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Nexus Between Political Stability and Economic Growth: An Empirical Study From Nepal

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Abstract

This study examines the impact of the political stability index, including inflation rate and gross capital formation growth, on Nepal's economic growth. This study uses secondary data from the World Bank, covering 27 annual data points from 1996 to 2022. Descriptive and exploratory research designs are used. Some statistical and essential econometric tools like graphs, descriptive statistics, correlation analysis, Johnsen co-integration test, vector error correction model, and Wald test are used in the study. The independent and dependent variables exhibit long-term cointegration. The preceding year's political stability has a favorable influence on current economic expansion. One percent improvement in the previous year's political stability index led to a 0.1896 percent increase in economic growth. One percent increase in inflation results in a 0.1884 percent decrease in economic growth in Nepal. Similarly, 84.96 percent of the variation in economic growth is influenced by factors such as past economic growth, political stability, inflation, and the expansion rate in gross capital accumulation over an extended period. The short-term economic growth of Nepal is influenced by factors such as the previous year's economic growth, political stability index, and growth in gross capital formation. Nevertheless, the inflation rate does not statistically explain short-term economic progress. To develop sustainable economic growth in Nepal, it is crucial to undertake critical policy initiatives such as enhancing the political stability index, encouraging capital formation, and efficiently managing inflation.

Keywords: Inflation, Capital accumulation, Significance, Causality, Co-integration

1 Introduction

Inflation is the continuous increase in the general price level of goods and services in an economy, which leads to a decrease in the purchasing power of a currency (Binder & Kamdar, 2022). Gross Capital Formation is the aggregate value of newly acquired tangible assets, such as machines, buildings, and infrastructure within a given timeframe. It represents the investment made to increase and expand the overall capital resources of an economy (Mohanty & Sethi, 2019).

Mild inflation can be conducive to economic growth as it encourages spending and investment. It can also reduce the real burden of debt. High or unpredictable inflation can harm economic growth (Mujtaba et al., 2022). It erodes purchasing power, reduces consumer confidence, and makes long-term planning difficult for businesses (Barro, 2013). Increasing gross capital formation, which includes investments in physical and human capital, can boost productivity and contribute to economic growth. It leads to the creation of new businesses, technological advancements, and improved infrastructure (Romer, 1986; Ali & Khan, 2020).

Political instability, such as frequent changes in government, civil unrest, or corruption, can adversely affect economic growth. Political stability affects economic growth by affecting the various determinants of economic parameters (Cervantes & Villasenor, 2015). Investors may hesitate to commit capital in uncertain environments,

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and the lack of stable policies can disrupt economic activities (Alesina et al., 1996). These factors often interact, and the overall economic environment can influence economic growth. For example, high inflation and political instability may amplify the adverse effects on growth (Gupta et al., 2005). Trade-offs between long-term stability and rapid growth may exist for nations. Policies that put short-term profits ahead of long-term investments run the risk of creating inflationary pressures (Kapur, 2023).

A mix of achievements and challenges has characterized Nepal's political stability. In recent decades, the country has undergone substantial political changes, such as the abolishment of the monarchy, the foundation of a federal democratic republic, and the introduction of a new constitution in 2015. Nevertheless, Nepal has seen intermittent political turmoil, governance dilemmas, and difficulties in efficiently implementing federalism (Dahal et al., 2024). Political movements, including protests and strikes, are common avenues for expressing grievances and advocating for change, reflecting the complex dynamics of Nepal's political landscape as it navigates the transition to democracy and strives for greater inclusivity and stability.

This study emphasizes the impact of the search for political stability on Nepal's economic growth. Secondly, it explores the individual and joint effects of inflation rate, capital formation growth, and previous economic growth rate on Nepal's economic progress.

This study is divided into six sections. The rest of the chapters of this study are as follows: Segment 2 reviews the theoretical and empirical literature on this topic. Part three presents the materials and methods of this research. Research design, data collection, nature of data, variable, and model specification are included. Segment four displays the data results and analyzes them to derive findings. Segment five discusses the study's results, and finally, segment six consists of the study's conclusion, policy implications, and limitations.

