

ECONOMIC GROWTH IN BANGLADESH: IMPACT OF FISCAL POLICY AND MONETARY POLICY

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Abstract: *The purpose of this research paper is to identify the impact of significant components of fiscal policy and monetary policy that determine the level of economic growth in Bangladesh. Correlation, regression, test of hypothesis, ANOVA and trend analysis have been conducted in this paper using SPSS software to analyze data. Both the primary and secondary data have been used in this paper. Data have been generated from economic reviews, journals, expert opinions etc. The results of this analysis evidence that investment of current year, net foreign finance, tax burden/tax revenue and trade balance are significantly influencing the economic growth in Bangladesh among several components of fiscal policy where tax revenue has been found as most significant determinant of economic growth. Besides, it has been found that several tools of monetary policy are significantly influencing economic growth where most significant determinants are low variable reserve ratio, flexibility in rationing of credit and fixation of less margin requirement.*

Keywords: Fiscal Policy, Monetary Policy, Budget Deficit, GDP, Economic Growth.

JEL Classification: E52, E62, O23.

1.0 Introduction: Economic indicators of Bangladesh seem favorable in some cases such as, GDP growth rate above 7 percent, better crop production, consistent decline in inflation, satisfactory remittance inflow, comfortable balance of payment, stable exchange rate and ample foreign exchange reserve (CPD, 2016). But, economy of Bangladesh is facing acute problems in some economic indicators such as higher non-performing loans (NPLs), sluggish private investment, shortfall of fiscal targets for both income and expenditure, fiscal pressure on government due to capital deficit of state owned commercial banks (SCBs), missed export target, volatility in net foreign aid and widening trade deficit (CPD, 2016).

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Fiscal policy is the combination of some economic indicators that play vital role for economic growth in a country. It is issued and implemented by the government.

Fiscal policy is based on the value added tax(VAT) and tax revenue to allocate and conduct expenditure to different sectors of economy. All the economic indicators of fiscal policy do not play equal role for economic growth. Hence, it is required to identify the most significant factors to draw special attention. Besides, monetary policy also contributes for economic growth through injecting money supply in the economy. Monetary policy is based on interest rate to maintain appropriate level of money supply (M2) in the economy with the purpose of moderate inflation and sustainable economic growth. It is issued and implemented by central bank (Bangladesh Bank) in any country. Contractionary monetary policy is taken targeting to control inflation where expansionary monetary policy is taken targeting to boost up economic growth. Hence, it is also important to identify the significant tools of monetary policy that drive the economic growth. In Bangladesh, tools of monetary policy can be divided into two types such as quantitative and qualitative. Quantitative tools include bank rate, open market operations and variable reserve ratio. Qualitative tools include rationing of credit, moral suasion, regulation of consumer's credit and fixation of margin requirement.

Figure-01: Monetary Policy Framework



Source: Bangladesh Bank Monetary Policy Statement, 2017-18

In the aftermath of the global financial crisis, potential output in many affected countries declined sharply. Restoring robust growth is essential for addressing the fiscal challenges ahead. Fiscal policy can make an important contribution for lifting potential growth. At the macro level, fiscal policy helps to ensure macroeconomic stability, an essential prerequisite for growth. At the micro level, tax and expenditure policies can boost growth by altering work and investment incentives, promoting human capital accumulation and enhancing productivity.

Economic growth is one of the most important determinants of economic welfare. The global economic crisis that broke out in 2008 has reawakened interest in fiscal policy

as an instrument for longer term growth and development (Shihab et al., 2014). The term fiscal policy has conventionally been associated with the use of taxation and public expenditure to influence level of economic activities (Shihab et al., 2014). The implementation of fiscal policy is essentially routed through government's budget. Fiscal policy deals with government deliberate actions in spending money and leaving taxes with a view to influencing macro-economic variables in a desired direction (Shihab et al., 2014). This includes sustainable economic growth, high employment creation and low inflation. This fiscal policy aims at stabilizing the economy (Shihab et al., 2014). In general, fiscal policy can be considered as one of the most important economic policies of economic policy makers. The significance of fiscal policy is perceived in connection with basic functions of this policy, such as allocation, stabilization and redistribution (Macek & Janku, 2015). However, it is necessary to realize that fiscal policy must also be perceived as the tool of economic growth (Macek & Janku, 2015). Fiscal policy is usually represented by the level and structure of government spending on the one hand and the level of individual taxes, tax mix on the other hand (Macek & Janku, 2015).

