level of development of the sampled countries, the relative size of the public sector, institutional quality, the composition of the economy, and the selected control variables, among others.

Parmar (2023) investigated the influence of government fiscal policy on economic growth using fixed-effects regression analysis. The researcher found a relationship between government spending, taxation, and economic growth. The findings suggested that fiscal policy could have both positive and negative effects on economic growth, depending on its composition and timing.

Tanchev and Mose (2023) studied to estimate the impact of macroeconomic variables such as tax revenue, government expenditure, and public debt on the economic development of 28 European countries. They used the Ordinary Least Squares (OLS) method and found that an increase in government expenditure and tax revenue led to an increase in economic growth in these countries. However, higher rates of public debt led to a decrease in economic growth. From the standpoint of fiscal policy, the study concluded that Keynesian theory was evident in the 28 EU countries.

Dhungel (2022) studied the effects of public spending on Nepalese GDP growth from the fiscal year 1990/91 to 2019/20 using the Ordinary Least Squares (OLS) method. The study found that community expenditure in the health and education sectors led to an uplift in human capital, which ultimately had a positive influence on the economic growth of the country. Government spending in agriculture, education, health, transportation, and communication all showed favorable effects on Nepal's GDP growth.

Mengistu (2022) studied to give an overview of the recent discussion and establish a point of departure for future research using time series techniques and a rigorous empirical model. The study found a long-run relationship between the variables examined. By disaggregating government expenditure into productive and unproductive categories, and tax revenue into distortionary and non-distortionary types, it was found that unproductive expenditure and non-distortionary tax revenue had a neutral effect on growth, consistent

with economic theory predictions. Additionally, productive expenditure was found to have a positive effect on growth, while there was evidence of distortionary effects from distortionary taxes on growth

Nuru and Gereziher (2021) investigated the short-run and long-run asymmetric effects of fiscal policy, specifically government spending, on economic growth over the sample period from 2004Q2 to 2018Q1 for the South African economy. Using the Nonlinear Autoregressive Distributive Lag (NARDL) model, the study found that the negative change effect of government spending was greater than the positive change effect on economic growth. Additionally, the real effective exchange rate was found to have a positive and significant effect on economic growth both in the short run and long run. In contrast, the inflation rate was found to affect economic growth negatively and significantly in both the short run and long run.

Dangal and Gajurel (2021) studied to evaluate the trends of public expenditure and to show the relationship between public expenditure and economic growth in Nepal. The study employed charts, correlation analysis, and regression using time series datasets. It was found that there was a positive correlation between dependent variables and predictors. The results of the regression also confirmed a positive relationship between public expenditure and economic growth in Nepal. Specifically, healthcare expenditure (HE) and transportation and communication expenditure (TCE) had a negative relationship with real GDP (RGDP).

Mohsin et al. (2021) studied the relationship between external debt and economic growth in the South Asian region using ordinary least squares (OLS), fixed effects, quantile regression, and robust output regression methods. The study found that external debt had a negative impact, while the external debt stock had a positive impact on economic growth. The robust regression analysis substantiated these findings and indicated that total external debt and external debt service impacted economic growth by 39% and 31%, respectively. Additionally, the study demonstrated that gross capital formation and trade openness had a positive effect on economic growth.

In a study by Kim et al. (2021), the objective of the paper was to better understand the key features of the Chinese fiscal system and their impact on China’s economic growth. The study employed empirical analysis and found that local government expenditures had a

larger impact on output growth compared to central government expenditure or taxes. However, net taxes became progressively more influential in the long run. During the initial stage of market liberalization in the 1990s, manufacturing investment contributed the most to output, but in recent periods, public investment in R&D has made a substantial contribution.

Vintilă et al. (2021) studied the effects of fiscal and economic factors, as well as worldwide governance indicators, on the economic growth rate in OECD countries from 2002 to 2017 using the least squares method and generalized method of moments. The study found positive links between fiscal factors and economic growth due to the implementation of efficient and expansionary fiscal policies in OECD countries. Overall, worldwide governance indicators were shown to have positive effects on economic growth. However, government expenditure was the only economic variable under control that had a negative impact on economic growth.

Parajuli (2021) investigated the FDI inflows in Nepal and analyzed the impact of FDI on GDP using the Ordinary Least Squares (OLS) method. The study found that a good performance of the economy was a positive signal for the inflow of FDI. Additionally, the study concluded that there is a long-run relationship between FDI and GDP in Nepal.

Ahuja and Pandit (2020) studied to re-examine the relationship between public expenditure and economic growth using a more extensive panel dataset covering 59 countries from 1990 to 2019. The study employed empirical analysis and found a unidirectional causality between economic growth and government expenditure, indicating that public spending influences GDP growth. The results broadly supported the Keynesian framework, which emphasizes the role of government expenditure in stimulating economic growth. Furthermore, after accounting for control variables such as trade accessibility, investment, and inflation, the analysis revealed that public spending positively affected economic growth.

Aliyev and Dehning (2020) analyzed the impact of public expenditures and tax revenues on non-oil economic growth in Azerbaijan for the period from 2000Q1 to 2015Q2, using OLS, ARDL, FMOLS, DOLS, CCR, and Granger Causality techniques. The study found strong evidence of significant long-run positive contributions from public expenditures to non-oil sector output. Additionally, the results indicated that tax revenues significantly

slowed down non-oil economic growth in the long run. Furthermore, Granger Causality analysis revealed a bidirectional short-run association between non-oil GDP and public expenditures, suggesting mutual influences between these variables. On the other hand, tax revenues were found to Granger Cause both non-oil GDP and public expenditures, indicating a directional influence of tax revenues on these economic variables.

TL Oo (2019) studied to examine the effect of fiscal policy on economic growth in Myanmar, using the Ordinary Least Squares (OLS) method. The analysis showed the existence of a multiplier effect of deficit spending on economic growth, confirming Keynesian assumptions. Myanmar needed to provide more public spending to invest in infrastructure development and public services delivery due to a lack of private investment in infrastructure projects.

Makhoba et al. (2019) studied the impact of fiscal policy on economic growth in South Africa using annual time series data. The study found that government revenues and gross fixed capital formation had a significant positive long-run impact on economic growth in South Africa. On the other hand, government expenditure and public debt shared a negative long-run relationship with economic growth. It was noted that government expenditure had been growing at a higher pace than revenues.

Sriyalatha and Torii (2019) examined the long-term impacts of fiscal variables on economic growth in Singapore and Sri Lanka from 1972 to 2017 using the Autoregressive Distributed Lag (ARDL)-Error Correction Model (ECM) approach along with diagnostic and specification tests. The study found that government expenditure, government revenue, and investment expenditure positively and significantly affected economic growth in both Singapore and Sri Lanka in the long run. These results were consistent with Keynesian economic theory. Additionally, Toda-Yamamoto's Granger causality tests revealed bidirectional causality between inflation rate and economic growth in Singapore. Moreover, the study identified a bidirectional causality relationship between investment expenditure and economic growth in Sri Lanka.

Sriyalatha and Torii (2019) studied to shed light on the relationship between the composition of government expenditure and economic growth using data from 1972 to 2016. They employed the Autoregressive Distributed Lag (ARDL)-Error Correction Model (ECM) approach along with several diagnostic and specification tests. The study found that

government expenditure and revenue had a statistically positive and significant impact on economic growth in the long run. Conversely, the inflation rate had a statistically negative and significant impact on economic growth in the long run, while the interest rate was found to be insignificant in its impact on economic growth over the long term. These findings supported the Keynesian approach, highlighting the potent effect of government spending on economic growth.

Abdullah et al. (2019) studied to examine the relationship between fiscal policy and economic growth in ASEAN-5 countries for the period from 1970 to 2016. They used the Autoregressive Distributed Lag (ARDL) approach to investigate this relationship. The study found that government expenditure was statistically significant in ASEAN-5 economies except for Indonesia. Additionally: Non-tax revenue was found to be significant in supporting government expenditure in ASEAN-5 countries except Indonesia. Both tax and non-tax revenues were significant in the Philippines, Thailand, and Singapore in the long run. Debt was significant in Indonesia and Thailand. The study recommended policy measures such as increasing non-tax revenue in the Philippines and Thailand to support growing expenditures. In Singapore, it was suggested to increase both tax and non-tax revenues to reduce accumulated debt effectively.