2 Literature review

Political stability and economic growth are intertwined concepts in political economy and development studies. Various theories attempt to explain the relationship between political stability and economic growth. Modernization theory posits that as societies advance economically, they undergo a modernization process leading to political stability. According to this theory, economic growth fosters the development of democratic institutions, the rule of law, and political stability (Lipset, 1959). Dependency theory argues that political instability can result from economic underdevelopment and dependence on more developed countries. It suggests that unequal economic relationships between nations perpetuate political instability in less developed countries (Frank, 1966). Institutional theory focuses on the role of political institutions in promoting economic growth and stability. It argues that strong institutions, including effective governance structures, property rights protections, and the rule of law, are essential for sustained economic growth and political stability (North, 1990). State-building theory suggests that political stability is closely linked to the capacity of the state to provide public goods, enforce laws, and maintain order. Practical state-building efforts are crucial for fostering economic growth and stability (Tilly, 1985).

Various theories offer different perspectives on the relationship between inflation and economic growth. Monetarist theory, associated with economists like Milton Friedman, emphasizes the role of money supply in driving inflation. According to this theory, sustained inflation is primarily a monetary phenomenon caused by excessive growth in the money supply. Monetarists argue that high inflation rates can impede economic growth by distorting price signals, reducing investment, and eroding purchasing power (Friedman, 1968). The neo-Keynesian theory builds upon Keynesian economics and suggests that inflation can positively and negatively affect economic growth depending on its level. Moderate inflation may stimulate economic growth by reducing accurate interest rates and encouraging consumption and investment. However, high and unpredictable inflation rates can create uncertainty, distort resource allocation, and hinder long-term growth (Barro & Gordon, 1983).

The Harrod-Domar model highlights the significance of gross capital formation (investment) in promoting economic growth. Based on this paradigm, greater levels of investment result in enhanced capital accumulation, which fosters economic growth. The model posits that the pace of economic growth is closely correlated with the ratio of investment to capital output (Horrod, 1939, & Domar, 1946). The Solow growth model, established by Robert Solow, integrates technological advancement's influence alongside capital accumulation. The statement implies that gross capital production enhances economic growth by augmenting the capital stock, whereas technological advancement is the principal catalyst for sustained economic expansion. The model demonstrates that accumulating capital has diminishing returns, indicating that ongoing technological progress is necessary for sustainable economic growth (Solow, 1956).

Adhikari (2014) and Bhatt (2015) also discovered the damaging impact of inflation on Nepal's economic growth. Poudel and Raut (2020) examined the influence of inflation on Nepal's economic growth. A positive association was shown between inflation and economic growth. A positive link was found between inflation and economic growth up to the threshold level of 6.38 ± 1.36 percent, with a negative influence shown beyond this threshold. Seema et al. (2020) also discovered the detrimental impact of inflation after it is above a specific threshold rate. In their investigation, the researchers set a criterion of approximately 6 percent. Adaramola and Dada (2020) examined the influence of inflation on the economic expansion in Nigeria. It was observed to exert a detrimental and substantial impact on economic growth.

Sayehmiri et al. (2021) search for the impact of inflation on economic growth by applying a meta-analysis approach. They summarized that inflation has both positive and negative effects on economic growth based on the level of inflation, i.e., moderate or hyperinflation. Fabayo and Ajilore (2006) found an inflation threshold of 6 percent; below this level, there is a significant positive relation between inflation and economic growth, but above this threshold, there is an adverse impact on economic growth. The finding of Yemba et al. (2020) indicates that an inflation rate below 17.2 percent would drive economic growth, but any inflation beyond that threshold hurts the economic growth in Cango. Rihan and Bawady (2018), Azam and Khan (2022), chu et al. (2019), Islam (2021), and Mignamissi et al. (2023) found a positive effect of inflation on economic growth before the specific threshold of inflation but negative impact on economic growth beyond the threshold. Madurapperuma (2023) found the negative effect of short-run and long-run inflation on economic growth in Sri Lanka.