Chairman of National Board of Revenue in Bangladesh, Nojibur Rahman, has recently expressed his satisfaction over response received from tax payers. He said that the revenue authority promised to provide services over the year and inspired people to pay taxes to build a healthy nation (The Independent, November 08, 2017). Government should take some necessary steps like tax fair to increase the collection of tax revenue and tax collection process should be simplified (The Independent, November 08, 2017). Besides, initiatives should be taken to make the tax payer known about the benefits of tax paying (The Independent, November 08, 2017).

In Bangladesh, export and import have significant impact on economic growth. If Government can ensure the maximum use of local raw materials in the production and encourage the establishment of backward linkage industries then production can be increased. According to some authors, there are two macro-economic reasons for why government spending can undermine economic performance. The first reason is "resource displacement". The second reason is the "financing cost". So, government expenditure should be increased at a standard amount that will not create any negative impact on economic growth.

From review of literature, it has rarely been found to develop multiple regression model based on the components of fiscal policy and monetary policy in Bangladesh. That is why; multiple regression models have been developed in this research paper taking consideration into several components of fiscal policy and monetary policy as independent variables that have impact on economic growth in Bangladesh. Hence, most significant components of fiscal policy and monetary policy have been identified to give more emphasize for ensuring expected economic growth.

2.0 Objective of the Study:

- To explain how components of fiscal policy and monetary policy influence the economic growth in Bangladesh.
- To determine statistically significant drivers and accelerators of economic growth in Bangladesh among the components of fiscal policy and monetary policy

- To recommend for the development of the significant components of both the policies to accelerate economic growth in Bangladesh.

3.0 Research Methodology:

3.1 Type of Research: The research is empirical in nature. Theoretical analysis along with numerical evidences has been used to substantiate the findings of the paper comprehensively. Data has been presented in the simple and logical form.

3.2 Data Source: Data has been collected from both the primary and secondary data sources. To develop the theoretical background of the study and numerical evidences, secondary data were collected from economic reviews, journals and different websites. As all the components of considered tools of monetary policy are associated with the credit department of banks, survey on the components of monetary policy has been conducted with 5 point (1 to 5) likert scaled (ranging from strongly disagree to strongly agree) structured questionnaire where respondents were heads of credit department serving in the head offices of different banks selected randomly. Numerical secondary data of last 11 years (2006-17) regarding several components of fiscal policy have been taken into consideration from Bangladesh economic review.

3.3 Variables Covered: In case of fiscal policy, GDP has been taken as dependent variable where several components of fiscal policy such as investment current year, net foreign finance, tax burden/tax revenue and trade balance have been taken into consideration as independent variables. In terms of monetary policy, GDP has been selected as dependent variable where low bank rate, restriction in reverse repo, low variable reserve ratio, flexibility in rationing of credit, proper moral suasion, flexibility in regulation of consumer's credit and fixation of less margin requirement have been selected as dependent variables.

3.4 Sampling Method: Total number of sample for the survey on the components of monetary policy as primary data is 38 heads of credit department taken randomly where total number of heads of credit department is 57 in the scheduled banks serving in Bangladesh. Besides, numerical secondary data on several components of fiscal policy has been collected for last 11 years (2006-17).