Al-Masaeed and Tsaregorodtsev (2018) examined the impact of fiscal policy, including government expenditure (GE), government revenues (GR), inflation (IPD), and exports (EPD), along with external public debt, on Jordanian GDP growth from 1990 to 2010. They employed multiple linear regression and the Ordinary Least Squares (OLS) method. The study revealed that government expenditure and exports had a positive and statistically significant impact on Jordanian GDP growth. Conversely, government revenues were found to have a negative and significant effect on GDP growth in Jordan. The analysis also indicated that external public debt negatively influenced GDP growth, although this relationship did not achieve statistical significance.

Agugua and Jerry (2017) studied to determine the significant relationship between total government expenditure, tax revenue, and economic growth in Nigeria using multiple regression analysis. From the findings, government expenditure and tax revenue were found to have had a significant impact on the Nigerian economy during the periods under study.

Pasichnyi (2017) studied to examine the role of fiscal policy in economic growth in advanced and emerging market economies over the period from 2001 to 2015, using regression analysis. The results emphasized the need to increase the positive influence of budget policy on economic development in countries with emerging market economies.

Akinyede and Elumah (2017) studied to examine the impact of economic policy (monetary policies, fiscal policies, and trade policies) on economic stability using the ARDL approach. The study found that economic policy had a significant effect on economic stability, emphasizing the crucial role of economic policy in contributing to the economic stability of the country.

Odetayo and Adeyemi (2017) studied to examine fiscal policy sustainability and economic growth in Nigeria between 1980-2015, using the Autoregressive Distributed Lag (ARDL) and Error Correction Model (ECM) approaches. The study found that government revenue, government expenditure, and fiscal deficit increased tremendously during the period covered. The results of the ARDL model, further subjected to Wald test, revealed that fiscal policy was weakly sustainable in Nigeria during the period 1980-2015 (t-statistic = 3.0127, F-statistic = 8.5641, $P < 0.005$, and β-value = 0.8564). Additionally, the study showed that there was a long-run relationship between fiscal policy and economic growth in Nigeria, and fiscal policy variables had an impact on economic growth.

Najaf (2016) analyzed both the short and long-run impacts of fiscal policies on the development of India using the Johansen cointegration test, error correction model, and variance decomposition model. The study found that there was a long-run association between fiscal policy and the Indian economy. The results showed that exogenous shocks existed between the variables, including GDP, net taxes, population growth rate, real interest rate, consumption price index, and government expenditure.

Dinca and Dinca (2013) analyzed the correlation between fiscal policy and economic growth using multiple regression analysis. The study found that the economic growth rate was positively influenced by fiscal pressure, gross capital formation in the private sector, the degree of economic openness, and labor productivity. Conversely, government expenditures, exchange rate, and public debt exerted a negative influence on economic growth.

Ahmed (2011) investigated the role of fiscal policy in enhancing economic growth in Pakistan using annual time series data from 1982 to 2010. The study utilized Ordinary Least Squares (OLS) method and time series analysis. According to the findings: Federal and provincial non-tax revenues positively and significantly impacted economic growth, Federal tax revenue had a significantly negative effect on economic growth, Development expenditure was found to play a significant role in enhancing economic growth, and Current expenditures were deemed insignificant and showed no impact on increasing economic growth.

Ghali and Al-Shamsi (1997) studied and established stylized facts regarding the effects of fiscal policy on long-run economic growth for the small oil-producing economy of the United Arab Emirates. They used multivariate cointegration techniques and found that government investment had a positive and significant effect on growth, while the effect of government consumption was negative and insignificant. During recent years, the United Arab Emirates government faced a substantially growing budget deficit.

Table 1

Summary of Empirical Review

SN	Author(s)	Variables	Objective	Methodology	Finding and Conclusion
1	Gara et al. (2024)	government spending, income from taxes, public debt, government effectiveness, fiscal freedom, rule of law index, corruption and economic growth	To analyze social variables such as government spending, income from taxes, public debt, government effectiveness, fiscal freedom, rule of law index, and corruption in	OLS, OLS Robust fixed and random effects models, and GMM (Generalized Method of Moments)	The findings from the research show that fiscal policy instruments have a positive impact on the economic growth of the countries of Southeast Europe, while the effectiveness of the government, the rule of law, and corruption show a statistically

			economic growth.		significant impact on the economic growth of these countries.
2	Aisyah et al. (2024)	aggregate demand, the level of economic activity, patterns of resource allocation, income distribution, taxes and government spending.	Analysis of the Impact of aggregate government spending.	Library data collection method	A close relationship between fiscal policy and economic growth in Indonesia.
3	Leghari (2023)	Gross domestic product (GDP), government unproductive expenditures (UPRO), direct taxation (DXT), and productive expenditure	This study looks at the role of economic governance in the partnership between public expenditure, private investment, and economic development.	Johansen co integration, error correction test, and Impulse Response Function	The study's results indicate that fiscal instruments and economic development in Pakistan have a significant long-term and short-term relationship. Furthermore, the impulse response indicates that when direct taxes are higher than GDP, both productive and unproductive expenses grow. Some unproductive

					investments have also been found to pave the path for economic development.
4	Al-Kasasbeh (2023)	government expenditure, taxation, debts, and gross domestic product.	To review the research work conducted on fiscal policies and economic growth, noting that there are three tools of fiscal policy; the first type is government expenditure, the second type is taxation, and the third type is debts.	Theoretical and Empirical review	This review demonstrates that the effect of fiscal policy on economic growth is not constant and varies depending on number heterogeneous factors, such as research methodology used. The level of development of the sampled countries, the relative size of the public sector, institutional quality the composition and the selected control variables among others.
5	Parmar (2023)	government spending, taxation, and economic growth.	To investigate the influence of government fiscal policy on economic growth.	fixed-effects regression analysis	The researcher analyzed the relationship between government spending, taxation, and economic growth. The findings suggest that fiscal policy can have both positive and negative effects on economic growth, depending on

					its composition and timing.
6	Tanchev and Mose (2023)	tax revenue, government expenditure, public debt and economic growth	To estimate the impact of macroeconomic variables such as tax revenue, government expenditure and public debt on the economic development of 28 European countries.	Ordinary least squares (POLS)	Increase in government expenditure and tax revenue leads to an increase in economic growth in 28 EU countries. However, the higher rates of public debt lead to decrease in economic growth. From the standpoint of fiscal policy, we conclude that Keynesian theory in the 28 EU countries was present.
7	Dhungel (2022)	Government Expenditure (Agriculture, education, health and transportation and communication) and Economic Growth of Nepal	To investigates the effects of public spending on Nepalese GDP growth from the fiscal year 1990/91 to 2019/20.	Ordinary least square method	Community expenditure in health sector as well as education sector leads to uplift the human capital which have ultimately positive influence on the economic growth of the country. Agriculture, education, health and transportation and communication are all included in government spending. All explanatory variables

					have made favorable effect on Nepal's GDP growth.
8	Mengistu (2022)	government expenditure (productive and unproductive) tax revenue (distortionary and non-distortionary), and economic growth rate	To give an overview of the recent discussion and establish a point of departure for future research	Time series techniques and Rigor empirical model	There was a long-run relationship between the variables. Disaggregating government expenditure into productive and unproductive and tax revenue into distortionary and non-distortionary, this study found unproductive expenditure and non-distortionary tax revenue to be neutral to growth as predicted by economic theory. Moreover, productive expenditure has a positive effect on growth while there was evidence of distortionary effects on growth of distortionary taxes.
9	Nuru and Gerezih	Government spending, real effective exchange rate,	To investigate the short-run and long-run asymmetric	Nonlinear autoregressive distributive lag model	The results exhibit the negative change effect of government spending is found to be greater

	er (2021)	inflation rate, and economic growth.	effects of fiscal policy, namely government spending on economic growth over the sample period 2004Q2 up to 2018Q1 for the South African economy.		than the positive change effect of government spending on economic growth. Real effective exchange rate is found to have a positive and significant effect on economic growth both in the short run and long run. Whereas, inflation rate affects economic growth negatively and significantly in the short run and long run.
10	Dangal and Gajurel (2021)	recurrent expenditure (RE), capital expenditure (CE), expenditure on education (EE), expenditure on health (HE), and expenditure on transportation and communication (TCE), and economic growth (RGDP)	To evaluate the trends of public expenditure and to show the relationship between public expenditure and economic growth in Nepal.	the chart, correlation, and regression were employed by using time series data sets	There is positive correlation between dependent and predictors. The results of regression also confirmed that there is positive relationship between public expenditure on economic growth of Nepal. Particularly, HE and TCE had negative relationship with RGDP.

