HOW IS THE MONETARY AND FISCAL POLICY RELATED TO INTERNATIONAL TRADE ?

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Abstract

Policymakers have grappled with issues arising from disparities in monetary, fiscal, and trade activities. Macroeconomists and policymakers employ fiscal and monetary policies as primary instruments to tackle these challenges. This study aims to describe how is the monetary and fiscal policy related to international trade. It is a descriptive qualitative research with a literature study method. Interest rates and money stand out as pivotal variables, garnering significant attention from Bank Indonesia due to their strong interaction with the government budget. The fiscal policy multiplier tends to be low in Indonesia.

Keywords: *Fiscal; International Trade; Monetary; Policy*

A. Introduction

Monetary policy is the measures taken by a country's central bank to regulate the money supply in circulation (neither excessive nor deficient). The objectives of monetary policy are to achieve and maintain price stability, promote healthy economic growth, and maintain financial system stability (STIE YKPN, 2023). Fiscal policy is a series of government actions to manage the country's expenditure and income. The objectives of fiscal policy are to achieve stability/balance of income vs expenditure, stimulate economic growth, and address issues such as income inequality and unemployment.

International trade is an important element of the globalisation process. Opening trade with various countries in the world will provide benefits and bring economic growth in the country, both directly in the form of effects on resource allocation and efficiency (Rusydiana, 2007), and indirectly in the form of increased

investment levels. Any form of barriers and protection is a source of distortion to international trade that must be avoided and eliminated.

Historically, policymakers have grappled with issues arising from disparities in monetary, fiscal, and trade activities. Macroeconomists and policymakers employ fiscal and monetary policies as primary instruments to tackle these challenges (Sari et al., 2023). The pivotal tools for both policies involve government expenditure and money supply. The equilibrium in government budget can influence the trade balance (Nwagu et al., 2022), with a trade deficit arising from a net inflow of foreign financial investment and a trade surplus resulting from a net outflow of foreign financial investment.

Monetary policy is represented by money supply (Rusiadi et al., 2022), fiscal policy by government expenditure, and trade policy by trade openness, serving as proxies for each (Jawaid et al., 2011). The impact of trade policy on economic growth is negligible, both in the short term and the long term. Based on these findings, it is advised that policymakers prioritize monetary policy to foster economic growth in the country. Additionally, it is suggested that further research be undertaken to identify specific components of exports and imports contributing to the ineffectiveness of trade policy in stimulating economic growth (Nasution et al., 2023).

A modification in the exchange rate aids the monetary authority in achieving external balance. In cases of a deficient trade balance, adjusting the exchange rate can be advantageous (Siregar, 2023). Theoretically, developing nations might require some devaluation to realize long-term benefits from international trade. However, the enhancement in the trade balance (Nwagu et al., 2022) may not be immediately evident. It undergoes adjustments before manifesting improvement. The initial adjustment occurs during periods of currency depreciation, leading to a deterioration in the trade balance. Due to the initial fixation of trade contracts at previous exchange rates, there is a delayed response in the trade balance toward improvement. This phenomenon is known as the J-Curve effects (O., 2020).

B. Method

This study is a descriptive qualitative research with a literature study method through literature studies sourced from journals of previous research results (Kurniawan, 2014) related to the title, also through access to data obtained from the website as an information publication. Qualitative descriptive research can be interpreted that the researcher is the key instrument where data collection techniques are carried out by combining and analysing data inductively (Sugiyono,

2012) so as to produce and process descriptive data such as narrating the results of interviews and or observations.

C. Discussion

From empirical evidence, there exists a causal relationship between monetary and fiscal policies (Bhowmik et al., 2022). Interest rates and money stand out as pivotal variables, garnering significant attention from Bank Indonesia due to their strong interaction with the government budget (Yunanto & Medyawati, 2015). An analysis of Indonesia's economy over the past two decades, encompassing the research period, indicates that monetary policy is more impactful than fiscal policy in influencing GDP growth. This assertion is supported by a higher monetary policy multiplier compared to the fiscal policy multiplier, as evidenced by the steep slope of the IS curve model and the relatively less elastic slope of the LM curve model.