In his study, Feng (1997) investigated the influence of democracy, political stability, and economic growth. He discovered the favorable effect of political stability on economic growth. More specifically, he found the opposite effect of regime change and a positive impact on the probability of the ruling party remaining in power. Ahmedi and Pulok (2013) discovered that political stability adversely influences long-term economic growth, while it does yield a favorable outcome in the short term. Rodhu (2015) established a clear and direct relationship between the stability of the political situation and the growth of the economy in Romania. Hamdaoui et al. (2021) discovered a positive correlation between political stability and economic growth in general but also saw a brief negative impact. Goldsmith (1987) identified a negative link between political stability and economic progress.

Rajah (2018), Zeaiter and Kassem (2017), and Shabbir et al. (2016) observed that political stability plays a positive role in promoting economic growth. Kyarem et al. (2020) examined Nigeria's political elites' corruption, political stability, and economic growth. They found that political stability has a positive and significant impact on economic growth in the short run and an insignificant effect in the long run. Mandal (2022) observed the minimum impact of political stability and the absence of violence/ terrorism on Nepal's long-term economic growth. Ben and Rahali (2018) found the negative effect of political instability on investment and economic growth. Kapur (2023) found a bilateral relationship between political stability and economic growth, i.e., economic condition causes political instability and hurt economic growth.

Ajose and Oyedokun (2018) studied the correlation between Capital formation and economic growth in Nigeria. The researchers discovered a significant correlation between long-term relationships and economic growth. Nevertheless, the impact was adverse and statistically insignificant. In their study, Aslen and Altinoz (2021) observed a detrimental influence of capital formation on economic growth in European nations while noting a favorable impact on African countries. In the long term, a reciprocal correlation was observed between capital accumulation and economic expansion in European and Asian nations. Adhikari (2015) has noted the detrimental effect of gross capital formation on economic advancement.

Adhikari (2011) and Maune et al. (2023) discovered that capital development has a dynamic and substantial influence on economic growth. Uneze (2013) found the bilateral causality between economic growth and capital formation. He concluded that higher economic growth leads to higher capital formation and that, in turn, an increase in capital formation results in higher economic growth. Obobisa et al. (2021) and Kesar et al. (2023) found gross capital formation's positive and significant impact on economic prosperity.

The relationship between the inflation rate and political stability has been established through many ideas and empirical evidence, indicating their impact on economic advancement and GDP growth. Several research studies aim to develop the correlation between these characteristics. The present study aims to assess the separate and combined effects of the previous economic growth rate, capital formation, inflation rate, and political stability on the economic growth of the Nepalese economy.

3 Materials and methods

This study is based on descriptive and exploratory research design. Secondary data was used in the study. The secondary data are collected from various reports from the World Bank. The annual data for 27 years from 1996 to 2022 are used in the study. Economic growth is the dependent variable, and inflation rate, political stability index, and capital accumulation growth rate are independent variables. The data is processed and analyzed with the help of EViews12. Some statistical and econometric tools like graphs, correlation, descriptive statistics, vector error correction model, and Wald test for short-run causality are used in this study. Economic growth is affected by the political stability index, inflation rate, and gross capital formation. In this sense:

Economic growth = f (Political stability index, Inflation rate, Capital formation growth) (1)

In Symbol, GDPGR =f (PSI, INFRT, GCFGR) (2)

A Vector Error Correction Model (VECM) is a type of time-series econometric model commonly used for analyzing relationships among multiple variables that are non-stationary and potentially co-integrated. It's an extension of the Vector Autoregression (VAR) model, designed specifically for cointegration variables, implying a long-term equilibrium relationship among them.

When vector autoregressive (VAR) variables are co-integrated, the vector error correction (VEC) model is used. The VECM model is specified as:

$\Delta Y_t = \beta_{Yo} + \beta_{Y1}\Delta Yt-1 + \ldots\ldots + \beta_{Yp}\Delta Y_{t-p} + \gamma_{Yp}\Delta Xt-p - \lambda_Y(Y_{t-1} - \alpha_0 - \alpha_1 X_{t-1} + V^Y_t$ (3)

$\Delta X_t = \beta_{Xo} + \beta_{X1}\Delta Yt-1 + \ldots\ldots + \beta_{Xp}\Delta Y_{t-p} + \gamma_{X1}\Delta Xt-1 + \ldots\ldots + \gamma_{XP}\Delta X_{t-p} + \gamma_{Yp}\Delta Xt-p - \lambda_X(Y_{t-1} - \alpha_0 - \alpha_1 X_{t-1} + V^Y_t$ (4)

In these equations, λ_X and λ_Y are the error correction parameters that measure how X and Y react to deviations from long-run equilibrium.