3.5 Data Analysis Tools: Well accepted regression models have been developed separately in the study for each policy evaluating some components of fiscal policy and monetary policy in Bangladesh. Data entry was conducted in SPSS 16.0 data editor and analyzed under some specific hypothesis. Statistical tools like correlation, regression coefficient, analysis of variance (ANOVA), factor analysis and trend analysis were used.

4.0 Limitation of the Study: It is not possible to draw multiple regression models taking into consideration some more components of fiscal policy as there is high correlation among some components as independent variables. Besides, due to not having quantitative data of all the components of monetary policy, qualitative data has been used to generate findings. Moreover, qualitative data has been used as quantitative approaches of monetary policy have some numerical data which do not change over the years against GDP growth.

5.0 Literature Review: Private investment has been treated as one of the most important factors contributing in economic growth. On the one hand, private investment may facilitate and stimulate public investment through the provision of infrastructural support (Blejer & Khan 1984, Auer 1989). On the other hand, public investment may crowd out private investment (Blejer & Khan 1984, Auer 1989). Iqbal and Zahid (1998) have identified that rising budget deficit is one of the main constraints of economic growth in Pakistan and recommended policy such as reducing non-developmental expenditure for lowering the budget deficit. According to Nightingale (2002), no one really likes paying taxes yet they are inevitable for the provision of social welfare. So, Administration should find out the way of encouraging tax payer to pay the tax. Tax policy must be generally accepted by the people if it must gain compliance (Nightingale, 2002). Le and Suruga (2005) explored the impact of public investment and FDI on economic growth and they also investigated the effect of public investment on FDI using panel data of 105 of developed and developing countries over the period 1970-2009. Their result shows that both public investment and FDI have a positive relationship with economic growth. Laffer (2009) cautioned that “A government simply cannot tax a country into prosperity”. As important as tax revenue is to a nation, many people still find it difficult to comply with their tax obligation. Kumar and Woo (2010) have found the inverse relationship between initial debt and subsequent growth as a 10 percentage point increase in the initial debt-to-GDP ratio is associated with a slowdown in annual real per capita GDP growth of around 0.2 percentage points per year. Isaac and Samuel (2012) have found that government intervention in three areas such as reexamination of government spending, channeling more credit to the private sector and designing appropriate policies that deal with the current high domestic public debt and budget deficit should get emphasize for economic growth in Kenya. Haque (2013) in his research paper has identified that both public and private investment have positive impact on economic growth in the short and long run process where private investment is more effective in the long run than public investment. Odhiambo et al.,(2013) have found positive relationship between fiscal deficits and economic growth. The study has recommended that the government should enhance revenue generation capacity through broadening the tax base to finance the government expenditure. It should determine the optimal level of government expenditure for avoiding deficits and the crowding out effect of private investment (Odhiambo et al., 2013). Malik (2013) has identified current expenditure as non-productive while development expenditure as productive when expenditures are regressed in disaggregated form and productivity of development expenditure is dependent on the existence of current expenditures. Osuala and Jones (2014) have identified the long run equilibrium relationship between fiscal policy and economic growth in Nigeria during the period from 1986 to 2010 where government’s recurrent and capital expenditures have significant and positive impact on economic growth. Noman (2015) in his study concluded that exchange rate, interest rate, inflation rate, government revenue and expenditure are significant policy variables that affect economic growth in Bangladesh. Falade and Folorunso (2015) in their research paper concluded that the appropriate instrument mix in promoting and sustaining economic growth in Nigeria are level of government revenue, level of foreign exchange rate,

domestic interest rate and level of money supply. Bangladesh export trade is characterized by the procedure of a few commodities in a confined market. It is not desirable to depend on limited number on export items aimed at limited market for economic development. So, the market for economic development in Bangladesh should concentrate on both at product and market diversification (Akther, 2015). Cyril (2016) in his study concluded that rising capital inflow will increase economic growth and recommended that for stabilizing the economy, government should formulate and implement viable fiscal policy options. The national income tax fair has set the record on revenue collection, with Tk 2129,67,75,811 collected from the weeklong event at the end of 2016 (November 8, 2016, Dhaka Tribune).