11	Mohsin et al. (2021)	External debt, gross capital formation, trade openners, domestic debt and economic growth	To analyzes the relationship between external debt and economic growth in the South Asian region	ordinary least square (OLS), fixed effect, Quantile regression, and robust output regression	The external debt has a negative impact, and on the other hand, external debt stock has a positive impact on economic growth. The robust regression analysis substantiated the findings and yielded total external debt and external debt service impact of 39% and 31%, respectively. The study also showed that gross capital formation and trade openness have a positive effect on economic growth.
12	Kim et al. (2021)	net taxes, central government expenditures, local government expenditures, consumption, trade balance, and GDP	Objective of this paper is to better understand the key features of the Chinese fiscal system and their impact on China's economic growth.	Empirical analysis	Local government expenditures have a larger impact on output growth than central government expenditure or taxes. However net taxes become progressively more influential in the long run. During the initial stage of market liberalization in 1990s, manufacturing investment contribute

					the must output but in recent period, public investment R&D made a substantial contribution.
13	Vintilă et al. (2021)	economic growth rate, taxes, political stability, government effectiveness, rule of law, government expenditure, gross capital formation	To highlights the effects of the fiscal and economic factors as well as of the worldwide governance indicators on the economic growth rate in the OECD countries for period of time between 2002 and 2017	least squares method, and generalized method of moments	The evidence shown positive links between the fiscal factors and economic growth as a result of the implementation of efficient and expansionary fiscal policies in the OECD countries. On a large scale, the worldwide governance indicators have proven to have positive effects on economic growth, but the government expenditure is the only economic variable of control which has negative impact on the economic growth.
14	Parajuli (2021)	Gross Domestic Product, Foreign Direct Investment	To study the FDI inflows in Nepal and to analyze the impact of FDI on GDP of Nepal	Ordinary least square method	Good performance of economy is positive signal for inflow of FDI. And there is long run

					relationship between FDI and GDP.
15	Ahuja and Pandit (2020)	Government spending, Government revenue, Terms of trade, Investment, Population, Inflation, Unemployment, and GDP	To re-examines the relationship between public expenditure and economic growth using more copious panel data set covering 59 countries in 1990 2019.	Empirical Analysis	the unidirectional causality between economic growth and government expenditure where the causation runs between public spending and GDP growth. The results at large support the Keynesian framework that asserts the importance of government expenditure in stimulating economic growth. Further, the analysis reveals that after considering all the control variables such as trade accessibility, investment and inflation public spending positively affects economic growth.
16	Aliyev and Dehning (2020)	Public expenditure, tax revenue, and GDP	To analyses the impact of public expenditures and tax revenues on non-oil economic growth in	OLS, ARDL, FMOLS, DOLS, CCR and Granger Causality techniques.	There is strong evidence of significant long-run positive contributions from public expenditures to non-oil sector output. Results

			Azerbaijan for the period of 2000Q1-2015Q2		also show that tax revenues significantly slow down non-oil economic growth in the long run. Granger Causality analysis finds the existence of a bidirectional short-run association between non-oil GDP and public expenditures, while tax revenues Granger Cause both variables.
17	TL Oo (2019)	gross domestic product, gross capital formation, real exchange rate, budget defcit, general government expenditure, population growth rate as a proxy of labor force, trade openness.	To examines the effect of fiscal policy on economic growth in Myanmar.	Ordinary least squares (OLS) method	Analysis shows the existence of a multiplier effect of deficit spending on economic growth, which confirms Keynesian assumptions. Myanmar actually needs to provide more public spending to invest in infrastructure development and public service delivery due to lack of private investment in infrastructure projrcts.
18	Makho ba at al. (2019)	Government expenditure, revenues, public	To analyze the impact of fiscal policy on	Annual time series data	The government revenues and gross fixed capital formation

		debt, gross fixed capital formation, and economic growth.	economic growth in South Africa.		have a significant positive long run impact on economic growth in South Africa. While government expenditure and public debt share a negative long-run relationship with economic growth, the government expenditure has been growing at a higher pace than revenues.
19	Sriyalatha and Torii (2019)	real GDP, Consumer Price Index, government expenditure, government revenue, Investment expenditure, defense expenditure	To examine the long-term impacts of fiscal variables on economic growth in Singapore and Sri Lanka from 1972 to 2017.	Autoregressive Distributed Lag (ARDL) ECM approach and some diagnostic and specification tests.	The government expenditure, government revenue and investment expenditure positively and significantly affect in Singapore as well as Sri Lanka's economic growth in the long run. This result is consistence with the theory of Keynesian views. Moreover, the Toda-Yamamoto's Granger causality results reveal that there is bidirectional causality between inflation rate and economic growth in

					Singapore. Further, the results show that bidirectional causality relationship between investment expenditure and economic growth in Sri Lanka.
20	Sriyalatha and Torii (2019)	government expenditure, government revenue, inflation, rate of interest, human capital, and economic growth.	To shed light on the relationship between the composition of government expenditure and economic growth using the latest data from 1972—2016.	Autoregressive Distributed Lag (ARDL) ECM approach and a number of diagnostic and specification tests	The government expenditure and revenue have a statistically positive and a significant impact on economic growth while inflation rate has a statistically negative and a significant impact on economic growth in the long run. Rate of interest is insignificant in the long-run. These findings are in line with the Keynesian approach, which indicates a powerful effect of government spending, on economic growth.
21	Abdullah at al. (2019)	Gross Domestic Product per capita, government	To examine the relationship between fiscal policy and	The Autoregressive Distributed	fiscal policy instrument namely government expenditure is statistically significant

		expenditure, tax, debt, human capital, foreign direct investment flow	economic growth in ASEAN-5 for the period of 1970–2016.	Lag (ARDL) approach	in ASEAN-5 economies except for Indonesia. Results also shows that implementation of non-tax in the long run results in expenditure being significant in ASEAN-5 except in Indonesia; tax and non-tax are significant in the Philippines, Thailand, and Singapore; and debt is significant in Indonesia and Thailand. Results in case of Singapore highly recommends increasing the rate of tax and non-tax to decline its accrued debt.
22	Al-Masaeed and Tsaregorodtsev (2018)	Government expenditure (GE), Government revenues (GR), internal public debt (IPD), external public debt (EPD), export, inflation, GDP growth.	To examined the impact of fiscal policy measured by (GE, GR, IPD, EPD) in addition to exports and inflation factors on the Jordanian GDP growth for the period 1990 2010.	multiple linear regression and least squares method (OLS)	The government expenditure, exports and government revenues has a positive and significant impact on the Jordanian GDP growth, and negative and significant impact on the Jordanian GDP growth. The study found that external public debt has a negative but not

					significant impact on the Jordanian GDP growth.
23	Agugua and Jerry (2017)	Gross Domestic Product, Total Government Expenditure, Tax Revenue	To determine the significant relationship between total government expenditure, tax revenue and economic growth of Nigeria.	Multiple regression analysis	From the findings, government expenditure and tax revenue were found to have a significant impact on the Nigerian Economy for the periods under study.
24	Pasichnyi (2017)	government spending, taxation, budget deficit, and GDP.	To examines the role of fiscal policy in the economic growth ensuring in advanced and emerging market economies over the period from 2001 to 2015.	Regression analysis.	The study emphasized the directions to increase the positive influence of budget policy on economic development for countries with emerging market economies.
25	Akinyede and Elumah (2017)	Gross Domestic Product Rate, Tax Revenue, Government Debt, Real Interest Rate, Broad money supply, Total Export and	To examines the impact of economic policy (monetary policies, fiscal policies and trade policies) on economic stability	ARDL approach	Economic policy has a significant effect on economic stability therefore the usefulness of economic policy cannot be over-emphasized in the contribution to the Economic stability of

		import of goods and services.			the country. (tax, government debt and GDP)
26	Odetayo and Adeyemi (2017)	Real Gross Domestic Product, Government Revenue, Government Expenditure, Budget Deficit.	To examined fiscal policy sustainability and economic growth in Nigeria between1980-2015	Autoregressive Distributed Lag (ARDL), Error Correction Model (ECM)	The government revenue, government expenditure and fiscal deficit increased tremendously during the period covered. The results of ARDL which further subjected to Wald test revealed that fiscal policy was weakly sustainable in Nigeria during the period 1980 2015with the results of (t statistic=3.0127, F-statistic = 8.5641, P<0.005 and β-value = 0.8564). In addition, the results showed that there is a long run relationship between fiscal policy and economic growth in Nigeria, and fiscal policy variables have impact on economic growth.
27	Najaf (2016)	Gross Domestic Product, Net Tax	To analysis the both short and	Johansen co integration	There is long run association between

		Revenue, Population Growth rate, Real Interest Rate, Consumer Price Index, Government Expenditure, Gross Fixed Capital Formation.	long run impact of fiscal policies on the development of India	test, error correction model and variance decompositio n model.	fiscal policy and economy of any country. results are showing that there is long run association between fiscal policy and economy of India and there are exogenous shocks between the variables. (GDP, Net taxes, Papulation growth rate, Real interest rate, Consumption price index, Government expenditure, etc.)
28	Dincă And Dincă (2013)	Gross capital formation, exchange rate, labor productivity, economic openness, and Gross Domestic Product per capita.	To analyze the correlation between fiscal policy and economic growth.	Multiple regression	The economic growth rate is positively influenced by fiscal pressure, gross capital formation in the private sector, degree of economy openness and labor productivity. The variables government expenditures, exchange rate and public debt likely exerted a negative influence upon the economic growth.