Let ΔY_t represent the first difference of the vectors of variables Yt at time t. If Yt is K×1, then ΔY_t is also K×1. A typical VECM of order P can be presented as given below:

$\Delta Y_t = \alpha + \text{Þ}Yt\text{-}1 + \sum_{i=1}^{p-1} Ti\ \Delta Yt - i + \mu_t$ (5)

In equation (5), α is a constant term, Þ is a coefficient matrix of size K×K, which captures the adjustment towards equilibrium in the long run. It is also called co-integrating vectors. *T*i is the coefficient matrix of the size of K×K capturing the short-run dynamics (lagged first difference). μt is a vector of white noise disturbances. This model includes both short-run dynamics (captured by co-integrating vectors). The error correction term in a VECM is crucial. It is derived from the co-integrating relationships among the variables. For a system with γ co-integrating relationships, the error correction term (ECT) for each variable Yi is given by:

$ECTi = \lambda i\ (Yi - \sum_{j=i}^{k} \beta ijYj$ (6)

In equation (6), λi represents the speed of adjustment for variable Yi. βij are the elements of the co-integrating vectors (row of the Þ matrix). This term describes the disequilibrium from the long-run relationship and adjusts the short-run dynamics towards the long-run equilibrium (Johnsen, 1991).

4 Presentation and Analysis

4.1. Conditions of Dependent and Independent Variables

Before analyzing the data, the situation of response and predictor variables are presented in graphical form and summary statistics. Figure 1 shows the graphical representation of economic growth, inflation rate, gross capital formation growth rate, and political stability index. The gross capital formation is found to have a more fluctuating trend than other variables. The political stability index gradually decreased after 1996 AD with slight variation but increased after 2013 AD. In short, all study variables change with some variation.

