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THE RELATIVE EFFECTIVENESS OF FISCAL AND MONETARY POLICIES IN PROMOTING ECONOMIC GROWTH IN NEPAL

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ABSTRACT

This research paper examines the extent of effectiveness of fiscal and monetary policies in promoting economic growth in Nepal between 1976 and 2023 by applying the auto-regressive distributed lag (ARDL) model. Annual data from the World Bank were employed, where fiscal policy is denoted by government expenditure growth and monetary policy by broad money growth, with export growth included as a control variable. The unit root and bounds tests confirmed mixed integration and long-run cointegration among the variables. Empirical results show that monetary policy has a strong and significant influence on long-run GDP growth, whereas fiscal policy has only a small and short-term impact. A 1% increase in broad money supply adds about 0.51% to real GDP, equivalent to roughly USD 185 million per year. A 1% rise in exports increases GDP by 0.099% or around USD 36 million annually. Conversely, government expenditure shows a negative long-term effect of –0.115, translating to a potential GDP reduction of nearly USD 42 million, suggesting inefficiencies in fiscal allocation. The error correction term exhibits a negative sign with statistical significance, supporting a rapid adjustment toward equilibrium. Diagnostic tests verify model stability, normality, and the absence of serial correlation. The results show that monetary and external sector factors are the main long-term drivers of Nepal's economic growth. Fiscal measures, in contrast, provide only a short-term boost. The study recommends strengthening monetary management, improving fiscal efficiency, and promoting exports to ensure sustained and balanced growth in Nepal. Future research should explore sector-specific and nonlinear responses to fiscal and monetary measures to refine targeted policy interventions.

Keywords: ARDL, economic growth, fiscal policy, monetary policy, Nepal, exports, government expenditure

JEL Classification: E52, E62, O23, C32

INTRODUCTION

Sustaining economic growth is a key challenge for developing economies like Nepal. Fiscal and monetary policies play important but distinct roles in shaping macroeconomic performance. Fiscal policy, through government spending and taxation, mainly supports short-term growth by boosting aggregate demand. Monetary policy, in contrast, affects long-term stability by managing credit supply, liquidity, and confidence in financial markets. Proper coordination and implementation are crucial for the effectiveness of these policies. This holds particularly in the case of a small, open economy facing structural constraints.

In Nepal, fiscal and monetary authorities have tried to boost growth. The results have been uneven. Fiscal measures sometimes increase consumption. They have little effect on productivity. Monetary policy supports stability and investment growth. Monetary expansion and exports have a stronger and longer impact on output. Fiscal measures give only temporary support. This is because of inefficient spending.

This study examines the relative effectiveness of fiscal and monetary policies in promoting Nepal's economic growth from 1976 to 2023 using the ARDL framework. It aims to determine which policy channel has been more influential in the short as well as the

long term and to quantify the direction and magnitude of these effects. The findings are expected to inform evidence-based policy coordination that enhances macroeconomic stability and supports sustainable growth.

LITERATURE REVIEW

Economic policies, particularly fiscal and monetary interventions, are indispensable tools for promoting economic stability and long-term growth. Scholars have long emphasized that their effectiveness varies by country context, institutional quality, and the degree of economic openness. Ozili (2024) argues that fiscal policy and monetary policy frameworks play a central role in advancing sustainable development, showing that well-coordinated policy instruments can help achieve inclusive growth. He further suggests that analyzing their combined impact allows policymakers to design country-specific strategies suited to structural realities. In the same spirit, Maitra (2017) finds that in Sri Lanka, changes in nominal interest rates respond to both money supply and fiscal balances. This shows how closely these policy channels are linked. Together, these studies highlight the need to align fiscal expansion with careful monetary management. This is essential for sustaining long-term growth.

Regional differences make policy design more complex. Aginta and Someya (2024) show that Indonesia's provinces respond differently to monetary shocks due to their production structures. Manufacturing-heavy provinces react differently from those focused on mining or agriculture. This is relevant for Nepal, where regional economies also vary widely in structure and productivity. Onaga et al. (2023) extend this discussion to sub-Saharan Africa, revealing that monetary channels such as credit and exchange rates boost agricultural productivity but sometimes weaken industrial output. These findings focus on the fact that one-size-fits-all policy frameworks rarely achieve balanced outcomes; instead, region-specific and sector-sensitive strategies are required to avoid uneven growth patterns.

Evidence from South Asia further clarifies the comparative influence of fiscal and monetary instruments. Hasan et al. (2016) employ vector error correction and cointegration approaches to analyze Bangladesh's economy and conclude that broad money supply has a stronger and more persistent influence on output growth than government expenditure. Hossain (2020) validates these results, emphasizing that monetary policy, particularly through liquidity expansion, remains the dominant long-run driver of economic performance. These insights imply that countries like Nepal, with small financial markets and limited fiscal space, may achieve more sustainable growth through efficient monetary transmission mechanisms than through expansionary government spending alone.

In contrast, studies from other developing regions yield mixed evidence. Adegboyo et al. (2021) analyze Nigeria using an endogenous growth framework and find that fiscal expansion supports growth more consistently than trade or monetary interventions. Similarly, Beyene and Kotosz (2020) demonstrate that in Ethiopia, fiscal policy continues to dominate output determination, aligning with Keynesian principles of demand management. Mahmood and Sial (2021), focusing on Pakistan, report that development expenditures positively influence GDP, while excessive currency circulation and inflationary pressures undermine growth. These cross-country findings reveal that institutional efficiency, budget discipline, and financial depth largely determine which policy, fiscal or monetary, proves more effective.

The debate on fiscal sustainability has also attracted considerable attention. Kirchgässner and Prohl (2008) show that in Switzerland, fiscal sustainability fluctuates over time, requiring ongoing evaluation of public spending efficiency. Chibi et al. (2019) emphasize that external shocks such as global crises can alter fiscal space, making long-term sustainability dependent on adaptive and forward-looking policy design. These findings reflect Nepal's situation. Cyclical budget deficits and recurrent spending often limit development expenditure and long-term investment.