29	Ray (2012)	GDP and FDI	to analyze the causal relationship between Foreign Direct Investment (FDI) and economic growth in India	ordinary Least Square Method	the Error-Correction Term is statistically significant and has a negative sign, which confirms that there isn't any problem in the long-run equilibrium relation between the FDI and GDP. For FDI to be a noteworthy provider to economic growth
30	Ahmed (2011)	log of real gross domestic product, fiscal deficit, tax revenue, government expenditure.	To investigates the role of fiscal policy in enhancing economic growth of Pakistan by using annual time series data during the period from 1982 to 2010.	Ordinary least square method, Time series analysis	Only the federal and provincial non-tax revenues have positive significant impact on economic growth. On the other hand, federal tax revenue has significantly negative impact on economic growth. Conversely, development expenditure play significant role in enhancing economic growth whereas current expenditures are insignificant and have no impact in increasing the growth.
31	Ghali and Al – Shamsi (1997)	Government consumption, government investment, government	To study and hence establish stylized facts for the effects of fiscal policy on	Multivariate cointegration techniques,	The government investment has a positive and significant effect on growth, while the effect of government

	expenditure, economic growth, budget deficit.	long-run economic growth for the small oil producing economy of the United Arab Emirates.	consumption is negative and insignificant. Since in recent years the United Arab Emirates' government is facing a substantially growing budget deficit.

2.4 Research Gap

Research on the impact of fiscal policy on economic growth and stability has predominantly concentrated on government expenditure and taxation. However, factors such as budget deficits or surpluses, debt levels, and foreign direct investment (FDI) are often overlooked in many studies. This presents several research gaps that could be addressed in this study.

Firstly, while there is existing research on the relationship between fiscal policy and economic growth, there is limited investigation into how specific fiscal policy parameters affect GDP in the context of Nepal. It is crucial to determine whether findings from previous studies are applicable in Nepal's unique economic environment.

Another gap in the literature is the lack of focus on the combined effects of government expenditure, taxation, debt levels, budget deficits or surpluses, and FDI on economic growth and stability in Nepal. Investigating how these combined factors influence GDP can offer a more comprehensive understanding of the elements that drive economic growth and stability in the country.

Additionally, current research shows conflicting results regarding the effects of fiscal policy variables on GDP growth. While some studies find a positive impact from factors such as government spending, debt, FDI, budget deficits, and taxation, others report negative effects. This inconsistency highlights the need for further investigation to clarify these relationships. This study aims to address this inconsistency by providing a detailed analysis of how these independent variables affect GDP in Nepal.

Finally, although some research has explored fiscal policy's impact on economic growth and stability in Nepal, there is a noticeable lack of extensive academic studies on this topic. This study aims to fill this gap by using secondary data to examine how fiscal policy influences economic growth and stability. Such an approach could offer a deeper insight into the dynamics of fiscal policy in Nepal and uncover new perspectives that previous research may have missed.

CHAPTER - III

RESEARCH METHODOLOGY

Research methodology is a systematic approach used to address research problems. It encompasses the sequential steps a researcher follows to investigate a problem and achieve specific objectives. This includes designing the research framework, determining the nature of data, outlining data collection methods, defining the population and sample, and detailing data processing procedures. The primary goal of this chapter is to discuss the various research methods and conditions employed in conducting the study.

3.1 Research Design

The research design for this study incorporates both descriptive and causal-comparative approaches. The descriptive approach is used to explore qualitative factors that impact economic growth and stability. Conversely, the causal-comparative approach investigates the relationships between dependent and independent variables. The study defines the research problem, formulates mathematical equations to illustrate these relationships, and employs research design methods to direct the investigation. It is crucial for the researcher to clearly outline each stage and its sequence during the research design process to effectively anticipate and address potential biases.

3.2 Population, Sample and Sampling Design

The objective of this study is to examine the effects of government fiscal policy on economic growth and stability. Data sources include books, private sources, articles, newspapers, websites, and official records. The research population encompasses government expenditures, foreign direct investment, tax revenue, budget deficits, and public debt recorded for each fiscal year. The study utilizes a 20-year dataset covering the period from 2004 to 2023, focusing on data collected post-liberalization of the Nepalese economy. The data, which are time series in nature, cover the dependent and independent variables of interest for the specified timeframe.

Table 2

Variables selected for the study period

S.N.	Variables	Study Periods	Observations
1.	Government Expenditures	2004-2023	20
2.	Foreign Direct Investment	2004-2023	20
3.	Tax Revenue	2004-2023	20
4.	Deficit Budget	2004-2023	20
5.	Public Debt	2004-2023	20

3.3 Nature and Sources of Data

The study relies on secondary data, sourced from various official and published resources. Data are obtained from the World Bank database, Economic Surveys and budgetary speeches issued by the Ministry of Finance, Statistical Pocket Books from the Central Bureau of Statistics (CBS), newspapers, published journal articles, and the IMF database through the Nepal Statistical Department.

3.4 Data Analysis Tools

In data analysis, figures and statistics are meticulously examined to understand the underlying reasons behind significant findings. The process involves cleaning, modifying, and scrutinizing data to extract valuable insights that aid in decision-making and enhance judgments. The following statistical techniques are employed to address the research objectives.

Various methods are available for analyzing the relationships between government expenditure, budget deficits, foreign direct investment (FDI), tax revenue, public debt, and economic growth. Different studies have utilized diverse approaches to explore these connections.

This analysis utilizes correlation and regression techniques. Correlation analysis is employed to assess the strength and direction of the relationship between two variables.

Regression analysis, on the other hand, is used to evaluate the impact of government expenditure, FDI, tax revenue, and public debt on economic growth.

3.4.1 Descriptive Analysis

The study employs descriptive data analysis to elucidate the variables within the sample period. Descriptive statistics, including measures such as the mean, standard deviation, coefficient of variation, minimum, and maximum values, are used to summarize and clarify the characteristics of various variables. These variables include government expenditure, foreign direct investment (FDI), budget deficits, tax revenue, and public debt as independent factors, with economic growth serving as the dependent variable.

i. **Mean**

The mean is a statistical measure that indicates the central tendency of data. In this study, it will be used to calculate the average values of government expenditure (GE), foreign direct investment (FDI), tax revenue (TR), budget deficit (BD), public debt (PD), and economic growth (GDP). By comparing the mean values of these variables across different periods, this study aims to identify trends and patterns in economic performance.

i. **Standard Deviation**

The primary use of standard deviation in this study is to measure the extent to which variables such as government expenditure (GE), foreign direct investment (FDI), tax revenue (TR), budget deficit (BD), public debt (PD), and economic growth (GDP) deviate from their mean values. By calculating the standard deviation, this study aims to assess the degree of dispersion of these data points around the mean, which helps evaluate the level of variability and risk associated with these economic indicators. A low standard deviation indicates that the values are closely clustered around their respective means, whereas a high standard deviation suggests that the values are more widely dispersed.

3.4.2 Correlation Analysis

Additionally, correlation analysis is incorporated into the descriptive research design to assess the strength and direction of relationships between pairs of dependent and explanatory variables. This method illustrates how two variables move in relation to each

other. The study uses bivariate Pearson's correlation coefficient to define these relationships. The correlation coefficient ranges from -1 to +1, where a value of -1 indicates a perfect negative relationship, meaning the variables move in exactly opposite directions, and a value of +1 denotes a perfect positive relationship, where the variables move in the same direction.