Figure 1. *Graph showing the condition of variables.*

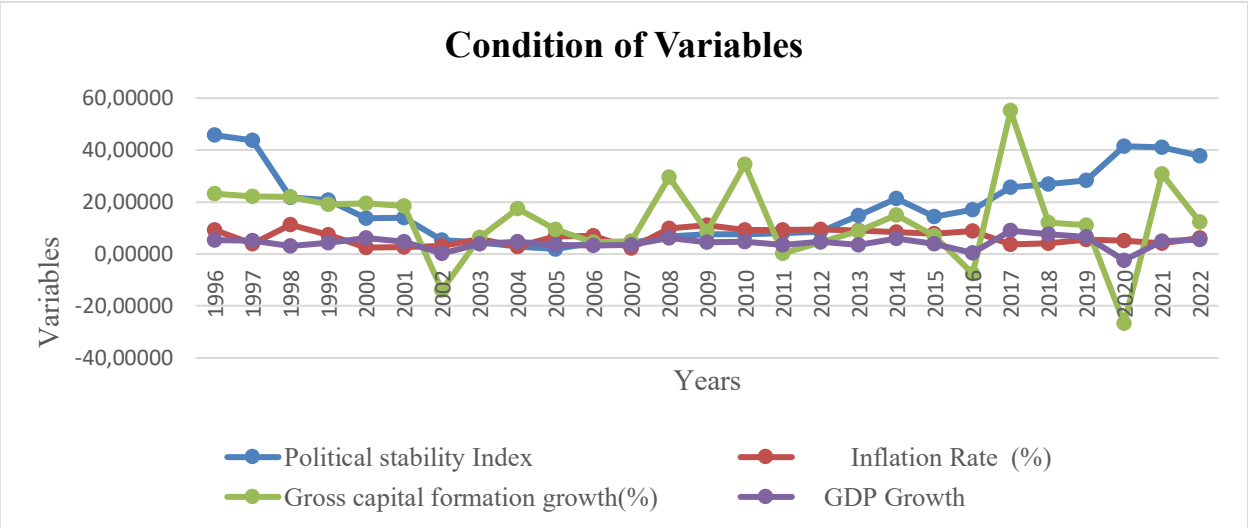

Table 1 shows the key information on four key variables: GDP growth rate (GDPGR), gross capital formation growth rate (GCFGR), inflation rate (INFRT), and political stability index (PSI). The mean values indicate a positive overall economic trend, with GDPGR at 4.3199, GCFGR at 12.926, INFRT at 6.5285, and PSI at 18.1596 percent. However, significant variability is evident, as illustrated by high standard deviations and coefficient of variation percentages. The standard deviation of the economic growth rate is smaller than other variables. So, the average GDP growth is more representative than others. Based on the coefficient of variation, the inflation rate is more consistent,

and Gross capital formation is more unstable. The skewness and kurtosis values highlight the distributional properties, with GDPGR displaying a negatively skewed pattern.

Table 1. *Key information of variables*

Base	GDPGR	GCFGR	INFRT	PSI
Mean	4.3199	12.926	6.5285	18.1596
Median	4.6701	12.183	6.8363	14.285
Maximum	8.977	55.171	11.244	45.744
Minimum	-2.369	-26.673	2.2692	1.9417
Std. Dev.	2.280	15.772	2.835	13.829
Skewness	-0.881	0.0443	-0.010	0.714
Kurtosis	4.726	4.402	1.681	2.249
Coefficient of Variation	52.78%	121.96%	43.49%	76.19%
Observations	27	27	27	27

4.2. Analysis of associations between variables

The correlation matrix indicates the relationships among the economic variables: GDP growth rate (GDPGR), gross capital formation growth rate (GCFGR), inflation rate (INFRT), and political stability index (PSI). Strong positive correlations are observed between GDP growth and gross capital formation (0.81) and GCFGR and PSI (0.15). However, GDPGR shows a weak negative correlation with INFRT (-0.09), and PSI displays a weak positive correlation with GDPGR (0.10). These insights suggest potential interdependencies between dependent and independent variables.

Table 2. *Pairwise association between Variables*

Variables	GDPGR	GCFGR	INFRT	PSI
GDPGR	1.0000	0.8087	-0.08764	0.10322
GCFGR	0.80874	1.0000	-0.00828	0.14733
INFRT	-0.08764	-0.00828	1.00000	-0.10765
PSI	0.10322	0.14733	-0.10765	1.0000

GDPGR= Gross Domestic Product growth rate, INFRT= Inflation rate, GCFGR= Gross Capital Formation growth rate, and PSI= Political Stability Index

4.3. Long co-integration test of variables

The Johansen cointegration test is a statistical technique utilized to evaluate the existence of cointegration among several variables in a time series. This test aids in identifying the number of co-integrating vectors, offering a valuable understanding of the enduring connections between variables in a multivariate time series framework (Johnsen, 1988). The results of the Johansen cointegration test in Table 3 indicate the presence of at least one co-integrating link among the variables. The Trace and Maximum Eigenvalue statistics repeatedly reject the null hypothesis that there is no cointegration, demonstrating the existence of a long-term link with a significance level of 0.05. Hence, it can be inferred that at least one co-integrating equation exists among the examined variables. The Vactor Error Correction Model (VECM) can be executed.

Table 3. *Trace and Max-Eigen test for long-run Co-integration*

Hypothesized: No of CE(S)	Eigenvalue	Trace Method			Maximum Eigen Method		
		Trace statistics	Critical value at 0.05	P-value	Max-eigen stat.	Critical value 0.05	P-value
None*	0.8998	84.0112	47.8561	0.0000	57.531	27.584	0.0000
At most 1	0.5371	26.4810	29.7971	0.1150	19.258	21.132	0.0896

At most 2	0.1656	7.2224	15.4947	0.5519	4.525	14.265	0.8002
At most 3	0.1022	2.6973	3.8445	0.1005	2.697	3.841	0.1005

Note: - Both Trace and Max-eigen test indicates one co-integrating equation at the 0.05 level

4.4. Vector Error Correction Model

Vector Error Correction Model (VECM) is a framework primarily used to analyze long-run relationships among variables. The Vector Error Correction Model (VECM) is a statistical model used to investigate the long-run relationships among multiple time series variables and their short-run dynamics. It extends the Vector Autoregression (VAR) model to incorporate cointegration among the variables, allowing for the correction of short-run deviations from the long-run equilibrium.

