Research Article **JME 2018,1:1**

Journal of Modern Economy
(ISSN:2577-8218)

Impact of Monetary Policy on Growth and Poverty: Drastic Consequences of Government Intervention

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ABSTRACT

It is unfortunate that growing poverty and widening rich-poor gaps at the initial stage of globalization created several questions about the future of liberalization regime. The present world has been divided into two parts. The upcoming distribution is not geographical. Every region is silently being divided into masters and slavers. This study is mainly concerned with the role of monetary policy in determining the level of poverty in a country. It was concluded in this study that monetary expansion– either to finance the budget deficit or credit to private sector – will always lead the inflation. The increase in the supply of goods and services will be required to defuse the demand pull inflationary pressure. Consequently credit easing policies to boost the investment activities will be required. It indicates the complexities in intervention policies. One intervention requires further intervention to set off the side effects and tuning of the outcomes of policy measures. It was concluded in this study that a parallel qualitative easing is always required with the quantitative easing for tuning the rate of GDP growth, investment, inflation, unemployment and level of poverty.

Keywords: Quantitative Easing, Easy Access to Credit, Inflation, Growth in M2

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How to cite this article:
Ayub Mehar. Impact of Monetary Policy on Growth and Poverty: Drastic Consequences of Government Intervention. Journal of Modern Economy, 2018,1:1

eSciencePublisher
eSciPub LLC, Houston, TX USA.
Website: http://escipub.com/

I) Regressive Economic Policies in Liberalization Regime: A Drastic Phenomenon

The end of a bipolar regime after collapse of Soviet Union diverted the world economies to globalization regime, where economic freedom and liberalization have been adopted as most powerful and popular philosophies of the economic welfare and development. The origination of a free trade regime, decentralization in public finance and revival of the classical school of thought in economic policies are the natural outcomes of the global failure of centrally controlled economic planning experiences. Autonomy of the central banks, market oriented exchange rates, convertibility of the currencies, privatization, deregulation and free trade are the banners of classical economic thoughts in present regime. It is extremely unfortunate that the liberalization polices are not being implemented in "liberal" sense; the powerful lobbies and interest groups can use the liberalization policies only for implementation of their economic agendas, while intervention in the way of liberalization has become common to achieve certain benefits by the powerful groups. This dirty liberalization can mislead the world economies to a harmful direction. If we recognize economics as a social science, we will have to admit that political uses of science distort the society and human lives. The political use of economics to implement socio-political agendas distorts the economic growth, welfare and development.

Unfortunately, in the present inclination of globalization, the world is being divided into two parts: Riches are becoming more riches, and poor are becoming poorer, because of the uneven distribution of the benefits of globalization, cultural transformation and free trade. It is astonishing side of the liberalization policies that unusual and severe concentrations of wealth have been observed in the global economy. The growing poverty and the rich-poor gaps at the initial stage of globalization crated several questions about the future of liberalization regime. At present we do not have a single world, we have two worlds: one belong to the affluent peoples who have achieved the ability of culture adoptability because of their education, frequent travelling, trainings, investing their monetary resources, and developing their cross boarder contacts. The other part belongs to the peoples who do not have ability to get the benefits of globalization and they will have to live in isolation without knowing the contemporary world. The creation of two worlds from the present one is more dangerous as compared to the cold war era, when world was divided geographically. The upcoming distribution is not geographical. Every region is silently being divided into masters and slavers, and unfortunately this type of 'slavery' is not being recognized; taking the measures for its rectification is out of question. Unfortunately, it is coincidence that severe poverty indicators have been taken placed at the time of globalization and free trade regime. Protectionist's policies, growing terrorism, clashes between the cultural and ethnic groups, and uneven living standards are those phenomena which have been observed at the earlier stage of globalization regime.

In the present liberalization regime there are several examples that how economic policies are damaging the society by accelerating poverty and widening the rich poor-gaps, however, this study is mainly concerned with role of monetary policy in determining the growth and inflation which are ultimate factors of the level of poverty in a country.

