The Impact Of Fiscal And Monetary Policy On Economic Performance

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Abstract

This study aims to analyze and determine the effect of: (1) government spending on economic growth in Indonesia, (2) taxes on growth in Indonesia, (3) money supply on economic growth in Indonesia and (4) interest rates on economic growth. This study used the Ordinary Least Squared (OLS) analysis tool method. The dependent variable in this study is economic growth. While the independent variables in this study are government spending, taxes, money supply and interest rates. The results of the study conclude that (1) government spending has a significant and positive effect on economic growth in Indonesia. (2) taxes have a significant and positive effect on economic growth in Indonesia. (3) the money supply also has no positive effect on economic growth in Indonesia. (4) interest rates have no effect on economic growth in Indonesia and are negative. Based on these results, the policy that can be suggested by the Government of Indonesia is the need for local government efforts or policy makers to increase government spending (Fiscal Expansion Policy). The government is expected to be able to regulate the appropriate tax allocation so as not to undermine consumers' purchasing power. Central Government and Bank Indonesia in order to maintain liquidity or availability of money in the economy in Indonesia. The government together with the banking sector, especially Bank Indonesia, should maintain a healthy interest rate so that it does not have an impact on reducing investor interest in investing.

Keywords: Fiscal Policy, Monetary Policy, Economic Performance

INTRODUCTION

Economic growth has always been a central issue in development issues. Economic development aims to improve people's welfare in terms of increasing income, fighting unemployment and reducing poverty. To overcome these economic problems, the government can implement its policies through fiscal policy and monetary policy (DIMA, 2021; Wei et al., 2022). Fiscal policy and monetary policy play a very important role in maintaining economic stability, as a balance between aggregate demand and supply. Despite their different functions, the two policies can be used simultaneously to achieve price stability and balance of payments. Fiscal policy and monetary policy are an integral part of macroeconomic policy, with objectives to be achieved in the short and long term. There is often a debate between fiscal policy and monetary policy. On the one hand, monetary policy aims to achieve the goal of maintaining price stability, on the other hand fiscal policy is directed at economic growth. This then results in compromises that are mainly price stability or economic growth, especially in the short term. Managing fiscal and monetary policies with good coordination will bring positive results to the Indonesian economy (Safriadi, 2014).

LITERATURE REVIEW

a. Fiscal policy

According to Mankiw (2013: 68) explains what is meant by fiscal policy, namely economic policies implemented by the government in order to manage or direct the economy towards better conditions or are expected through the act of changing government revenues and spending and taxes. In general, there are two types of fiscal policy, namely expansionary fiscal policy and contractionary fiscal policy. Expansive fiscal policy is expected to increase national income and reduce the unemployment rate. Meanwhile, contractionary fiscal policy aims to reduce the inflation rate and reduce the deficit in the foreign balance of payments.

Fiscal policy aims to steer the economy in a better direction which is characterized by economic growth and social welfare (welfare economics).
According to Keynes, fiscal policy will produce a fiscal multiplier (multiplier effect) for national output. The rationale of Keynes is that fiscal expansion has a multiplier effect on aggregate demand and then in line with aggregate supply conditions that are still able to respond to increases in aggregate demand, it does not cause price increases (Abimanyu, 2005: 3).

Basically, fiscal policy instruments are very diverse and related to state finances such as taxation, customs, debt, fiscal decentralization, and so on. However, in general, fiscal policy is pursued through two means, namely by varying government revenues and expenditures which are reflected in the APBN each fiscal year.

b. Monetary policy

Monetary policy is a policy implemented by the central bank related to money supply management and interest rates to influence variables in the economy (Mishkin, 2010:10). The goal to be achieved in general is the creation of macroeconomic stability which is reflected, among others, by price stability (maintained inflation), improved per capita income, and the availability of broad employment opportunities (Mishkin, 2010: 11).

In macroeconomic theory and public finance, economic models are not built on a single equation but by a system of structural equations. Therefore, changes in one macroeconomic variable will simultaneously affect other macroeconomic variables.

The ultimate goal of macroeconomic policy is to achieve high output, controlled inflation, and low unemployment, while the ultimate goal can be said to achieve social welfare (Mankiw, 2013: 533). The essence of Keynes's macro policy is how the government can influence aggregate demand through the APBN mechanism, namely changing tax revenues and government spending.