Monetary policy, on the other hand, has been found to affect capital flows and investment patterns in developing economies. Karahan and Bayır (2022) observe that low interest rates and expansionary liquidity conditions tend to attract foreign direct investment, linking monetary conditions with external financing. This highlights the importance of stable and transparent monetary policies. Such policies are key for countries aiming to diversify their growth sources. In the Egyptian context, El Husseiny (2023) applies the ARDL bounds test to compare fiscal and monetary influences on productivity growth. This analysis finds that fiscal measures provide short-term gains. Monetary expansion, in contrast, supports long-term development. This mirrors Nepal's experience, where spending raises immediate activity, but lasting growth relies on monetary stability and export performance.

Complementary findings from advanced economies also enrich this discussion. Kugler and Sheldon (2010) demonstrate that in Switzerland, monetary actions influence unemployment and inflation through multiple transmission channels. Similarly, Gidey and Nuru (2022) find that fiscal spending shocks can influence exchange rate stability in Ethiopia. This supports the idea that coordinating macroeconomic policies is key to achieving balanced outcomes. Together, these studies provide

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a conceptual framework for understanding how Nepal's fiscal and monetary authorities might align their actions to ensure consistent and sustained economic performance.

Nepal-specific research further highlights structural challenges in fiscal management and monetary transmission. Rimal (2023) examines the composition of public spending and reports that regular expenditure has a stronger long-term association with GDP than capital investment, suggesting inefficiencies in resource allocation. Such findings imply that fiscal policy in Nepal often favors consumption over productivity-enhancing investment. In contrast, monetary expansion, particularly through growth in broad money supply, appears to have a steadier and more powerful influence on economic activity. Short-term fiscal boosts and long-term monetary effects show similar patterns across emerging economies.

The reviewed literature demonstrates that the success of fiscal and monetary policies relies on country-specific structural, institutional, and financial factors. For Nepal, where fiscal deficits persist, and productive investment remains limited, the evidence suggests that prudent monetary management—supported by targeted fiscal reforms—could yield more stable growth. Effective policy coordination, improved spending efficiency, and stronger monetary transmission mechanisms are therefore essential for achieving long-term economic sustainability. This body of research provides a solid empirical and conceptual foundation for assessing how Nepal can balance fiscal and monetary levers to support inclusive and resilient economic development.

AIMS AND OBJECTIVES

This study aims to estimate how fiscal and monetary policies influence Nepal's economic growth. It focuses on their relative effectiveness in promoting expansion in both the short and long run. Using the ARDL method, the study captures dynamic relationships among key macroeconomic variables:

1. To examine how fiscal policy, measured by government expenditure, affects Nepal's economic expansion in both the short run and long run.
2. To analyze how monetary policy, reflected by the broad money supply, influences Nepal's economic growth over both short- and long-term periods.
3. To compare which policy — fiscal or monetary — has been more effective in supporting sustainable economic growth.
4. To provide policy insights for enhancing coordination between fiscal and monetary authorities in Nepal.

Through these objectives, the research seeks to offer empirical evidence on which policy lever — fiscal or monetary — has been more effective in shaping Nepal's economic trajectory. The findings are expected to guide policymakers toward better-designed and more balanced economic interventions.

METHODS

This research applies a quantitative, time-series research design. It uses annual data for Nepal from 1976 to 2023. To assess empirically how effective fiscal and monetary policies are in fostering Nepal's economic growth, we adopted the methodology likened by El Husseiny (2023), who made two significant adjustments to the innovative St. Louis equation model that was presented in Andersen and Jordan (1968). First, instead of using the "first difference" form, all variables were measured using the "growth rate" form. According to Carlson (1978), the goal of this procedure was to address any probable heteroscedasticity issues that might have arisen in the initial iteration of the St. Louis equation. Second, the independent expenditure component of global trade was taken into account by adding the "exports" variable. Therefore, the following specifications were included in our multivariate regression model:

$$\text{GDP growth} = f(\text{export growth, broad money growth, final consumption expenditure growth}) \quad (1)$$

It was significant that El Husseiny (2023) adopted the specification that we used in this investigation.

Since the exports variable served as a stand-in for the independent spending aspect of international trade, it was utilized to represent the foreign trade sector in our analysis. Darrat (1984) argues that the original St. Louis equation was formulated under the assumption of a closed economy, excluding external trade and financial linkages. For developing nations, whose economies were mostly shaped by the foreign sector, this made the original specification inappropriate. Darrat (1984) therefore recommended incorporating exports as an extra explanatory variable, particularly in models designed for developing countries.

Apart from the earlier specification, another version of the model was estimated with all variables presented in their natural logarithms (real terms):

$$LNGDP= f (LNX, LNM_2. LNFCE) \quad (2)$$

In this context, LNGDP represents the natural logarithm of real GDP; LNFCE represents the natural logarithm of real government final consumption expenditure; LNM2 refers to the natural logarithm of the real broad money supply; and LNX indicates the natural logarithm of real export earnings.

Notably, a similar specification was estimated by Tarawalie and Kargbo (2020), Özer and Karagöl (2018), and Hussain (2014). The study tested Gramlich's (1971) hypothesis that the effect of fiscal policy and monetary policy on GDP growth varies when variables are quantified using real or nominal figures.

Data Sources and Variables

The World Bank's World Development Indicators (WDI) provided the data for all variables, and Table 1 provides their definitions along with the measurement details. The variables in the study are summarized in Table 1, along with information on how they were measured.

Table 1. Variables, descriptions, and data sources for model specifications.

