Monetary and Trade Growth Positions Based on Economical Exchanges

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Abstract: This study empirically examines the impact of monetary, fiscal and trade policies on economic growth in Pakistan by using annual time series from 1981 to 2009. The money supply, government expenditure and trade openness as a proxy of the monetary, fiscal and trade policies used in each case. Cointegration and error correction model indicate the existence of significant positive long-term and short-term relationship between monetary and fiscal policy to economic growth. Result also shows that monetary policy is more effective than fiscal policy in Pakistan. In contrast, the trade policy insignificant impact on economic growth both in the short run and long run. Given the findings, it is suggested that policymakers should focus more on monetary policy to ensure economic growth of the country. It is also recommended that further research should be conducted to determine how components of exports and imports, leading to improve the inefficacy of trade policy to economic growth.

Key words: monetary, fiscal, trade, economic growth

INTRODUCTION

Economic growth has been in the area is still of interest to academics as well as for policy makers, although this is also one of those areas in which extensive theoretical and empirical studies have been carried out. The reason for this particular interest is the role of economic growth to improve the economic, social and political well-being of people in nations.

There is extensive material available in the literature, the different determinants of economic growth. Most of such materials in accordance with exogenous or endogenous growth theory was increasingly difficult, the importance of monetary, fiscal and trade policies in relation to their contribution to the Ignoring economic growth if we keep endogenous growth theory in mind.

Despite the broad agreement about the role of various political variables in economic growth, there were several disagreements over the relative importance and effectiveness of different policies. Monetarist approach to stimulate overall economic activity is based on unexpected increase in money supply, while fiscal policy is considered less effective or ineffective because of the crowding-out effect. In addition, the contribution of the Government or the size of the public sector in the aggregate demand also controversial among academics and among politicians. On the other hand, the Keynesians point out several shortcomings of monetary policy, especially when an economy stuck in a liquidity trap and the only way out is the use of fiscal policy.

There are several studies, which are the positive role of trade openness has been found in economic growth. These results are consistent with previous expectations, because the opening of trade increases efficiency in production, economic activity has a positive effect. The current study is an attempt, the relationship between monetary, fiscal and trade policy with the economic growth in Pakistan to investigate. The aim of this study is to see whether such a relationship exists in Pakistan and more importantly, to determine the relative importance of these measures.

The study is divided into the following sections. Section 2 describes the selected review of previous studies on the same area, Section 3 of the methodology of the current study, explains, Section 4 presents the results and Section 5 concludes the discussion and provides some policy recommendations.

2. Review of Literature:

Javed and Sahinoz (2005) examined the relationship between economic growth and government spending in the Turkish economy with and without the use of the money supply as an explanatory variable. The study employed quarterly data 1992:1 to 2003:3 for the period of GNP growth in government spending and money supply. The study examined the long-term relationship between these variables by Engle Granger, Phillips - Ouliaris and Johansen co-integration test, while Granger test is used to check the causality. Engle and Granger Philips - Ouliaris no long-term relationship between economic growth and government spending in the long term relationship but the evidence was to the inclusion of money in the equation. The study showed bi-directional causality between economic growth and money supply after excluding government spending during uni-directional causality between government expenditure and money supply after exclusion of economic growth.
Ali et al. (2008) examined the effects of fiscal and monetary policies on economic growth, with annual time series from 1990 to 2007. The results show that M2 and inflation have a significant and positive impact on economic growth in both the short and long term, while the tax policy has a significant and negative impact on economic growth in the long run. They conclude that monetary policy has become a more powerful tool than fiscal policy to improve economic growth in South Asian countries.

Yücel (2009) analyzed the relationship between financial development, trade openness and economic growth in the Turkish economy by using the monthly data from January 1989 to November 2007. The authors employed Johansen and Juselius technique to examine the long-term relationship between variables, while employing Granger-causality test to verify the evidence of causality. The study found that trade openness is positive, while financial development is negatively associated with economic growth. Granger test found the evidence of the bi-literal causality between financial development, trade openness and economic growth.

Mohammad et al. (2009), the long-run relationship between M2, inflation, government spending and economic growth in Pakistan and studied by annual time series from 1977-2007. Cointegration results show that public spending and inflation significantly and negatively, while M2 has a significant and positive impact on economic growth in the long run.

Ogunmuyiwa and Ekon (2010) examined the relationship between money supply and economic growth in Nigeria by the data for the period 1980-2006. The study employs OLS and error correction mechanism to verify the relationship, while Granger-causality test to verify the causality. The study found that economic growth is influenced by the level of money supply in the economy.

Jawaid et al. (2010) examined the comparative effects of fiscal and monetary policies on economic growth in Pakistan by using annual time series from 1981-2009. Cointegration test confirms a positive long-term relationship between monetary and fiscal policy to economic growth. However, monetary policy is more effective than fiscal policy in the strengthening of economic growth. They suggested that policymakers should focus more on monetary policy and fiscal policy, economic growth, however, it can focus should also have short-term relationship.

Adefeso and Mobolaji (2010) empirically examines the relative effectiveness of fiscal and monetary policy on economic growth in Nigeria. Annual time series data from 1970-2007 is used. Error correction mechanism and Co-integration technique has been used in the study. Gross domestic product, money supply, government spending and the degree of openness has been used in the study. The results show that the effect of monetary policy on economic growth in Nigeria, much stronger than fiscal policy. They recommended that policymakers should emphasize on the monetary policy for the purpose of economic stabilization in Nigeria.

Taban (2010) re-examine the government spending-economic growth nexus for the Turkish economy with limits and test procedures. MWALD Granger-causality by using quarterly data from 1987:Q1 to 2006:Q4. The results show that the share of government spending and the share of public investment in GDP have a significant and negative effect on the growth of real per capita in the long run. On the other hand, the government consumption expenditure relative to GDP insignificantly affect on the per capita growth. The results also show that there is bidirectional causality between government spending and economic growth. The study also found that the coefficient of labor force participation rate and the share of government expenditure to GDP ratio insignificantly related to economic growth. The study recommends that the government should keep the politics to make this negative relationship in mind.

3. Stability Analysis:

The stability of the relationship is a prerequisite for the effectiveness of monetary, fiscal and trade policies. CUSUM and CUSUM of the square of the recursive residual (Brown, Durbin and Evans 1975) were used to check the stability of the estimates in the long run.

Figure I shows that are stable in the long run estimates of the monetary, fiscal and trade policies with economic growth over the survey period.

4. Concluding Remarks and Policy Implications:

Widely used in large amount of literature has been the relationship between monetary, fiscal and trade policies are discussed with economic growth. This study empirically examines the impact of monetary, fiscal and trade policies on economic growth by using annual time series from 1981-2009. The money supply, government expenditure and trade openness as a proxy of the monetary, fiscal and trade policies and cointegration and error correction model indicate the existence of positive significant long-term and short-term
relationship between monetary and fiscal policy with the economic growth. It shows also that monetary policy is more effective than fiscal policy. In contrast, the trade policy insignificant impact on economic growth both in the short run and long run.

**Fig. I:** Test of Stability Analysis.

**REFERENCES**