Based on the theoretical framework, it has been explained that monetary and fiscal policies have different focuses and objectives. Any shock to monetary and fiscal policies will be transmitted to other variables in the economy. If the government wants to increase economic growth, one of the policies that can be taken is to increase the portion of government spending. An increase in government spending will lead to an increase in aggregate demand. With an increase in aggregate demand will cause the price of goods tends to rise. An increase in demand that exceeds supply will cause inflation. In facing this inflationary pressure, the central bank will adopt monetary policy by raising the benchmark interest rate. As a result, the fiscal deficit will get bigger, especially if the government has to pay interest on its debts (Mankiw, 2013: 315).

When the central bank adopts a policy of raising interest rates, there is a decrease in the demand for money, then consumer credit growth declines, investment costs increase and savings become a more attractive instrument so that aggregate demand falls again. At the same time, a restrictive monetary policy will reduce inflation and limit the contraction of the budget deficit (Mishkin, 2010: 535).

c. Economic growth

Sinom Kuznets defines economic growth as a long-term increase in a country's ability to provide more and more kinds of economic goods to its population, this ability grows in accordance with technological advances, and the institutional and ideological adjustments it requires.

Economic growth is the increase in the income of the community as a whole that occurs in the area, namely the increase in all added values that occur. Initially, regional income calculations were made at current prices, but in order to see the increase from one period to the next, it must be stated at a real value, meaning that it is stated at a constant price. Regional income describes the remuneration for the factors of production operating in the area (land, capital, labor and technology) which roughly describes the prosperity of the area.

According to Arsyad, several factors influence the economic growth of a society, namely: capital accumulation, population growth, technological advances, management, entrepreneurship, and information.

**METHOD**

**Figure 1. Conceptual Framework**

Economic growth in this study is influenced by fiscal policy and monetary policy. The fiscal policy instruments consist of government spending and taxes while the monetary policy instruments consist of the money supply and interest rates. If government spending increases and taxes fall, economic growth will increase and vice versa.
Meanwhile, if the money supply increases and interest rates fall, it will have an impact on increasing economic growth and vice versa. Based on the variables that have been compiled in this study, an equation model is created as follows:

\[ Y = \beta_0 + \beta_1 G + \beta_2 T + \beta_3 Ms + \beta_4 i + \mu \]  
…………….. (1)

To simplify the above equation, then the equation is transformed into a logarithmic equation with the aim of obtaining elasticity, therefore the following equation is obtained:

\[ Y = \beta_0 + \beta_1 \log G + \beta_2 \log T + \beta_3 \log Ms + \beta_4 i + \mu \]  
…………….. (2)

Where:

- \( Y \) = Economic Growth
- \( G \) = Government Spending
- \( T \) = Tax
- \( Ms \) = Total Money Supply
- \( I \) = Interest Rate
- \( \beta_0 \) = Constant
- \( \beta_1 \) = Estimated Coefficient of Government Spending
- \( \beta_2 \) = Estimated Tax Coefficient
- \( \beta_3 \) = Estimated Coefficient of Interest Rate
- \( \mu \) = Error Term

RESULTS AND DISCUSSION

1. Multicollinearity Test

   Based on the results of the Multicollinearity Test using the Variance Inflation Factor (VIF) method, a VIF value < 10 and a tolerance value < 0.01 can be concluded that there is no multicollinearity problem. With the meaning of the word in this study there is no relationship between fellow independent variables (independent).

2. Heteroscedasticity Test

   From the results of the Heteroscedasticity test with the Durbin-Watson (DW) test, the DW value is 2.195. Meanwhile, from the DW table with a significance of 0.05 and the number of data (n) = 10, and k = 4 (k = number of independent variables) the value dL = 0.376, dU = 2.413, 4-dL = 1.586, 4-dU = 3.624. Because the DW value is 2.19564 between dU and 4-dU, it can be concluded that there is no autocorrelation. With the meaning of the word in this study there is no correlation between the residuals in one observation with other observations.