Model	Variable	Explanation	Sources of data
Specification-1 (Variables in current prices)	GDP growth	GDP annual growth rate	World Bank,2025
	Export growth	Export annual growth rate	World Bank,2025
	Broad money growth	Broad money annual growth rate	World Bank,2025
	Final consumption expenditure growth	Government final consumption expenditure annual growth rate	World Bank,2025
Specification-2 (Variables in constant prices)	LNGDP	Natural logarithm of GDP	World Bank,2025
	LNX	Natural logarithm of exports	World Bank,2025
	LNM2	Natural logarithm of broad money	World Bank,2025
	LNFCE	Natural logarithm of general government final consumption expenditure	World Bank,2025

Stationarity Test

The condition of stationarity in the time series variables served as the foundation for most time series econometric methods. Thus, in the dynamic time series model, standard estimations and test procedures were used (Poudel et al., 2025a). Examining each series' stationary property was a prerequisite. Unit root tests were performed to determine the order of integration for all time series variables (Poudel et al., 2024). In the ARDL model, variables are required to be integrated at either the I(0) or I(1) level. Hence, the KPSS, ADF, and PP tests were employed to identify the integration order. Once established, the ARDL F-bounds test was conducted.

ARDL Bounds Test

The Johansen (1988) and Engle-Granger (1987) models were popular in co-integration tests, but they needed non-stationary I(0) and stationary I(1) properties in the variables (Poudel et al., 2024a). The ARDL bounds testing approach does not necessitate all variables to be integrated at the same order and can manage both stationary and non-stationary data (Pesaran & Shin, 1995; Pesaran et al., 2001). It also permits analysis of long- and short-term dynamics using the ECM framework (Ozer and Karagol, 2018).

The method also produced Specification 1, calculated in current prices, and Specification 2, calculated in constant prices, both based on World Bank data. It provided unbiased long-term estimates despite the endogeneity of the regressors and was applicable to small sample sizes—an advantage over traditional co-integration methods (Udoh et al., 2015).

ECM

The ARDL model in error correction form helped to reflect cointegration underlying the relationship among variables and was estimated by using ECM (Stock & Watson, 1993; Poudel et al., 2025). Short-term dynamics were investigated by the

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use of the coefficients of the lagged values. Using equations starting with a long-term link between the growth rates of annual nominal GDP, export receipts, broad money supply, and government final consumption expenditures, it was stated in the following linear form:

$$\text{GDP growth}_t = \beta_0 + \beta_1 \text{ export growth}_t + \beta_2 \text{ broad money growth}_t + \beta_3 \text{ final consumption expenditure growth}_t + e_t \quad (3)$$

The unrestricted error correction representation of the ARDL model is:

$$\Delta(GDP\ growth) = \alpha_0 + \delta_1 GDP\ growth_{t-1} + \delta_2 export\ growth_{t-1} + \delta_3 broad\ money\ growth_{t-1} + \delta_4 final\ consumption\ expenditure\ growth_{t-1} + \sum_{i=1}^{p} \varrho_i\, \Delta(GDP\ growth_{t-i}) + \sum_{i=1}^{p} \Upsilon_i\, \Delta(export\ growth_{t-i}) + \sum_{i=1}^{p} \phi_i\, \Delta(broad\ money\ growth_{t-i}) + \sum_{i=1}^{p} \psi_i\, \Delta(final\ consumption\ expenditure\ growth_{t-i}) + \upsilon_t \quad (4)$$

where, Δ represented the first difference operator; δ_1, δ_2, δ_3, δ_4, were the long-run parameters; and p was the optimal lag minus 1.

The null hypothesis assumed that the variables in equation (4) were not cointegrated. (H_0: $\delta_1 = \delta_2 = \delta_3 = \delta_4 = 0$) is tested against the alternative hypothesis of having cointegration (H_1: $\delta_1 \neq \delta_2 \neq \delta_3 \neq \delta_4 \neq 0$). Consequently, rejecting the null hypothesis indicated the existence of a long-run cointegration relationship among the examined variables.

The significance of the adjustment speed coefficient indicates whether a cointegration relationship exists (Ozer & Karagol, 2018). If a long-run relationship between the variables was established, a short-run (error correction) form of the ARDL model was expressed by equation (5) as follows:

$$\Delta GDP\ growth_t = \alpha_0 + \sum_{i=1}^{p} \varrho_i\, \Delta(GDP\ growth_{t-i}) + \sum_{i=1}^{p} \Upsilon_i\, \Delta(export\ growth_{t-i}) + \sum_{i=1}^{p} \phi_i\, \Delta(broad\ money\ growth_{t-i}) + \sum_{i=1}^{p} \psi_i\, \Delta(final\ consumption\ expenditure\ growth_{t-i}) + \mho ecm_{t-1} + u_t \quad (5)$$

The ecm $_{t-1}$ term shows adjustment speed to equilibrium. Its coefficient must be negative and significant. Residuals were checked for normality, serial correlation, and heteroscedasticity. Stability was tested with RESET, CUSUM, and CUSUMSQ. The same was done for Specification 2.

Software Used

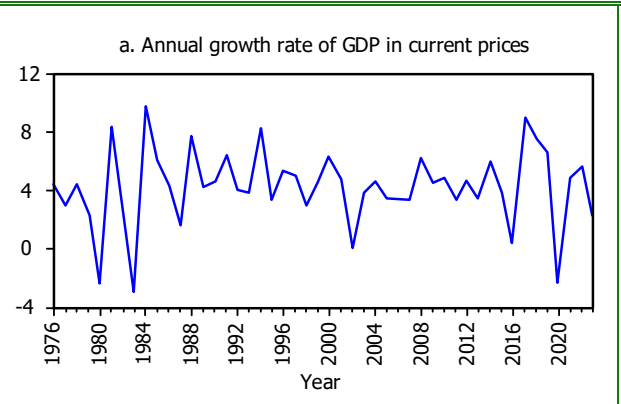
All estimations are conducted using EViews 12. Graphical and statistical outputs are used to interpret both the short-term and long-term impact of monetary and fiscal policies on economic growth.