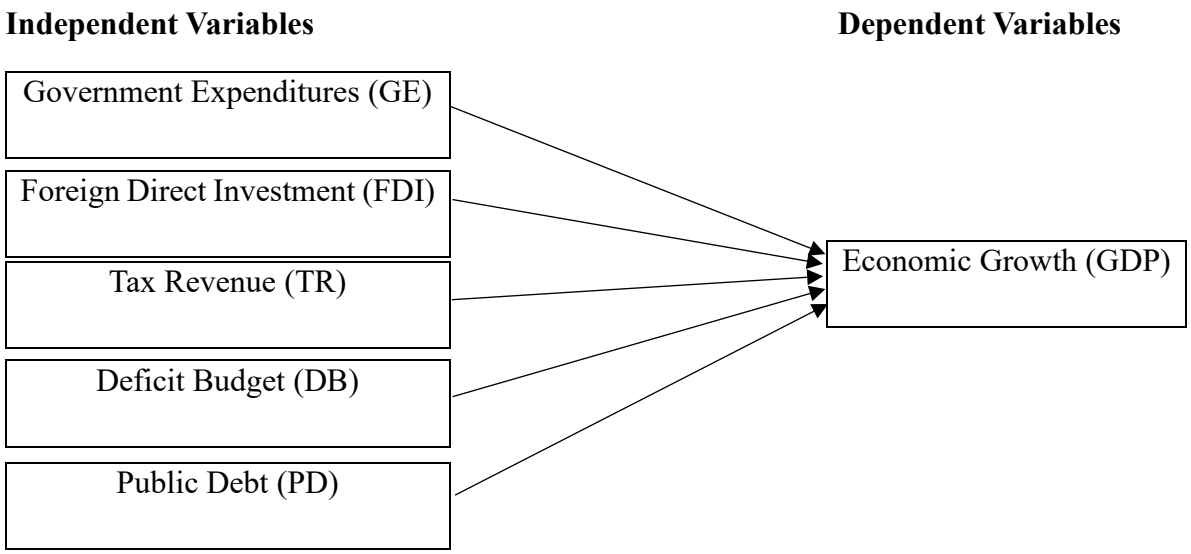
3.4.3 Regression Analysis

The aim of regression analysis is to identify and quantify relationships between variables, particularly examining how one or more independent variables influence a dependent variable. This process involves creating a regression equation by estimating the model parameters and describing the hypothesized relationships. Regression analysis is used to model the connection between a response variable and predictor variables. Subsequently, the model undergoes various tests to evaluate its effectiveness and accuracy.

3.5 Research Framework and Definition of Variables

Figure 1

Research Framework



(Source: Phullel, 2023)

Definition of Variables

Independent Variables

Government Expenditure

Researchers such as Barro (1990), Barro and Sala (1992), and Easterly and Rebelo (1993) have highlighted the critical role of government policies in economic development, even though endogenous growth models tend to minimize the government's role in the growth process. The study's framework is based on Keynesian and spontaneous growth models, which suggest that increased government spending can accelerate economic growth. Various scholars have examined the impact of government expenditure, with some focusing on the efficacy versus inefficacy of such spending. For instance, Kneller et al. (1999) argue that the nature of government expenditure is more crucial than the total amount spent (Nijkamp & Pot, 2004). The composition of government spending is identified as a key factor in driving growth.

Government expenditures are generally categorized into current and development expenditures. Current expenditures cover routine administrative costs necessary for the day-to-day functioning of the government. In contrast, development expenditures are directed towards building infrastructure and providing services in sectors like education, health, and agriculture. Public expenditure thus serves as a significant policy tool for managing and influencing the economy (Sharma, 1999).

Foreign Direct Investment (FDI)

Foreign Direct Investment (FDI) has gained significant importance in the globalized economy. Sahoo (2006) highlights that FDI is a crucial conduit for capital, technology, and managerial expertise, all of which are vital for fostering economic growth. When a multinational corporation (MNC) invests in or acquires assets in a foreign country, it results in an infusion of investment into that nation. Kokko (2006) describes FDI as the direct purchase of foreign companies, investment in joint ventures, or the establishment of strategic partnerships with local firms to access advanced technologies or intellectual property. Developing countries, in particular, reap substantial benefits from FDI by importing and adapting cutting-edge technological equipment and products, obtaining foreign technology, and attracting skilled labor. This influx of international investment helps address capital shortages in these countries, thereby bolstering capital formation.

Notably, FDI facilitates economic development without detracting from the host country's current consumption levels. Foreign Direct Investment has thus proven to be a significant driver of economic growth, providing the capital, technology, and management expertise essential for economic advancement (Pokharel & Pokharel, 2019).

Tax Revenue

According to Todaro and Smith (2006), economic growth is defined as "the gradual process through which the productive capacity of an economy increases over time, leading to higher levels of national output and income." Various macroeconomic policies, such as taxation, consumption, and investment, influence the growth rate. Taxation is a mandatory financial charge imposed on firms and households by the government (Goode, 1984). Taxes must be established based on legal statutes; without such statutes, taxes cannot be lawfully enforced (Okafor, 2012). Taxes are levies placed upon taxpayers (individuals or entities) by the state or its equivalent, and they represent a primary source of government revenue used to fund public expenditures (Edame and Okoi, 2014). Tax policy pertains to the government's decisions regarding the amounts and targets of taxes. Governments implement tax policies for various purposes, including generating revenue for public spending, resource allocation, income redistribution, and mitigating wealth inequality among consumers. Romer and Romer (2010) also noted that tax policies are used to address budget deficits and respond to other economic conditions. The revenue collected from taxes is utilized by the government to fulfill its traditional roles, such as providing public goods, maintaining law and order, defending against external threats, and regulating trade and business to support social and economic stability.

Deficit Budget

Delays and inefficiencies in revenue collection, such as taxes, contribute to persistent budget deficits in Nepal's economy. The country has consistently struggled with budget deficits, and economists hold varying views on their impact on economic growth. Keynesian economists argue that budget deficits can stimulate economic growth by enhancing domestic production and private investment. Conversely, neoclassical economists suggest that deficits have adverse effects, as governments may shift tax burdens to future generations. This can lead to higher interest rates as governments attempt to stabilize capital markets, which in turn can reduce private investment. Barro's "Ricardian

equivalence" theory posits that deficits have a neutral effect because any increase in current deficits will be offset by future tax increases, keeping interest rates and private consumption stable (Bernheim, 1989).

Numerous studies highlight the importance of budget deficits as a critical indicator for analyzing fiscal policy, despite the challenges in measurement. Fischer (1993) notes that budget deficits are among the most reliable indicators for assessing economic growth and development. It's crucial to understand that budget deficits both influence and are influenced by other economic factors. The effect of deficits on economic growth can be either positive or negative, depending on the allocation of deficit spending, as demonstrated by Kneller et al. (1999). Eminer (2015) suggests that increased deficits can promote economic growth if directed toward productive investments but may hinder growth if allocated to non-productive purposes. The impact of such policies also depends on their duration whether they are implemented in the short term or sustained over the long term.

Public Debt

Public debt represents a government’s legal obligation to make scheduled interest payments and principal repayments to bondholders or other creditors. After World War II, public debt became a crucial source for funding development expenditures, with many countries adopting systematic borrowing strategies to accelerate economic growth (Joshi, 1982). Public debt serves as an essential financing mechanism for governments. The Keynesian economic theory emphasized the role of deficit financing, particularly during economic downturns or depressions, as a means to stimulate the economy by increasing aggregate demand (Dornbusch, 1990).

Public debt plays a significant role in a country's economic and social development. Various financing techniques are employed in the economic development of underdeveloped nations, and public debt is viewed as a valuable tool for both fiscal and monetary policy. It aids in revenue generation, mobilizes savings, and helps control inflation. Public debt is more commonly associated with developing countries, where the scope for domestic borrowing is limited due to a shortage of internal resources (Sapkota, 2018).

Dependent Variable

Economic Growth

Economic growth refers to the ongoing expansion of a country's production or expenditure over a set period, usually measured annually. It represents the increase in the economy's ability to produce goods and services over time. The primary metric for this national output is real Gross National Product (GNP), which is adjusted for inflation (Shapiro, 2001). To achieve economic growth, the increase in total output must surpass the rate of population growth. Countries aim to reach developed status, where sustaining a high rate of economic growth is essential. Developed nations successfully achieve and maintain high economic growth levels over time, whereas countries with slower growth are considered less developed (Dwivedi, 2010).