6.0 Statistical Results and Findings:

6.1 Impact of Fiscal Policy on Economic Growth:

From the econometric analysis of the secondary data of last eleven fiscal years (2006-2016) regarding GDP and several components of fiscal policy, following statistical outcomes have been found. Findings of the study have been categorically discussed in the following subsections:

6.1.1 Coefficient of Correlation: From table-01 of appendix, it has been found that there is a high degree of positive correlation ($R=1.00$) between several components of fiscal policy and GDP.

6.1.2 Regression analysis: From table -03 of appendix, the following multiple regression model has been developed by taking GDP as the dependent variable and some relevant components of fiscal policy as the independent variables.

The standardized regression model is:

$$GDP = \alpha_0 + \beta_1 INVC + \beta_2 FCI + \beta_3 TB - \beta_4 GTT + \epsilon_i (\text{Residual factors}) \dots \dots (i)$$

The fitted regression model is:

$$GDP = 1104.166 + 0.18(INVC) + 0.152(FCI) + 0.691(TB) - 0.067(GTT) \dots (ii)$$

Where,

INVC	Investment Current Year
FCI	Net Foreign Finance
TB	Tax Burden/ Tax Revenue
GTT	Trade Balance

According to table 01 of appendix, the value of $R^2 = 0.999$ or 99.90% which implies that 99.90% of the total variation of GDP can be explained by the above regression model where remaining 0.10% variation can be explained by the variables which are not included in the regression model (Kothari, 2001). Here, the value of adjusted R^2 is 0.998 or 99.80%

which suggests that addition of any other independent variable will not contribute in explaining any variation in the dependent variable. In the above model, if the value of all the independent variables is zero then GDP will be BDT 1103 crore.

6.1.3 Test of Hypothesis: In this study, following hypothesis have been developed:

H_0 : *The coefficient of multiple determinations in the population is zero*

H_1 : *The coefficient of multiple determinations in the population is not zero*

The statistical method of F-test has been used at 5% level of significance to identify whether there is significant relationship between GDP and above mentioned (section-6.1.2) four independent variables. In this regard, null hypothesis can be accepted if the calculated p (significance) value is greater than 0.05 and we can reject the null hypothesis if the calculated p (significance) value is less than 0.05. From table -02 of appendix, it has been found that the value of p (significance) is 0.000 against all the independent variables which is less than 0.05. Hence, the null hypothesis is rejected. There is significant relationship between the independent variables and the dependent variable. It can be said that economic growth in Bangladesh is dependent on various variables such as, investment current year, net foreign finance, tax burden/tax revenue and trade balance as statistically significant (Gujarati, 2012).

6.2 Impact of Monetary Policy on Economic Growth:

6.2.1 Coefficient of Correlation: From table-04 given in appendix, it has been found that there is a high degree of positive correlation ($R=0.953$) between several tools of monetary policy and GDP growth.

6.2.2 Regression analysis: From table -05 of appendix, the following multiple regression model has been developed by taking GDP growth as the dependent variable and some relevant components of monetary policy as the independent variable.

The standardized equation model is:

$$GDP = \alpha_0 + \beta_1 LBR + \beta_2 RRR + \beta_3 LVRR + \beta_4 FRC + \beta_5 PMS + \beta_6 FRCC + \beta_7 FLMR \dots\dots\dots (i)$$

The fitted regression model is:

$$GDP = 3.854 + 0.287(LBR) + 0.419(RRR) + 0.467(LVRR) + 0.474(FRC) + .345(PMS) + .311(FRCC) + .449(FLMR) \dots\dots\dots (ii)$$

Where,

LBR	Low Bank Rate
RRR	Restriction in Reverse Repo
LVRR	Low Variable Reserve Ratio
FRC	Flexibility in Rationing of Credit
PMS	Proper Moral Suasion
FRCC	Flexibility in Regulation of Consumer's Credit
FLMR	Fixation of Less Margin Requirement