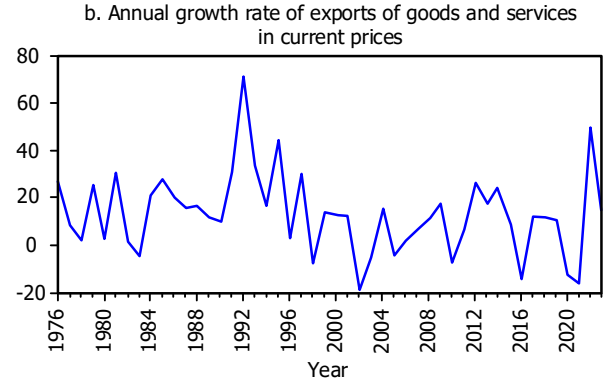
RESULTS

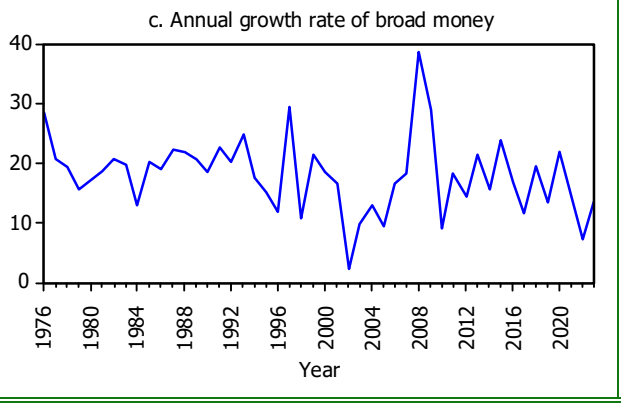
This section presents the empirical findings from the two model specifications described in the methodology. It analyzes both short- and long-run estimates to assess the effectiveness of monetary and fiscal policies in supporting Nepal's economic growth. The analysis uses key macro-financial indicators, including export receipts, money supply growth, and government expenditure trends, to show their impact on GDP.

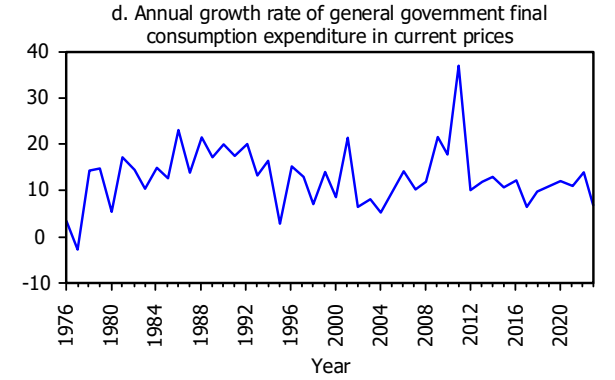
Figure 1 shows the trend line of the used variables. Figure 1a presents the trend line of GDP growth, which swung unpredictably, portraying expansion as well as contraction, fueled by political and external shocks. Figure 1b graphs export growth with high volatility and periodic spikes that indicate episodic trade improvement. Figure 1c graphs broad money growth, which was comparatively stable, portraying controlled monetary policy implementation. Figure 1d graphs government final consumption expenditure growth, which was volatile, reflecting uneven fiscal policy application. Figure 1e in Specification 2 shows the real GDP in log form trend, which was consistently upward, showing steady long-term growth. Figure 1f is real exports, with a steady improvement and stronger growth in recent years. Figure 1g charts real broad money, with a consistently increasing trend, indicating increasing financial depth. Finally, Figure 1h plots real government expenditure, with slow and uneven growth, suggesting limited and varying fiscal investment over the years.

Specification 1

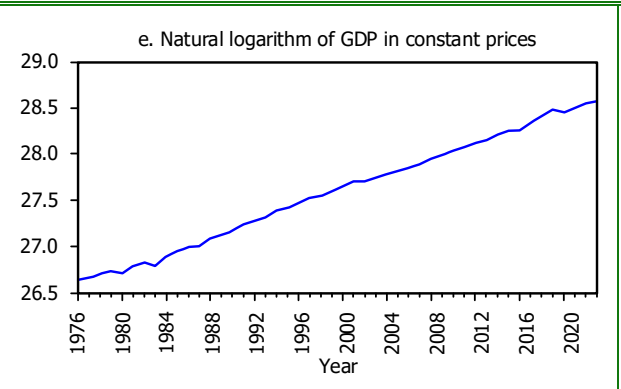


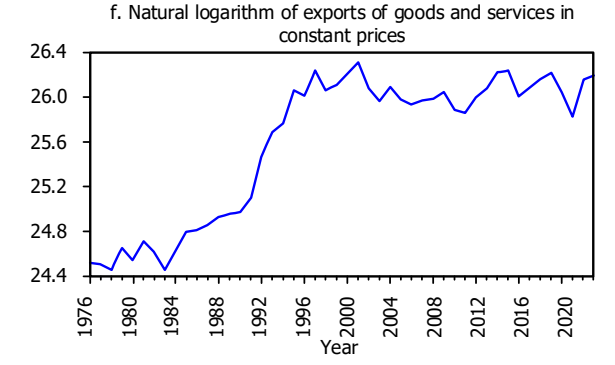


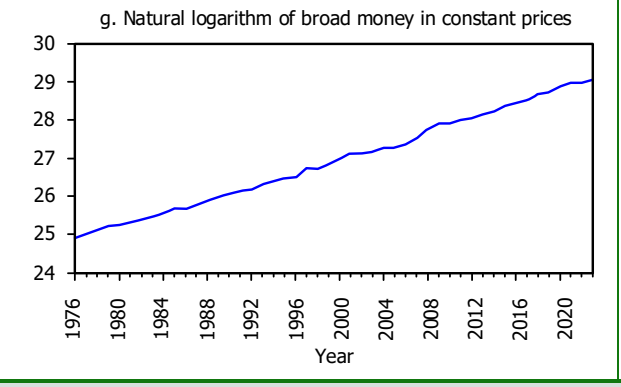




Specification 2







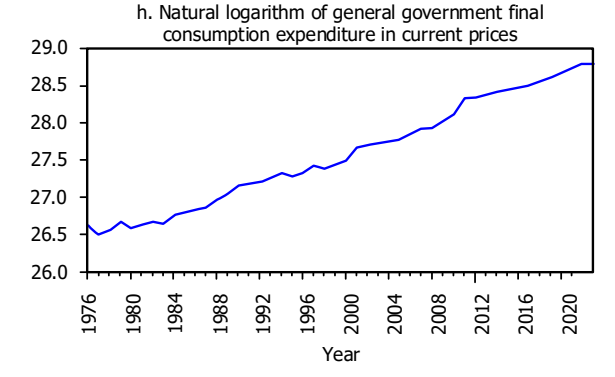


Figure 1. Trendline of used variables.