CHAPTER- IV

RESULTS AND DISCUSSION

This chapter presents the empirical findings on the impact of government fiscal policy on economic growth and stability in Nepal. It examines the relationships and causal links among government expenditure, foreign direct investment (FDI), tax revenue, budget deficits, and public debt in relation to economic growth and stability.

The discussion unfolds in several stages, beginning with an examination of the effects of government fiscal policy on economic growth and stability. The analysis includes the application of the Augmented Dickey-Fuller (ADF) test, along with descriptive statistics, correlation analysis, and unit root tests. Additionally, co-integration analysis is conducted using the Autoregressive Distributed Lag (ARDL) bounds test. The chapter also covers causality testing to explore the connections between government expenditure, FDI, tax revenue, budget deficits, and public debt concerning economic growth and stability in Nepal. The final section summarizes the overall findings of the chapter.

4.1 Descriptive Analysis

Table 3 provides an in-depth summary of descriptive statistics for both independent and dependent variables utilized in this analysis. It includes critical metrics such as arithmetic means, standard deviations, coefficients of variation, and the minimum and maximum values for each variable. The independent variables under consideration are government expenditure, foreign direct investment, tax revenue, budget deficits, and public debt. These variables are evaluated concerning their effect on economic growth, as measured by GDP, over the fiscal years from 2003/04 to 2022/23. This thorough statistical overview lays the groundwork for understanding data distribution and variability, which is crucial for interpreting the relationships and dynamics addressed in the subsequent analysis.

Table 3

Descriptive statistics for dependent and Independent Variable

(Growth rate in percentage)

variables	Mean	SD	CV	Min.	Max.
GDP	11.83	4.4	0.3723	0.5	21.2
GE	15.64	10.71	0.6850	-1.7	39.5
FDI	43.65	99.83	2.2870	-77	267
TR	17.1	12.01	0.7022	-12	37
DB	23.51	51.48	2.8196	-36.8	176
PD	11.5	14.28	1.2421	-24	40

(Source: Economic survey 2024)

Table 3 presents the descriptive statistics for the variables analyzed in the economic growth study. It includes the means, standard deviations, coefficients of variation, and the minimum and maximum values for each variable from the fiscal years 2003/04 to 2022/23.

The average annual growth rate of GDP is 11.83%, indicating a healthy expansion of the economy over the observed period. The standard deviation of 4.4% shows moderate variability, meaning GDP growth rates are relatively stable around the mean. The coefficient of variation (CV) of 0.3723 indicates that the standard deviation is approximately 37.23% of the mean GDP growth rate, reflecting consistent growth. The minimum and maximum growth rates are 0.5% and 21.2%, respectively, highlighting that GDP growth has experienced both slow and rapid phases within the period.

Government expenditure grows at an average rate of 15.64% per year. However, it exhibits high variability, with a standard deviation of 10.71%. The CV of 0.6850 suggests that government expenditure growth rates are quite dispersed around the mean, pointing to significant fluctuations. The negative minimum value of -1.7% indicates periods of reduction in government spending, while the maximum of 39.5% shows substantial increases in some years.

Economic growth, measured by gross domestic product (GDP) as the dependent variable, is influenced by government expenditure, foreign direct investment, tax revenue, budget deficit, and public debt, which serve as proxies for fiscal variables and are the explanatory variables in this study. Consequently, it is reasonable to anticipate some statistically significant relationships among these pairs of variables. Therefore, the purpose of this section is to describe the nature and strength of the associations between various pairings of these variables, as analyzed in this study.

Foreign direct investment (FDI) displays an exceptionally high average growth rate of 43.65%. This high mean is accompanied by extreme variability, as evidenced by the standard deviation of 99.83% and a CV of 2.2870, which is the highest among the variables. This large CV indicates that FDI growth rates vary widely from the mean, reflecting substantial volatility. The growth rates range from -77% to 267%, showing that FDI can swing dramatically from significant losses to massive gains.

Tax revenue grows at an average rate of 17.1% per year, with a standard deviation of 12.01%. The CV of 0.7022 indicates high variability in tax revenue growth rates. The growth rates range from a minimum of -12%, indicating reductions in some years, to a maximum of 37%, reflecting significant increases. This variability suggests that tax revenue can be highly influenced by various economic factors and policy changes.

The deficit budget shows an average annual growth rate of 23.51%, with a high standard deviation of 51.48%. The CV of 2.8196, the highest among the variables, indicates extreme variability in the deficit budget growth rates. This suggests large fluctuations in the budget deficit, with growth rates ranging from -36.8% to 176%. Such variability could reflect changes in fiscal policies, economic cycles, or unexpected financial events.

Public debt grows at an average rate of 11.5% annually, with a standard deviation of 14.28%. The CV of 1.2421 suggests high variability in public debt growth rates, indicating significant fluctuations. The growth rates range from a minimum of -24% to a maximum of 40%, showing that public debt can decrease significantly in some years while increasing substantially in others. This variability might be due to changes in borrowing needs, fiscal policies, and economic conditions.

4.2 Correlation Analysis

Economic growth, measured by Gross Domestic Product (GDP), serves as the dependent variable in this study, with government expenditure, foreign direct investment (FDI), tax revenue, deficit budget, and public debt acting as explanatory variables. Given this setup, it is anticipated that statistically significant relationships may exist among these variables. Therefore, this section aims to describe the nature and strength of associations between various pairs of these variables. The analysis has been conducted to explore these relationships.

Table 4

Correlations Analysis

		GDP	EG	FDI	TR	BD	PD
GDP	Pearson Correlation	1					
	Sig. (2-tailed)						
EG	Pearson Correlation	.581**	1				
	Sig. (2-tailed)	.007					
FDI	Pearson Correlation	-.175	.187	1			
	Sig. (2-tailed)	.461	.430				
TR	Pearson Correlation	.700**	.644**	.075	1		
	Sig. (2-tailed)	<.001	.002	.752			
BD	Pearson Correlation	.043	.600**	.228	.006	1	
	Sig. (2-tailed)	.856	.005	.335	.981		
PD	Pearson Correlation	-.279	.059	.041	.022	-.041	1
	Sig. (2-tailed)	.233	.805	.865	.926	.862	

***. Correlation is significant at the 0.01 level (2-tailed).*

In above table, we delve into the correlation matrix provided, examining the relationships between various economic variables, including GDP, GE (government expenditure), FDI (foreign direct investment), TR (tax revenue), BD (budget deficit), and PD (public debt). Understanding these relationships is crucial for comprehending how different economic factors interact and influence GDP.

GE (Government Expenditure) Correlation with GDP (0.581): There is a moderate positive correlation between GDP and government expenditure. The Sig. (2-tailed) value is .007 which means the relationship is statically significant. This suggests that as government expenditure increases, GDP tends to rise, highlighting the role of government spending in boosting economic activity.

FDI (Foreign Direct Investment) Correlation with GDP (-0.1749): There is a weak negative correlation between GDP and FDI. This indicates a slight inverse relationship, where increases in FDI are weakly associated with decreases in GDP growth. This weak negative correlation might imply that FDI inflows do not always translate directly into immediate GDP growth, possibly due to the time lag in the economic benefits of FDI or other mitigating factors.

TR (Tax Revenue) Correlation with GDP (0.700): There is a strong positive correlation between GDP and tax revenue. The Sig. (2-tailed) value is < 0.001 which means the relationship is statically significant. This suggests that higher GDP is strongly associated with higher tax revenues. As the economy grows, income and corporate profits generally increase, leading to higher tax collections. This strong correlation highlights the direct relationship between economic growth and the government's revenue-generating capacity.

BD (Budget Deficit) Correlation with GDP (0.04325): There is a very weak positive correlation between GDP and the budget deficit. This near-zero correlation indicates that changes in the budget deficit have little to no consistent relationship with GDP growth. The budget deficit might affect GDP through various mechanisms, but the impact is not strongly linear or immediate based on this correlation.

PD (Public Debt) Correlation with GDP (-0.2795): There is a weak negative correlation between GDP and public debt. This suggests that increases in public debt are weakly associated with decreases in GDP growth. High levels of public debt might lead to concerns

about fiscal sustainability and higher borrowing costs, which can negatively impact economic growth, though the relationship is not strongly pronounced in this dataset.