The findings indicate that the spillover effects exhibit time-dependent characteristics, with certain significant events causing a notable surge in spillover indices. The prevalence of spillovers is primarily noticeable in the short term, with limited impacts in the medium and long term. These results carry important implications for policymakers and investors (Rangkuty & Hidayat, 2019), emphasizing the need for heightened awareness of short-term spillovers and uncertainty in monetary policy (Guo et al., 2022). This awareness can help reduce vulnerability to shocks related to policy uncertainty.

The expansive money supply exerts a negative influence on both the deposit rate and the real interest rate, whereas income demonstrates positive impacts on all three interest rates. In the short term, the fiscal deficit significantly decreases the deposit rate but has a positive effect on the real interest rate (Efendi et al., 2023). Both the exchange rate and trade openness contribute to reducing interest rates. To maintain interest rates within the desired range, careful adjustments of policy instruments and deficit management are recommended based on econometric evaluations (Maitra, 2022). The noteworthy influence of trade openness (Novalina et al., 2020) on interest rates poses a significant challenge for macroeconomic policy.

Simulation results underscore the considerable susceptibility of Indonesia's economy to the repercussions of large-scale capital outflows. Given the nation's reliance on foreign capital inflows, a swift and substantial exodus of capital could lead to a rapid deterioration of the national economic landscape (Yunanto & Medyawati, 2015). In both normal and crisis scenarios, this study demonstrates that the most effective approach involves implementing an expansive fiscal policy counterbalanced by a contractionary monetary policy (Rangkuty et al., 2022). To ensure the synergy of monetary and fiscal policies, it is imperative to meticulously

manage interest rate volatility or variations, keeping them as minimal as possible relative to GDP variations.

The fiscal policy multiplier tends to be low in Indonesia, prompting an investigation into the contributing factors (Rusiadi et al., 2022). Model testing results indicate an existing excess capacity in the economy, suggesting that an increase in government spending would stimulate higher demand for goods and services (Rangkuty & Hidayat, 2021). In practical terms, each authority should determine the opportune moments for policy implementation to yield the most optimal impact (Yunanto & Medyawati, 2015). The government can contribute to this by raising spending, thereby fostering increased output, given that government consumption plays a direct role in GDP formation. This situation implies that the fiscal sector's behavior requires ongoing attention from BI as the monetary authority.

Under an expansionary fiscal policy within a floating exchange rate regime (Bank Indonesia, 2020), the market goods balance (IS) shifts right, leading to a strengthened exchange rate and relatively fixed GDP. Changes in the money market balance (LM) are vertical, indicating an influx of foreign capital. The primary variables become interest rates and exchange rates (Yunanto & Medyawati, 2015), with domestic interest rates exceeding international rates, resulting in an inflow of foreign capital and a strengthened rupiah. Consequently, net exports decline, diminishing the impact of expansionary fiscal policy on lowering GDP (Fadlan & Pratama, 2024). On the monetary policy front, an increase in money supply affects domestic interest rates, preventing them from falling below international levels and averting the outflow of foreign capital.

The openness of a country's economy also has consequences (Rusiadi et al., 2016) for the planning and implementation of monetary policy (Bank Indonesia, 2022). International trade and financial transactions conducted by a country affect the flow of funds out of the country, which in turn affects the amount of money circulating in the economy. The government tries to encourage the smooth flow of international trade with various policies that directly or indirectly affect it (Badan Kebijakan Fiskal Kemenkeu RI, 2022). One policy that directly affects it is fiscal policy, namely duties, where certain tariffs are applied to exported or imported goods.

D. Conclusion

Monetary policy is represented by money supply, fiscal policy by government expenditure, and trade policy by trade openness, serving as proxies for each. Interest rates and money stand out as pivotal variables, garnering significant

attention from Bank Indonesia due to their strong interaction with the government budget. The fiscal policy multiplier tends to be low in Indonesia, the government tries to encourage the smooth flow of international trade with various policies that directly or indirectly affect it. One policy that directly affects it is fiscal policy, namely duties, where certain tariffs are applied to exported or imported goods. Monetary policy multiplier compared to the fiscal policy multiplier.

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