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Stationarity Testing

The ARDL bounds test requires I(0) or I(1) data, so the stationarity of each variable was checked via unit root analysis (Poudel et al., 2025). The KPSS, PP, and ADF tests were used. If the null hypothesis was rejected, it indicated that the variable was stationary (I(0)). If not, the variable was non-stationary and had a unit root. Non-stationary variables were differenced once to determine their integration order.

In Specification 1 (Table 2), GDP growth, export growth, money supply growth, and final consumption expenditure growth were tested. Both ADF and PP tests indicated that all variables were stationary at their level form, I(0), with significant t-statistics. KPSS also confirmed stationarity, as the test values were below critical limits. No differencing was needed for these variables.

Table 2. Results of the unit test for GDP growth, export growth, broad money growth, and final consumption expenditure growth. Notes: Significance levels are denoted as ***p < 0.01, **p < 0.05, *p < 0.1. ADF = Augmented Dickey-Fuller; (PP) = Phillips-Perron; KPSS = Kwiatkowski–Phillips–Schmidt–Shin

At Level (PP)		**Gdp growth**	**Export growth**	**Broad money Growth**	**Final consumption expenditure growth**
With Const.	t-Stat.	-8.9032***	-5.9605***	-5.8049***	-5.8423***
With Const. & Trend	t-Stat.	-8.8278***	-6.0771***	-5.8672***	-5.7619***
At First Difference		**d(GDP growth)**	**d(export growth)**	**d(broad money growth)**	**d(final consumption expenditure growth)**
With Const.	t-Stat.	-36.6790***	-30.2628***	-32.0485***	-14.9342***
With Const. & Trend	t-Stat.	-39.7709***	-31.7816***	-32.3611***	-16.4404***
Integration order		I(0)	I(0)	I(0)	I(0)
At Level (ADF)		**GDP growth**	**Export growth**	**Broad money growth**	**Final consumption expenditure growth**
With Const.	t-Stat.	-7.6166***	-5.9541***	-5.8008***	-4.0817***
With Const. & Trend	t-Stat.	-7.5599***	-6.0734***	-5.8795***	-5.7335***
At First Difference		**d(GDP growth)**	**d(export growth)**	**d(broad money growth)**	**d(final consumption expenditure growth)**
With Const.	t-Stat.	-8.7798***	-8.1281***	-10.5994***	-12.9719***
With Const. & Trend	t-Stat.	-8.7341***	-8.0289***	-10.4785***	-13.0347***
Integration order		I(0)	I(0)	I(0)	I(0)
At Level (KPSS)		**GDP growth**	**Export growth**	**Broad money growth**	**Final consumption expenditure growth**
With Const.	t-Stat.	0.0979	0.2797	0.2767	0.0899
With Const. & Trend	t-Stat.	0.0909	0.0883	0.0490	0.0889
At First Difference		**d(GDP growth)**	**d(export growth)**	**d(broad money growth)**	**d(final consumption expenditure growth)**
With Const.	t-Stat.	0.2848	0.5000**	0.5000**	0.2717
With Const.& Trend	t-Stat.	0.2961***	0.5000***	0.5000***	0.1500**
Integration order		I(0)	I(0)	I(0)	I(0)

In Specification 2 (Table 3), LNGDP, LNX, LNM2, and LNFCE were examined. PP and ADF tests showed that LNGDP and LNFCE were I(0). LNX and LNM2 were I(1). KPSS suggested that all variables became stationary after first differencing (I(1)). The dependent variable LNGDP and the fiscal-related variable LNFCE were stationary at the level. The monetary variable LNM2 and exports (LNX) required first differencing to achieve stationarity. The mixed integration orders in Specification 2 and uniform I(0) in Specification 1 support the application of the ARDL bounds testing approach for both specifications.

Table 3. Unit root test results for LNGDP, LNX, LNM2, and LNFCE using PP, ADF, and KPSS tests. Notes: Significance levels: ***p < 0.01, **p < 0.05, *p < 0.1. "Level" refers to the original series; "First Difference" refers to the differenced series. Integration order (I(0)/I(1)) determined from combined tests.

At Level (PP)		**LNGDP**	**LNX**	**LNM2**	**LNFCE**
With Constant	t-Statistic	0.3061	-1.3974	0.6282	0.7900
With Constant & Trend	t-Statistic	-3.5356**	-1.2782	-2.8766	-4.1930***
At First Difference		**d(LNGDP)**	**d(LNX)**	**d(LNM2)**	**d(LNFCE)**
With Constant	t-Statistic	-8.9453***	-6.8855***	-8.8104***	-8.5767***
With Constant & Trend	t-Statistic	-8.8420***	-6.9664***	-9.1016***	-8.4770***
Integration order		I(0)	I(1)	I(1)	I(0)
At Level (ADF)		**LNGDP**	**LNX**	**LNM2**	**LNFCE**
With Constant	t-Statistic	0.1299	-1.3987	0.2007	0.6990
With Constant & Trend	t-Statistic	-3.6313**	-1.2863	-2.9732	-4.1930***
At First Difference		**d(LNGDP)**	**d(LNX)**	**d(LNM2)**	**d(LNFCE)**
With Constant	t-Statistic	-7.5228***	-6.8855***	-7.1917***	-8.3136***
With Constant & Trend	t-Statistic	-7.4721***	-6.9511***	-7.1386***	-8.1927***
Integration order		I(0)	I(1)	I(1)	I(0)
At Level (KPSS)		**LNGDP**	**LNX**	**LNM2**	**LNFCE**
With Constant	t-Statistic	0.9052***	0.7259**	0.9084***	0.8991***
With Constant & Trend	t-Statistic	0.0848	0.1883**	0.2068**	0.1550**
At First Difference		**d(LNGDP)**	**d(LNX)**	**d(LNM2)**	**d(LNFCE)**
With Constant	t-Statistic	0.1066	0.1815	0.1640	0.1766
With Constant & Trend	t-Statistic	0.0988	0.0901	0.1410*	0.0934
Integration order		I(1)	I(1)	I(1)	I(1)