Table 4. *Analysis of long-run impact by using VECM*

Dependent Variables: GDP growth

Co-integrating Eq^{n}	ContiEq1	Intercepts	Standard error	t- statistics
GDPGR(-1)	1.000	-	-	-
INFRT(-1)	-	-0.0617	0.0311	-0.5384
PSI(-1)	-	-0.0167	0.0072	-2.4622
GCFGR(-1)	-	-0.0675	0.0120	-5.6254
C	-	-2.996	-	-

Dependent variable D(GDPGR)					
Error Correction	Intercept code	Intercept	Standard error	t-statistics	Prob.
Cont. Eq1	C(1)	-4.5677	1.0102	-4.5214	0.0000
D(GDPGR(-1))	C(2)	2.5176	0.7734	3.2552	0.0019
D(GDPGR(-2))	C(3)	1.2406	0.6101	2.0335	0.0467
D(INFRT(-1))	C(4)	0.0202	0.1417	0.1427	0.8871
D(INFRT(-2))	C(5)	-0.0496	0.1331	-0.3730	0.7106
D(PSI(-1))	C(6)	0.1896	0.0721	2.6306	0.0110
D(PSI(-2))	C(7)	0.0332	0.0659	0.5042	0.6161
D(GCFGR(-1))	C(8)	-0.2448	0.0729	-3.3561	0.0014
D(GCFGR(-2))	C(9)	-0.0972	0.0659	-1.4746	0.1459
C	C(10)	0.4327	0.3801	1.1385	0.2597

R-squared	0.8496	Adj. R-squared	0.7529
S.E. Equation	1.7728	F-statistics	8.7900
Log-likelihood	-41.3292	Mean dependent	0.1082
Sum of residuals	44.003	S.D. dependent	3.5671

In Table 4, the Vector Error Correction Model (VECM) is estimated to suggest a long-run equilibrium relationship among the dependent variable (GDP growth) and its lagged values, as well as the lagged values of inflation (INFRT), political stability index (PSI), and gross capital formation growth rate (GCFGR). The coefficients on the lagged values in the co-integrating equation indicate the adjustment process toward the long-run equilibrium. The error correction term coefficients in the D(GDPGR) equation indicate the short-run dynamics, with statistically significant coefficients suggesting the speed of adjustment toward the equilibrium. The overall model has a relatively high R-squared value (0.8496), indicating a good fit, and the significance of the F-statistic supports the model's overall explanatory power. The long-run VECM regression equation is found as given below:

D(GDPGR) = -4.5677*(GDPGR(-1) - 0.0167*INFRT(-1) - 0.0178*PSI(-1) - 0.0675*GCFGR(-1) - 2.996 + 2.5176*D(GDPGR(-1)) + 1.2406*D(GDPGR(-2)) + 0.0202*D(INFRT(-1)) -0.0496*D(INFRT(-2)) + 0.1896*D(PSI(-1)) + 0.0332*D(PSI(-2)) - 0.2448*D(GCFGR(-1)) -0.0973 *D(GCFGR(-2)) + 0.4327 (7)

The equation represents the dynamics of the dependent variable D(GDP growth), incorporating the lagged values of GDP growth, inflation, political stability, and gross capital formation growth rate. The coefficients provide insights into the long-run relationships and short-run adjustments, with the error correction term (C(1)) indicating the convergence speed towards equilibrium.