According to table 04 of appendix, the value of $R^2 = 0.908$ or 90.80% which implies that 90.80% of the total variation of GDP growth can be explained by the above regression model where remaining 0.10% variation can be explained by the variables which are not included in the regression model (Kothari, 2001). Here, the value of adjusted R^2 is 0.886 or 88.60% which suggests that addition of other independent variables will not contribute in explaining any variation in the dependent variable. In the above model, the value of α_0 (constant) is 3.854. In above model, we have excluded one variable titled regular guidance for generating new investment opportunities rather than direct action due to having low factor loading or importance (0.244) and we have considered all the variables having factor loading above (0.30) generated from factor analysis. Independent variables of the model are associated with liberalized policy reform, initiatives against excess liquidity in banking sector and financial inclusion.

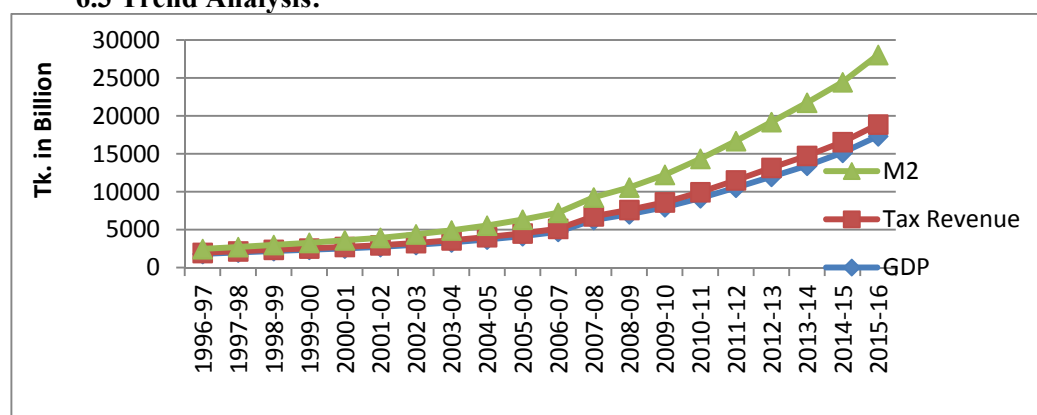
6.2.3 Test of Hypothesis: In this study, following hypothesis have been developed:

H_0 : The coefficient of multiple determinations in the population is zero

H_1 : The coefficient of multiple determinations in the population is not zero

The statistical method of F-test has been used at 5% level of significance to identify whether there is significant relationship between GDP growth and above mentioned (section-6.2.2) five independent variables. From table -06 of appendix, it has been found that the value of p (significance) is 0.000 against all the independent variables which is less than 0.05. Hence, the null hypothesis is rejected. It implies that, there is significant relationship between the independent variables and dependent variable (Gujarati, 2012).

6.3 Trend Analysis:



Data Source: Bangladesh Economic Review, 2015-16

From the above figure, it has been found that from fiscal year 1997 to fiscal year 2016, money supply (M2), tax revenue and GDP (current price) are in increasing trend. The trend seems rapid after FY 2006-07 than before FY2006-07. Tax revenue is in increasing trend even above GDP since FY2006-07. The trend analysis evidences that economy is rapidly growing after the FY 2006-07 and the growth is consistent as well. However, the gap between money supply in economy and GDP is increasing that may stimulate inflation if these money cannot produce more goods and services to contribute in GDP growth.