Table 4 reports the results of the ARDL bounds testing procedure for the first model requirement. This test utilizes the unrestricted ECM shown in equation (4) with automatically selected lags. The calculated F-statistic exceeds the upper-bound critical value at the 1% significance level, leading to the rejection of the null hypothesis. This indicates the presence of a long-run equilibrium relationship among the variables.

Table 4. Findings from the ARDL cointegration (F-Bounds) test.

Specification	**Optimal lag length**	**F-statistic**	**Bound critical values at 1% level (Finite Sample)**		**Outcome**
			I(0)	**I(1)**	
GDP growth = f(export growth, broad money growth, final consumption expenditure growth)	(2, 0, 1, 3)	13.8579	4.27	5.412	Cointegration exists between the examined variables
LNGDP = f (LNX, LNM2. LNFCE)	(1, 1, 3, 1)	6.1094	4.27	5.412	Cointegration exists between the examined variables.

Table 5 shows the estimated results for both the long-run and short-run periods. In the long run, export growth, broad money growth, and government expenditure had positive coefficients. None were statistically significant. Lagged GDP growth was positive and significant, showing a carry-over effect. Past growth influenced the current GDP.

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Table 5. Estimates of GDP growth from the short-run and long-run ARDL model. Notes: The asterisk (*) following CointEq(-1) is an automatic notation from EViews identifying the error correction term in the ARDL model, not a significance marker, and the asterisk (*) in the equation represents multiplication between the estimated coefficient and the respective explanatory variable.

Forms	Variable	Coefficient	t-statistic	Prob. Value
Long-run results: case 2: restricted constant and no trend Dependent variable: GDP growth	export growth	0.0228	1.4808	0.1476
	broad money growth	0.0233	0.4924	0.6255
	final consumption expenditure growth	0.0542	0.8630	0.3940
	C	2.8704	2.8829	0.0067
EC = GDP growth - (0.0227* export growth + 0.0233* broad money growth + 0.0542* final consumption expenditure growth + 2.8703)				
Short-run results (ECM Form) Dependent variable: D(GDP growth)	D(GDP growth (-1))	0.2831	2.4170	0.0210
	D(broad money growth)	-0.035595	-0.8797	0.3850
	D(final consumption expenditure growth)	0.091727	1.8485	0.0730
	D(final consumption expenditure growth (-1))	-0.132903	-2.2803	0.0288
	D(final consumption expenditure growth (-2))	-0.1493	-3.0723	0.0041
	CointEq(-1)*	-1.5819	-8.7868	0.0000

In the short run, variations in broad money were negative but not significant. This suggests monetary policy had little immediate effect. Changes in government spending were positive and of near 10% significance. This shows a modest short-term fiscal effect. Lagged changes in government expenditure were negative and significant. Past spending may lower current growth. This is likely due to inefficiency.

The error correction term exhibited a negative sign and was highly significant. Deviations from the long-run path were corrected quickly. This shows a strong adjustment mechanism. Fiscal policy had a limited short-term impact. Monetary policy had weak immediate effects. The results highlight the economy's tendency to return to equilibrium. Long-term stability requires consistent policy support.

Table 6 shows the diagnostic test results. Residuals are normally distributed (Jarque-Bera p = 0.9041), homoscedastic, and free from serial correlation. The Ramsey RESET test indicates minor specification issues (p = 0.0051). CUSUM and CUSUMSQ tests show overall model stability, though some parameter fluctuations may occur. These findings support the reliability of the model.

Table 6. Diagnostic tests. Notes: * = Multiplication.

Diagnostic tests	Test statistic	Probability
Normality (Jarque-Bera)	0.201685	0.904075
Heteroscedasticity (Breusch-Pagan-Godfrey)	F-statistic 0.749207	0.6622
	Obs*R-squared 7.269000	0.6091
Breusch-Godfrey Serial correlation LM test (2 lags)	F-statistic 0.607388	0.5507
	Obs*R-squared 1.597698	0.4498
Ramsey RESET Test	F-statistic 8.961171	0.0051
CUSUM	Stable	
CUSUM of Squares	Almost Stable	

Table 7 shows the short-run and long-run results for Specification 2. In the long run, export receipts (LNX) and broad money stock (LNM2) had positive and highly significant coefficients. This shows that both exports and monetary expansion supported GDP growth. Government final consumption expenditure (LNFCE) was negative and not significant. Fiscal policy had little long-run effect. The ECT was negative and significant, indicating a strong adjustment toward long-run equilibrium.

Table 7. ARDL estimates for LNGDP in the short- and long-run. Notes: * = Multiplication.