4.3 Regression Analysis

Regression analysis is a statistical technique used to explore the relationship between a dependent variable and one or more independent variables.

Table 5

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.838[a]	.703	.597	2.79704

a.Predictors: (Constant), PD, TR, DB, FDI, EG

The provided data represents the output of a multiple regression analysis, where the GDP is dependent variable and model includes Government Expenditure (GE), Foreign Direct Investment (FDI), Tax Revenue (TR), Budget Deficit (BD), and Public Debt (PD) as independent variables. The correlation coefficient (R) of 0.8384 indicates a strong positive correlation between the observed and predicted values of the dependent variable, suggesting that the model's predictions are fairly accurate.

The R Square value of 0.703 shows that approximately 70.30% of the variability in the dependent variable can be explained by the independent variables. The Adjusted R Square of 0.597, which accounts for the number of predictors, still indicates a good fit, with 59.70% of the variability explained by the model.

The standard error of the estimate is 2.7970, reflecting the average distance of the observed values from the regression line.

Overall, the model demonstrates a strong fit, good explanatory power, and reasonably accurate predictions, though there is potential for further improvement by exploring additional variables or different modeling techniques.

Table 6

ANOVA Table

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	259.054	5	51.811	6.623	.002[b]
	Residual	109.528	14	7.823		
	Total	368.582	19			

a. Dependent Variables: GDP

b. Independent Variables: GE, FDI, TR, BD and PD

In above table 6 provided ANOVA (Analysis of Variance) table helps to evaluate the statistical significance of the regression model with GDP as the dependent variable. The sum of squares for the regression is 259.05, with 5 degrees of freedom, resulting in a mean square of 51.81. This reflects the variation in GDP explained by the independent variables: Government Expenditure (GE), Foreign Direct Investment (FDI), Tax Revenue (TR), Budget Deficit (BD), and Public Debt (PD). The F-statistic is 6.62, and the significance level is 0.002321, indicating that the model is statistically significant. This low p-value suggests that there is only a 0.2321% chance that the observed relationship between the independent variables and GDP is due to random variation, allowing us to confidently reject the null hypothesis that these variables have no effect on GDP.

The residual sum of squares is 109.53 with 14 degrees of freedom, leading to a mean square of 7.82, representing the variation not explained by the model. The total sum of squares is 368.58 with 19 degrees of freedom, indicating the overall variability in GDP. The comparison of the mean squares shows that the explained variation is significantly larger than the unexplained variation, reinforcing the model's significance.

In summary, the ANOVA table confirms that the regression model is statistically significant and explains a substantial portion of the variability in GDP, making it a robust model for understanding the impact of GE, FDI, TR, BD, and PD on GDP.

Table 7

Coefficients Table

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig.
1	(Constant)	8.035	1.293		6.213	<.001
	GE	.233	.126	.566	1.844	.086
	FDI	-.010	.007	-.236	-1.572	.138
	TR	.133	.090	.362	1.481	.161
	DB	-.022	.020	-.258	-1.087	.295
	PD	-.099	.046	-.322	-2.182	.047

a. Dependent Variable: GDP

b. Alpha α: 0.05

In above table 7 provided regression analysis table evaluates the impact of Government Expenditure (GE), Foreign Direct Investment (FDI), Tax Revenue (TR), Budget Deficit (BD), and Public Debt (PD) on GDP.

The intercept of 8.034628, with a very low p-value of 2.27E-05, is highly significant, indicating the baseline value of GDP when all other variables are zero.

Government Expenditure (GE) shows a positive impact on GDP with a coefficient of 0.232658. Its p-value of 0.08641 is above the common 0.05 significance level, but it is marginally significant at the 10% level. This suggests that higher government expenditure is associated with an increase in GDP, though the evidence is not strong enough to be considered statistically significant at the 5% level.

Foreign Direct Investment (FDI) has a negative coefficient of -0.01042 and a p-value of 0.138188. This indicates that FDI does not have a statistically significant impact on GDP. The negative coefficient suggests that an increase in FDI might be associated with a slight decrease in GDP, but this relationship is not strong enough to be deemed significant in this model.

Tax Revenue (TR) has a positive coefficient of 0.132867 and a p-value of 0.160634. Like FDI, TR does not show a statistically significant impact on GDP. The positive coefficient implies that an increase in tax revenue could be associated with an increase in GDP, but the evidence is not statistically strong.

Budget Deficit (BD) has a negative coefficient of -0.02206 and a p-value of 0.295288, indicating that BD is not statistically significant in affecting GDP. The negative coefficient suggests that an increase in the budget deficit might be associated with a decrease in GDP, but this relationship is not statistically significant in the model.

Public Debt (PD) has a statistically significant negative impact on GDP, with a coefficient of -0.09929 and a p-value of 0.046671, which is below the 0.05 significance threshold. This suggests that an increase in public debt is associated with a decrease in GDP, and this relationship is statistically significant within the model.

Government Expenditure shows a marginally significant positive impact, while Foreign Direct Investment, Tax Revenue, and Budget Deficit do not demonstrate statistically significant effects on GDP in this model.

4.4 Discussion

The first objective of the study was to investigation of government expenditure, foreign direct investment, tax revenue, deficit budget, public debt and economic growth and stability in Nepal. The findings of this study indicate that Nepal's economy is dynamic, with significant fluctuations in key indicators. GDP growth is strong and stable, but government spending and foreign direct investment vary widely. Tax revenue and the budget deficit also change a lot, reflecting broader economic shifts and fiscal issues. Public debt also varies significantly, highlighting the need for careful management. This finding is similar with the research conducted by Phullel (2023), who found that South Asia's economic indicators exhibit considerable variability, with moderate average growth rates and wide ranges for gross capital formation, public debt, government expenditure, and tax revenue.

The second objective of the study was to examine and analyze how government expenditure, foreign direct investment, tax revenue, budget deficit, and public debt affect

economic growth and stability in Nepal. The findings of this study indicate that the regression model was statistically significant, explaining much of the GDP variability. Government expenditure showed a marginally significant positive impact on GDP, while public debt had a statistically significant negative impact, indicating higher debt was linked to decreased growth. Foreign direct investment and tax revenue exhibited weak, non-significant effects on GDP, with FDI showing a small negative impact and tax revenue a small positive one. The budget deficit also showed a minimal, non-significant negative effect on GDP. These findings emphasized the significant role of public debt in economic growth, with other factors having less clear impacts.

The study's findings aligned with previous research, such as Phullel (2023), which examined South Asian countries and found that government expenditure (GE) had an insignificant positive link with GDP, suggesting a weak association between spending and growth. Public debt (PD) showed a significant positive impact on GDP, indicating that higher debt levels were linked to increased GDP growth in South Asia. Conversely, tax revenue (TR) had a significant negative relationship with GDP, implying that higher tax revenues were associated with lower GDP growth. Similarly, Tanchev and Mose (2023) Showed in their study of twenty-eight EU countries that both GE and TR had positive impacts on GDP, suggesting that increased spending and tax revenues could boost economic growth. However, their research also showed that PD had a negative effect on GDP, highlighting a regional variation in the impact of public debt compared to the findings in South Asia.

Vintila et al. (2021) Showed that government expenditure (GE) had a negative impact on economic growth, indicating that increased spending might be associated with slower growth. In contrast, their study revealed that tax revenue and other economic variables had a positive effect on growth, suggesting that factors beyond government spending, such as effective tax policies, could enhance economic performance. Aliyev and Dehning (2020) focused on Azerbaijan and identified a significant positive link between GE and GDP, suggesting that higher government spending was associated with increased economic growth. However, their study also found a significant negative relationship between tax revenue (TR) and GDP, indicating that higher tax revenues could be linked to lower GDP growth in Azerbaijan.

Similarly, Makhoba et al. (2019) showed a negative long-run relationship between GE and economic growth in South Africa, as well as a negative impact of public debt (PD) on growth, highlighting concerns about the effects of both government spending and debt on long-term economic performance. On the other hand, Sriyalatha and Torii (2019) showed in their study in Singapore and Sri Lanka, both GE and TR had a positive and significant effect on GDP, indicating that increased government spending and tax revenues could promote economic growth in these countries. Abdullah et al. (2019) studied the ASEAN-5 countries and found that GE was statistically significant in most countries except Indonesia, while TR had a significant impact in the Philippines, Thailand, and Singapore, and PD was significant in Indonesia and Thailand with GDP. Agugua and Jerry (2017) observed in Nigeria that both GE and TR had a positive and significant impact on economic growth, underscoring the potential benefits of government spending and tax revenues in stimulating economic development.