3. Autocorrelation Test

   Based on the results of the Durbin-Watson (DW) test, the DW value is 2.195. Meanwhile, from the DW table with a significance of 0.05 and the number of data (n) = 10, and k = 4 (k = number of independent variables) the value dL = 0.376, dU = 2.413, 4-dL = 1.586, 4-dU = 3.624. Because the DW value is 2.19564 between dU and 4-dU, it can be concluded that there is no autocorrelation. With the meaning of the word in this study there is no correlation between the residuals in one observation with other observations.

4. Multiple Linear Regression Analysis

   From the above results it can be seen that government spending as a tool of fiscal policy has a significant and positive effect on Indonesia's economic growth. This can be seen from the estimated coefficient of 0.733 with a probability value of 0.003 < \( \alpha = 0.05 \). There is a significant influence between government spending on economic growth indicating that economic growth is influenced by government spending. This is
because if government spending increases, the budget allocation for infrastructure improvements such as road repairs, electricity supply and others will increase. This increase will expedite and improve the process of production of goods and services. An increase in the production of goods and services will in the future have implications for an increase in economic growth. Vice versa, if government spending is not increased or decreased, the smooth process of producing goods and services will be hindered. This condition will certainly reduce the production of goods and services so that in the future it will reduce economic growth.

Tax as a fiscal policy instrument has a significant and positive effect on economic growth in Indonesia. This can be seen from the estimated coefficient of 0.634 with a probability value of 0.002 < \alpha = 0.05. This situation is because an increase in taxes will result in a decrease in people's income so that people's purchasing power also decreases. A decrease in purchasing power will have an impact on decreasing public demand for goods and services so that it will reduce overall (aggregate) demand. This decrease in aggregate demand will reduce the ability of the economy to increase production, causing output to fall. This decrease in output will result in a decrease in economic growth. Vice versa, a reduction in taxes will result in an increase in people's income and purchasing power. The strength of this purchasing power will drive up public demand, which in turn will increase aggregate demand. This increase in aggregate demand will push up the production of goods and services so that in the end it will increase economic growth.

The money supply as an instrument of monetary policy has no significant and negative effect on economic growth in Indonesia. This can be seen from the estimated coefficient of -1.38 with a probability value of 0.062 > \alpha = 0.05. There is no significant effect between the money supply on economic growth indicating that economic growth is not affected by the money supply. This is because a decrease in the money supply will result in the unavailability of liquidity for the economy so that the economy becomes more sluggish. A decrease in existing liquidity for the economy will have an impact on a decline in productive economic sectors so that these sectors cannot increase their productivity.

Interest rates as one of the monetary policy instruments do not have a significant and positive effect on economic growth in Indonesia. This can be seen from the estimated coefficient of 0.348 with a probability value of 0.070 > \alpha = 0.05. There is no significant effect of interest rates on economic growth indicating that economic growth is less influenced by interest rates. This situation is because an increase in interest rates will have an impact on decreasing investment because interest rates are the cost of investment (cost of funds). High interest rates cause a decrease in investor interest in investing because the costs sacrificed are higher so that it will reduce the rate of return (return on investment) on an investment activity. This decrease in investment will cause a decrease in aggregate demand because investment is a component of aggregate demand so that output also decreases. This decrease in output will eventually reduce economic growth. Conversely, if interest rates decrease, the cost of investment will also decrease because interest is the cost of investment. This decrease in investment costs will have an impact on increasing investor interest in investing because the expected returns from investing will also increase. Therefore, this situation will encourage aggregate demand and aggregate demand will encourage an increase in output which in turn will increase economic growth.

CONCLUSION

Based on the results of the study it can be concluded (1) government spending has a significant and positive effect on economic growth in Indonesia. (2) taxes have a significant and positive effect on economic growth in Indonesia. (3) the money supply also has no positive effect on economic growth in Indonesia. (4) interest rates have no effect on economic growth in Indonesia and are negative. Based on these results, the policy that can be suggested by the Government of Indonesia is the need for local government efforts or policy makers to increase government spending (Fiscal Expansion Policy). The government is expected to be able to regulate the appropriate tax allocation so as not to undermine consumers' purchasing power. Central Government and Bank Indonesia in order to maintain liquidity or availability of money in the economy in Indonesia. The government together with the banking sector, especially Bank Indonesia, should maintain a healthy interest rate so that it does not have an impact on reducing investor interest in investing.

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