Forms	Variable	Coefficient	t-statistic	Prob. Value
Long-run results: case 2: restricted constant and no trend Dependent variable: GDP growth	LNX	0.099450	6.937480	0.0000
	LNM2	0.509815	6.838016	0.0000
	LNFCE	-0.115207	-0.929872	0.3588
	C	14.56728	9.646951	0.0000
EC = LNGDP - (0.0994*LNX + 0.5098*LNM2-0.1152*LNFCE + 14.5673)				
Short-run results (ECM Form) Dependent variable: D(LNGDP)	D(LNX)	0.117406	6.067521	0.0000
	D(LNM2)	0.055197	1.207146	0.2355
	D(LNM2(-1))	-0.064700	-1.083118	0.2862
	D(LNM2(-2))	-0.153660	-2.902167	0.0064
	D(LNFCE)	0.096277	1.649483	0.1080
	CointEq(-1)*	-0.582525	-5.834214	0.0000

In the short run, changes in export receipts strongly increased GDP growth. Monetary policy effects were mixed. The second lag of broad money (D(LNM2(-2))) had a negative impact, possibly due to delayed or inflationary effects. The first lag (D(LNM2(-1))) was small and not significant, indicating a weak short-run influence. Changes in government expenditure were positive but only marginally significant. Short-run fiscal effects were limited. The error correction term (ECT) confirmed that deviations from the long-run equilibrium were corrected quickly.

Exports were the key driver of both short- and long-run GDP growth. Monetary policy had a strong long-run effect but a weaker short-run impact. Fiscal policy had a limited influence in both periods. Policymakers should prioritize export promotion, efficient government spending, and sound monetary management to sustain growth.

Table 8 shows the diagnostic results. The Jarque-Bera test ($p = 0.5525$) confirmed that residuals are normally distributed. Breusch-Pagan-Godfrey tests found no heteroscedasticity. Breusch-Godfrey LM tests showed no serial correlation. The Ramsey RESET test was borderline ($p \approx 0.05$), indicating minor specification issues.

Table 8. Diagnostic tests. Notes: *= Multiplication

Diagnostic tests	Test statistic	Probability
Normality (Jarque-Bera)	1.186588	0.552504
Heteroscedasticity (Breusch-Pagan-Godfrey)	F-statistic 0.776382	0.6389
	Obs*R-squared 7.488784	0.5864
Breusch-Godfrey Serial correlation LM test (2 lags)	F-statistic 0.256913	0.7750
	Obs*R-squared 0.689928	0.7082
Ramsey RESET Test	F-statistic 3.943816	0.0552
CUSUM	Stable	
CUSUM of Squares	Stable	

CUSUM and CUSUMSQ tests confirmed model stability. No structural breaks were observed over time. Overall, the model is stable, well-specified, and reliable. Normal residuals, no heteroscedasticity, and the absence of serial correlation validate the estimates. Policymakers can trust the results.

Financial Analysis

To give a clearer financial perspective, the short- and long-run coefficients were converted into approximate annual effects on GDP. In the long-run ARDL model (Specification 2), a 1% increase in broad money (LNM2) raises real GDP by 0.51%. With Nepal's 2023 GDP of USD 36.3 billion, this adds about USD 185 million to annual output.

A 1% increase in exports (LNX) raises GDP by 0.099%, or roughly USD 36 million per year. Government consumption expenditure (LNFCE) was insignificant or negative in the long run. This suggests limited fiscal efficiency, possibly due to leakages or non-productive recurrent spending.

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These figures confirm the dominant long-term role of monetary expansion and trade in supporting GDP growth. Fiscal policy provides only a modest short-term boost, as shown by the short-run coefficient of 0.09 for government spending growth in Specification 1.

Table 9 shows the estimated financial effects of fiscal, monetary, and external sector variables on Nepal's real GDP, based on the long-run ARDL coefficients. Monetary expansion has the largest growth impact. A 1% raise in broad money increases GDP by around USD 185 million, showing a strong multiplier effect. Export growth adds around USD 36 million, confirming its steady contribution. Fiscal spending remains weak, as inefficient allocation lowers long-term output by nearly USD 42 million.

Table 9. Estimated financial effects of policy variables on real GDP. Notes: Based on Long-Run Coefficients, 2023 GDP = USD 36.3 Billion.

Variable	Long-run Coefficient	Type of Effect	Approximate Annual GDP Impact (USD millions)	Economic Interpretation
Broad Money (LNM2)	0.5098	Monetary	185.0	A 1% increase in money supply leads to a USD 185 million rise in GDP.
Exports (LNX)	0.0994	External	36.1	Export expansion contributes modest but stable growth to GDP.
Government Expenditure (LNFCE)	-0.1152	Fiscal	-41.8	Inefficient or consumption-heavy spending reduces long-term output.

DISCUSSION

The findings indicate that fiscal and monetary policies in Nepal work differently in the short and long run. Fiscal policy, measured by government expenditure, mainly affects short-run growth. Monetary policy, represented by broad money supply, drives long-run expansion. Inefficiencies in government spending limit the long-term effectiveness of fiscal policy. Monetary policy has only a limited immediate impact. The significant negative error correction term confirms a strong adjustment mechanism. The economy quickly returns to equilibrium after the shocks.

Compared with previous studies, the findings show both similarities and differences. Unlike Beyene and Kotosz (2020) and Adegboyo et al. (2021), who reported fiscal dominance in Ethiopia and Nigeria, monetary policy is more influential for Nepal's long-run growth. The results align with Hossain (2020) and El Husseiny (2023), who found monetary expansion to be the main driver in Bangladesh and Egypt. Unlike Maitra (2017), who emphasized fiscal-monetary coordination in Sri Lanka, this study observes a weaker fiscal channel in Nepal. It extends Özer and Karagöl (2018) by including export performance and quantifying the financial magnitude of policy effects. The key novelty is combining ARDL results with financial estimates, offering a measurable view of macroeconomic transmission in small open economies.

Regional and sectoral differences also matter. Aginta and Someya (2024) showed that industrial structure shapes monetary transmission in Indonesia. Onaga et al. (2023) found that credit and exchange rate channels strengthen agriculture but may weaken manufacturing. Nepal's diverse economic base requires regionally tailored fiscal and monetary policies to prevent uneven growth. Expansionary monetary policy can also attract foreign investment, as noted by Karahan and Bayır (2022). A stable monetary environment may boost both domestic and external investment.