Oo (2019) showed on Myanmar, the budget deficit (BD) had a significant positive impact on GDP, suggesting that increased government borrowing and spending potentially stimulated economic growth. However, researcher indicates that the impact of budget deficits on GDP can be mild but negative and statistically insignificant at the 5% level. This finding contradicts Keynesian theory, which advocates for deficit spending to stimulate economic growth, and aligns with Neo-classical theory, which asserts that budget deficits can lead to a reduction in GDP by crowding out private investment and increasing interest rates. The discrepancy between these findings highlights the complexity of economic relationships and suggests that the effects of budget deficits on GDP may vary significantly depending on the specific economic context and conditions of a country. Therefore, policymakers need to carefully consider these theories and their implications when designing fiscal policies to support sustainable economic growth.

Parajuli (2021) on Nepal and showed that foreign direct investment (FDI) had a positive but statistically insignificant impact on GDP. This suggests that while FDI might contribute to economic growth, its influence in Nepal was not strong enough to be deemed substantial within the study period. In contrast, Ray (2012) showed that FDI had a significant negative impact on GDP in India, indicating that increased foreign investment in the Indian context might have led to adverse economic outcomes, possibly due to factors like capital flight, repatriation of profits, or the crowding out of domestic investments.

CHAPTER-V

SUMMARY AND CONCLUSION

5.1 Summary

This study aims to evaluate the gross domestic product (GDP), government expenditure (GE), foreign direct investment (FDI), tax revenue (TR), deficit budget (DB), and public debt (PD). Additionally, it explores the relationship between GDP and GE, FDI, TR, DB, and PD, as well as how these factors impact GDP. This was accomplished by reviewing relevant literature and using related theoretical concept. To address the specific objectives of the study, both descriptive and causal comparison methods are utilized. A descriptive design is used to examine the trends and current state of GDP, GE, FDI, TR, DB, and PD. The causal comparison design allows for the quantification of the effects of GE, FDI, TR, DB, and PD on the GDP of Nepal. This investigation relies on secondary data sourced from the economic survey of the Ministry of Finance of Nepal and Nepal Rastra Bank official website for the relevant years over a 20-year period, from 2003–2004 to 2022–2023.

The first chapter covers the primary research topic, general context, the problem statement, research objectives, the significance of the study, and its limitations. The second chapter delves into theoretical analysis and provides a brief overview of relevant and related literature, including a summary of significant research and an explanation of the conceptual framework. The third chapter details the research methodology used in the study. This includes the definition of statistical tools, research design, data sources, analysis methods, and an examination of financial indicators and variables. In the fourth chapter, statistical methods are employed to present and analyze data. The analysis reveals a significant positive relationship between GDP and GE at the 10% level, and a significant negative relationship between GDP and PD at the 5% level. However, FDI and DB show a negative but insignificant relationship with GDP, and TR shows a positive but insignificant relationship with GDP through regression. But Pearson correlation shows positive significant correlation of GE and TR on GDP. FDI and PD were negatively correlated with GDP and DB was negatively correlated. This chapter also includes discussions on the findings. The fifth chapter presents the summary, conclusion, and recommendations, compares them with other empirical evidence where possible, and offers suggestions based on the findings.

5.2 Conclusion

The study examined the comprehensive analysis of economic indicators spanning from 2003/04 to 2022/23 sheds light on the dynamics influencing GDP growth. The data reveals a robust average annual GDP growth rate, indicating overall economic expansion. However, the moderate variability in GDP growth, combined with consistent performance, suggests that the economy experienced steady growth despite fluctuations.

Government expenditure shows a generally positive association with GDP, suggesting that increased spending can stimulate economic growth. Yet, the marginal significance of this relationship implies that while government spending can positively influence GDP, it does not do so with strong statistical certainty. This suggests that other factors may also play a crucial role in economic growth beyond just government expenditure.

Tax revenue exhibits a more substantial positive correlation with GDP, highlighting that as the economy grows, tax revenues also tend to increase. This relationship suggests a beneficial cycle where economic expansion leads to higher government revenues. However, the significance of this correlation, while present, is not strongly conclusive, pointing to the need for further investigation into how tax revenue impacts economic growth.

Foreign Direct Investment (FDI) demonstrates a small negative impact on GDP, but this effect is not statistically significant. This finding implies that while FDI might have some influence on GDP, its impact is minimal and not substantial enough to be considered a key driver of economic growth. The budget deficit presents a very weak positive correlation with GDP, indicating that changes in the budget deficit have a negligible effect on GDP growth. This suggests that the budget deficit does not play a significant role in influencing economic performance during the observed period.

In contrast, public debt shows a significant negative effect on GDP. This indicates that increasing levels of public debt are associated with decreased economic growth. The significant negative impact of public debt underscores the importance of managing public debt levels to sustain economic growth, as high levels of debt can hinder economic performance.

Overall, while the regression model demonstrates a strong fit, with a substantial proportion of GDP variability explained by the model, the analysis highlights the relative significance of each variable. Government expenditure and public debt emerge as the more influential factors affecting GDP growth, while the effects of FDI, tax revenue, and the budget deficit are less pronounced. This underscores the complex interplay between fiscal policies, investment, and economic performance, suggesting that a balanced approach to spending and debt management is crucial for sustaining economic growth. Further research could delve deeper into the specific mechanisms through which these variables impact GDP and explore additional factors that may contribute to economic performance.

5.3 Implications

The findings of this study could offer valuable insights for scholars and policymakers. While numerous studies have examined the impact of government fiscal policy on economic growth and stability in various countries, there is a lack of such research specific to Nepal. This research fills that gap by providing insights into the factors that should be considered in policy-making. Consequently, the study highlights the impact of government fiscal policy on Nepal's economic development and identifies key variables to consider when formulating policies.

The study offers valuable recommendations to researchers on selecting appropriate variables for analysis, noting that some variables used may not be relevant. Additionally, this research contributes to the literature on the role of government fiscal policy in Nepal's economy. It makes a significant addition to the ongoing debate on the impact of government spending on economic growth in the country, and future studies will benefit from its findings.

This study offers valuable insights for policymakers by highlighting the impact of government expenditure and public debt on economic growth. The positive association between government spending and GDP suggests that strategic investments in key areas such as infrastructure and social services can stimulate economic expansion. However, the study also emphasizes the importance of managing public debt effectively, as high levels of debt are linked to reduced economic growth. Policymakers should focus on maintaining

a balanced approach to fiscal policy, ensuring that government spending supports growth without leading to unsustainable debt levels.

For future research, the findings underscore the importance of selecting relevant variables to understand their effects on economic outcomes. While government expenditure shows a promising link to economic growth, other factors such as foreign direct investment and tax revenue also play a role but with varying degrees of impact. This study contributes to the existing literature by providing a framework for examining these relationships in the context of Nepal, setting the stage for further exploration of how different economic variables interact and influence growth. Researchers can use these insights to refine their analyses and develop more nuanced understanding of economic dynamics.

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Appendices

SN	fiscal year	GDP	GE	FDI	TR	BD	PD
1	2003/04	9	6.5	54	18	8.56	4
2	2004/05	9.8	14.7	-4	12	18.92	-1
3	2005/06	11	8.1	-1	6	18.97	-24
4	2006/07	11.3	20.5	22	24	21.52	40
5	2007/08	12.1	20.8	208	20	36.62	13
6	2008/09	21.2	36.1	-36	37	3.96	13
7	2009/10	20.7	18.2	45	37	-25.36	4
8	2010/11	14.6	13.7	10	11	-14.62	1
9	2011/12	11.7	14.8	-29	19	-18.56	18
10	2012/13	11	5.7	178	22	-36.8	4
11	2013/14	14.5	21.1	2	21	54	2
12	2014/15	9.4	22.2	235	14	113	-2
13	2015/16	8	12.9	-77	18	-15	15
14	2016/17	15.8	39.5	0	32	176	12
15	2017/18	9.7	29.9	267	19	67	30
16	2018/19	12.7	2.1	-54	12	6	14
17	2019/20	0.5	-1.7	48	-5	-6	35
18	2020/21	10.8	9.7	-15	24	-5	22
19	2021/22	12.4	9.5	68	13	-2	16
20	2022/23	10.4	8.5	-48	-12	69	14

(Source: economic survey of Nepal)

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