4.5. Exploration of impact by the ordinary least square method

In Table 5, the coefficients and probability values of variables are displayed. The regression results indicate that the gross capital formation growth rate significantly positively affects the GDP Growth Rate, as demonstrated by its coefficient of 0.1327 with a t-statistic of 7.1463. Conversely, the inflation rate negatively impacts GDP growth, as indicated by its coefficient of -0.1884 and t-statistic of -2.9087. Additionally, lagged real GDP growth positively influences current GDP growth, suggesting a persistent effect on economic growth dynamics. However, the political stability index (PSI) coefficient is not statistically significant, implying it doesn't have a discernible impact on GDP growth. Remarkably, the intercept term (C) is statistically significant at the 5 percent level, indicating a baseline level of GDP growth when all independent variables are zero. Overall, the model explains about 71.60 percent of the variation in GDP growth, suggesting a relatively good fit.

Table 5. *Estimation of coefficient of study variables*

Dependent variable: GDPGR

Variable	Coefficient	Std. Error	t-Statistic	Prob.
GCFGR	0.1327	0.018	7.1463	0.0000
INFRT	-0.1884	0.0648	-2.9087	0.0373
LAGRG	0.2638	0.1288	2.059	0.0420
PSI	-0.0096	0.0215	-0.4500	0.657
C	2.2258	1.004	2.2154	0.039
R-squared	0.7160	Mean dependent var		4.2811
Adjusted R-squared	0.6619	S.D. dependent var		2.3168
S.E. of regression	1.3470	Akaike info criterion		3.6047
F-statistic	13.238	Durbin-Watson stat		2.0270
Prob(F-statistic)	0.00002			

The Regression equation is estimated as given below:

GDPGR = 0.1327*GCFGR - 0.1884*INFRT + 0.2638*LAGRG - 0.0096*PSI + 2.225678 (8)

4.6. Diagnostic checking of the model

Table 6 presents a comprehensive overview of the different metrics used for diagnostic checks. The Breusch-Pagan Godfrey test for heteroscedasticity produces an F-statistic of 1.6004 with a p-value of 0.2113, suggesting no substantial evidence of heteroscedasticity in the model. Similarly, the Breusch-Godfrey serial correlation LM test yields an F-statistic of 2.1905 with a p-value of 0.1393, indicating the absence of substantial serial correlation in the residuals. Furthermore, the Jarque-Bera statistic of 0.551 with a probability of 0.759 suggests that the normality test does not yield enough evidence to reject the null hypothesis of normality in the residuals. Therefore, according to these tests, we can deduce that the model fulfills the assumptions of homoscedasticity, absence of serial correlation, and normality of residuals.

Table 6. *Various measures of model check*

Base	Heteroscedasticity test: Breusch-Pagan Godfrey		Breusch-Godfrey Serial Correlation LM Test		Normality test
	Value	Prob	Value	Prob	
F-statistics	1.6004	0.2113	2.1905	0.1393	Jarque-Bera =0.551
Observed R-squared	6.074	0.194	4.8717	0.0875	Probability = 0.759

4.7. Short-run causality test of variables on economic growth

The Wald Test is a statistical test used to assess whether specific parameters in a regression model are jointly significant by comparing the ratio of the estimated parameter to its standard error with a critical value from the chi-squared distribution. Table 7 displays the results of the Wald test of the concerned variables.

Table 7. *Short Causality Test of variables by using the Wald Test*

Variables	Hypothesis	Test statistics	Value	df	Probability
Previous growth rate D(GDPGR)	C(2) =C(3)=0	Chi-square	15.595	2	0.0004
Inflation rate (INFRT)	C(4)=C(5)=0	Chi-square	0.2275	2	0.8925
Political Stability Index (PSI)	C(6) =C(7)=0	Chi-square	7.0007	2	0.0301
Gross Capital Formation (GCFGR)	C(8) =C(9)=0	Chi-square	19.259	2	0.0001

The Wald tests conducted on the variables reveal significant findings. For the previous growth rate (D(GDPGR)), the null hypothesis that coefficients C (2) and C (3) are both equal to zero is rejected at a high level of significance (p-value = 0.0004), indicating a significant causal relationship. The economic growth rate of previous years affects the present growth rate in the short run. However, the inflation rate is not statistically significant in determining the economic growth rate in the short run. The political stability index and gross capital formation growth rate substantially determine short-run economic growth.