Financial estimates support the analytical results. A 1% increase in broad money adds USD 185 million to GDP. A 1% rise in exports adds about USD 36 million. Government expenditure reduces long-term output by roughly USD 42 million, showing the limited productivity of recurrent spending. These figures confirm that monetary expansion and trade performance are key drivers of Nepal's growth. Fiscal measures remain short-lived and constrained by inefficiency.

The rapid adjustment shown by the error correction term confirms the stability of Nepal's macroeconomic system. It also emphasizes the need for consistent policy coordination. Overall, the study is original in integrating financial quantification with ARDL analysis. It shows that monetary and external factors, rather than fiscal policy, are the main long-run drivers of Nepal's growth.

Scientific Novelty and Contribution to Science

This study links financial quantification with an ARDL framework to assess fiscal and monetary policies in Nepal. Unlike previous research, it translates econometric coefficients into real GDP impacts. This provides a clear, tangible policy interpretation. Including exports as an external variable captures Nepal's trade dependence. The study shows that monetary

expansion and external sector growth have measurable, long-term financial effects. Fiscal policy, in contrast, remains short-lived and inefficient. This approach advances empirical macroeconomic research in small, developing economies.

Limitations

The study has several limitations. First, it uses aggregate national data, which may hide regional and sectoral differences. Second, broad measures of fiscal and monetary policy may miss specific tools, such as interest rate changes, targeted subsidies, or credit allocation. Third, structural breaks and global shocks, like pandemics or trade disruptions, are not explicitly modeled. Finally, the ARDL framework assumes linear relationships. Future research could explore nonlinear or asymmetric effects.

Policy Implications

The findings suggest several recommendations for Nepalese policymakers:

1. Use fiscal policy for short-term stimulus and monetary policy for long-term stability.
2. Prioritize spending in productivity-enhancing sectors such as infrastructure, education, and health.
3. Tailor policies to provincial and sectoral characteristics to prevent uneven growth.
4. Control liquidity and broad money supply to manage inflation while supporting investment.
5. Align fiscal and monetary measures to maximize effectiveness.
6. Improve the collection and tracking of regional and sectoral economic data.
7. Examine sectoral responses to fiscal and monetary policies, including agriculture, industry, and services, to guide targeted interventions.

CONCLUSIONS

This research shows that fiscal and monetary policies both influence Nepal's economic growth, but their effects differ over time. Government expenditure mainly boosts short-term growth. Broad money supply drives long-term expansion. Inefficiencies in fiscal policy limit its sustained impact. Monetary policy has weaker short-run effects. The ARDL analysis confirms cointegration among key variables and highlights the need for coordinated, balanced policy.

Policy implications include improving the efficiency of government spending, especially in productivity-focused sectors. Fiscal policy should be used for short-term stimulus, while monetary policy supports long-term stability. Attention to regional and sectoral differences is important, as uniform policies may not yield balanced growth. Export promotion, careful liquidity management, and stronger fiscal–monetary coordination are key to sustaining economic performance.

By comparing fiscal and monetary effectiveness and quantifying financial impacts, the study provides practical insights for policymakers in developing economies. Future research should examine sector-specific and nonlinear responses to fiscal and monetary measures to refine targeted policy interventions. Overall, this study enriches the empirical discourse on macroeconomic policy effectiveness in small, open developing economies.

ADDITIONAL INFORMATION

AUTHOR CONTRIBUTIONS

All authors have contributed equally.

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CONFLICT OF INTEREST

The Authors declare that there is no conflict of interest.

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ВІДНОСНА ЕФЕКТИВНІСТЬ ФІСКАЛЬНОЇ ТА ГРОШОВО-КРЕДИТНОЇ ПОЛІТИКИ В СПРИЯННІ ЕКОНОМІЧНОМУ ЗРОСТАННЮ В НЕПАЛІ

У цій дослідницькій роботі розглянуто ступінь ефективності фіскальної та грошово-кредитної політики в сприянні економічному зростанню в Непалі протягом 1976-2023 років шляхом застосування моделі авторегресійного розподіленого лагу (ARDL). Використані щорічні дані Світового банку, де фіскальну політику визначають зростанням державних витрат, а монетарну політику – широким зростанням грошей, при цьому зростання експорту включено як контрольну змінну. Тести одиничного кореня й границі підтвердили змішану інтеграцію й тривалу коінтеграцію між змінними. Емпіричні результати свідчать, що монетарна політика має сильний і значний вплив на довгострокове зростання ВВП, водночас фіскальна політика має лише невеликий і короткостроковий вплив. Збільшення широкої грошової маси на 1% додає близько 0,51% до реального ВВП, що еквівалентно приблизно 185 мільйонам доларів США на рік. Зростання експорту на 1% збільшує ВВП на 0,099% або близько 36 мільйонів доларів США на рік. І навпаки, державні видатки демонструють негативний довгостроковий ефект на рівні –0,115, що означає потенційне скорочення ВВП майже на 42 мільйони доларів США, що свідчить про неефективність фіскальних розподілів. Термін виправлення помилок демонструє негативний знак зі статистичною значущістю, схвалюючи швидке пристосування до рівноваги. Діагностичні тести перевіряють стабільність моделі, її нормальність і відсутність серійної кореляції. Результати показують, що грошово-кредитні та зовнішні секторальні фактори є основними довгостроковими драйверами економічного зростання Непалу. Фіскальні заходи навпаки дають лише короткостроковий поштовх. Дослідження рекомендує посилити грошово-кредитне управління, підвищити фіскальну ефективність і стимулювати експорт для забезпечення стійкого та збалансованого зростання в Непалі. Майбутні дослідження мають вивчати галузеві та нелінійні реакції на фіскальні й монетарні заходи з метою уточнення цільових політичних заходів.

Ключові слова: ARDL, економічне зростання, фіскальна політика, монетарна політика, Непал, експорт, державні витрати

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