7.0 Conclusions and Recommendations: Throughout the study, it has been found that there is high degree of positive correlation between dependent variable and independent variables. From the perspective of fiscal policy, it can be mentioned that economic growth in Bangladesh is significantly dependent on investment current year, net foreign finance, tax burden/tax revenue and trade balance as important components of fiscal policy that deserve to be more emphasized by the government during proposing and implementing budget to foster economic growth. Besides, quantitative and qualitative tools of monetary policy prescribed by Bangladesh Bank have been taken into consideration that are used by Bangladesh Bank targeting sustainable economic growth and controlled inflation. Among these tools, low variable reserve ratio, fixation of less margin requirement and flexibility in rationing of credit have more impact on economic growth compared to other four tools and these three tools of monetary policy should be taken into consideration by central bank more importantly during issuing and implementing monetary policy to foster economic growth. However, all the tools of monetary policy considered under the study have been found statistically significant.

Government and central bank have to work together so that the excess money supply greater than the GDP in current price can be utilized to foster economic growth

through investment opportunity creation and employment generation for inclusive economic growth under controlled inflation. The study will help policy makers to take decisions regarding several components of fiscal policy and monetary policy according to the level of significance to foster economic growth.

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Appendix

Table: 01

Model Summary				
Model	R	R Square	Adjusted R Square	Durbin-Watson
1	1.000	0.999	0.999	2.311
a. Predictors: (Constant), GTT, FCI, INVC, TB				
b. Dependent Variable: GDP				

Table: 02

ANOVA						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	170100000.000	4.000	42520000.000	1879.000	.000 ^a
	Residual	135775.529	6.000	22629.255		
	Total	170200000.000	10.000			
a. Predictors: (Constant), GTT, FCI, INVC, TB						
b. Dependent Variable: GDP						

Table: 03

Coefficients						
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
			Std. Error	Beta		
1	(Constant)	1104.166	296.008		3.730	0.010
	INVC	0.351	0.050	0.180	6.978	0.000
	FCI	12.141	4.054	0.152	2.995	0.024
	TB	5.984	0.579	0.691	10.335	0.000
	GTT		0.379	-0.067	-4.283	0.005
a. Dependent Variable: GDP						

Table: 04

Model Summary ^b										
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics					Durbin-Watson
					R Square Change	F Change	df1	df2	Sig. F Change	
1	.953 ^a	.908	.886	.87692	.908	42.197	7	30	.000	1.972

a. Predictors: (Constant), Fixation of less margin requirement, Restriction in reverse repo, Low variable reserve ratio, Flexibility in regulation of consumer's credit, Low Bank Rate, Flexibility in rationing of credit, Proper moral suasion

b. Dependent Variable: GDP

Table: 05**ANOVA^b**

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	227.141	7	32.449	42.197	.000 ^a
	Residual	23.069	30	.769		
	Total	250.211	37			

a. Predictors: (Constant), Fixation of less margin requirement, Restriction in reverse repo, Low variable reserve ratio, Flexibility in regulation of consumer's credit, Low Bank Rate, Flexibility in rationing of credit, Proper moral suasion

b. Dependent Variable: GDP

Table: 06**Coefficients^a**

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	95% Confidence Interval for B		Correlations			Collinearity Statistics	
	B	Std. Error	Beta			Lower Bound	Upper Bound	Zero-order	Partial	Part	Tolerance	VIF
1	(Constant)	3.854	1.944	1.983	.057	-.116	7.825					
	Low Bank Rate	.683	.139	4.916	.000	.399	.966	.346	.668	.273	.899	1.112
	Restriction in reverse repo	1.367	.190	7.186	.000	.979	1.756	.252	.795	.398	.905	1.105
	Low variable reserve ratio	1.072	.162	6.632	.000	.742	1.402	.297	.771	.368	.620	1.614
	Flexibility in rationing of credit	1.119	.144	7.770	.000	.825	1.413	.553	.817	.431	.827	1.210
	Proper moral suasion	1.016	.213	4.774	.000	.581	1.451	-.210	.657	.265	.588	1.701
	Flexibility in regulation of consumer's credit	.716	.136	5.262	.000	.438	.994	.441	.693	.292	.879	1.137
	Fixation of less margin requirement	1.092	.142	7.704	.000	.802	1.381	.529	.815	.427	.905	1.105

a. Dependent Variable: GDP