5 Discussion

The present study found a positive association between capital formation growth rate and economic growth. This finding aligns with Ajose and Oyedokun's (2018) and Maune et al. (2023) findings. The five variables, like previous growth, inflation, capital formation, and political stability index, have long-run cointegration. One percent increase in past economic growth results in a 2.5176 percent increase in present economic growth. Previous economic growth affects present economic growth due to the presence of lags and momentum effects in economic variables, where past growth tends to influence current levels of investment, consumer behavior, and overall economic activity.

The political stability index has no significant impact on Nepal's economic growth. It contradicts most similar studies but is supported by the work of Goldsmith (1987) and Ahmedi and Pulok (2013). The political stability index may have no significant effect on economic growth in Nepal due to potential confounding factors or the dominance of other determinants such as infrastructure, education, or foreign investment. The political stability of previous years positively affects the present economic growth. One percent increase in the political stability index results in a 0.1896 percent increase in economic growth in the short run. It aligns with Hamdaoui et al.'s (2021) and Feng's (1997) findings. In the short run, the political stability index and economic growth may have a positive impact due to increased investor confidence, reduced uncertainty, and enhanced policy continuity, leading to

higher investment and economic activity levels. The finding of Kapur (2023) aligns with the findings of this research, but Mandal (2022) found only a minimum impact of political stability on economic growth.

Inflation has a negative and significant impact on economic growth. One percent increase in inflation results in a -0.1884 percent decrease in economic progress. The findings of Poudel and Raut (2020), Seema et al. (2020), Bhat (2015), and Adaramola and Dada (2020) align with this finding. Inflation harms economic growth in both the short and long run due to its adverse effects on consumer purchasing power, uncertainty in investment decisions, and potential distortions in resource allocation. Madurappernuma (2023), Mignamissi et al. (2023), and Azam and Khan (2022) found a negative impact on inflation after a threshold level of inflation.

6 Conclusion, policy implications, and limitations

This study has examined the impact of the political stability index on economic growth in the Nepalese economy in the short and long run. It has also examined the effect of the previous year's economic growth, inflation rate, and gross capital formation growth rate on the economic progress of the Nepalese economy. All variables are found in fluctuating trends. Economic growth and capital formation growth have a high degree of positive association, But GDP growth and inflation rate have a meager degree of negative correlation. Nepal's political stability index and economic progress show a low positive correlation. The independent and dependent variables have long-run cointegration. The political stability of the previous year [D(PSI (-1)] has a positive impact on present economic growth. One percent increase in the political stability index of the previous year resulted in a 0.1896 percent increase in economic growth. Likewise, 84.96 percent variation in economic growth depends upon previous years, economic growth, political stability, inflation, and gross capital formation growth rate in the long run. The economic growth during the last few years, political stability index, and gross capital formation growth have affected Nepal's economic growth in the short run. However, the inflation rate does not statistically explain short-run economic progress.

The findings underscore the critical role of political stability in driving economic growth in Nepal, both in the short and long term. Policymakers should prioritize measures that enhance political stability to stimulate economic progress. Additionally, fostering sustained economic growth and encouraging capital formation are crucial strategies for long-term development. Moreover, policymakers should maintain stable inflation rates to prevent adverse effects on economic growth. Overall, investing in political stability, promoting capital formation, and managing inflation effectively are essential policy actions to foster sustainable economic growth in Nepal.

Among the various determinants of economic growth, the political stability index, inflation rate, and gross capital formation growth are included in this study. Secondary data from the World Bank covers 27 years, from 1996 to 2022. Descriptive and exploratory research designs are used. The EViews12 is employed to analyze and explore the impact of political stability, inflation rate, and gross capital formation growth on the economic progress in Nepal. Simple statistical and econometric tools like graphs, summary statistics, correlation analysis, Johnsen cointegration test, vector error correction method, and Wald test are used for the analysis. Therefore, further studies are necessary using more variables, data, processes, countries, and tools for more comprehensive, reliable, and representative findings.

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