Regressive fiscal policies play a drastic role in widening rich-poor gap and acceleration of poverty by means of dependency on indirect taxes – mainly the taxes on consumption - and exemptions from tax to the attractive incomes from real estates, capital gains from stock market, and feudal' income from agriculture farms. Such fiscal policies are common in developing world. Trade policies focus on exports of the goods and services and they ignore usually the local trade; it may create price

hike in the local markets especially in food and common used products, which is against the interest of local consumers. In majority of cases the prices of those products which are commonly used by the low income groups are accelerated because of their exports from the country, while benefits of export trade in terms of export proceeds and reducing the cost of imports go to the higher income groups. The import baskets of low income economies show the products which do not belong to the lower income groups. The widening economic disparities are a natural consequence of such trade policies in the free trade regime. It is more interesting that development in the science and technology lead the further inequalities because in most of the cases technological advancement leads the unemployment. Moreover, the use of new technologies – like computers, mobile phones, new models of cars, consumer durables and appliances – change the patterns of household budgets and in most of the cases the share of locally produced commodities and services reduce. Migration and access to higher education are the other ways of widening the rich-poor gap in the age of liberalization. All such economic policies can be classified as regressive policies.

The monetary policy may be a most “regressive option” in the liberalization because of its drastic effects. There are several mechanisms which make monetary policy a regressive option to manage the economies. The most important is the interest rate spread. A higher spread indicates that depositors are receiving lesser return on their deposits as compare to the investors. If in an economy the larger part of banks deposits belong to the lower income groups – like household savings, retirement money, pension funds, and endowments for orphans, old age peoples, non working widows, and disable persons etc. - the higher spread will make the monetary system regressive. Another common phenomenon in contemporary monetary and banking practices is the higher rate of return on the higher level of deposits. Obviously, it provides more earning opportunities to the well worthy peoples. The increasing (or constant) return to scale on the monetary assets may also enhance the rich-poor gap and poverty levels. The similar practice is the higher rate of return on the deposits of longer duration. There is no need to mention that only the rich peoples can afford the higher duration of fixed deposits, while lower income groups do not have either their bank accounts or they prefer to deposits their money on saving accounts where withdrawal of their money can not be predictable.

A higher rate of interest may lead the cost push inflation in those economies where producers are used to get financing facilities for their production process and inventory holding through working capital loans from the banking sector. The industries – like sugar, textile, tobacco, and food – where availability of raw material depends on crop seasons, and the sales activities are spread over the year are likely to adopt working capital financing from banking sector; this situation will lead to higher inflation if interest rate increases. Again lower income groups will be the net looser if the products are commonly used.

The consumer oriented monetary policy encourages the banking system to provide loan facilities to the households. Financing for cars, personal loans and extensive use of credit cards are the tools of consumer oriented monetary policy. The unusual higher interest rate is always associated with such financing because of the expected high rate of defaults. The inexperienced consumers are compelled to pay the higher cost of financing because of change in their spending habits. They buy those products, which are not affordable in their present income. Such practices create artificial demand for consumer durables and luxuries. These demands are not really derived from commodity prices or incomes of the peoples. Consequently, the households consume their future savings and they have to pay higher amount for these products in terms of interest.

This disturbance in the demand-supply equilibrium leads the higher rate of inflation. Moreover, because of higher liabilities and regular repayments for several years, the households' budgeting patterns are changed. Obviously, the cut in the transfer payments from middle and lower middle incomes classes to poorer peoples is the first step to manage the households' budget. The second effect of this practice is to wipe out the households' savings. In short a blockade in trickling down effect is created due to consumer oriented monetary policies. This blockade leads the ultimate re-shifting of the funds to the upper class. This bounce back effect encourages the concentration of wealth at the cost of poor segment of the society by creating artificial demands of bank credit and consumers products. There are three possibilities of such bounce back effects: (I) The transfer of benefits of the higher sales volume either to the financial institutions or to domestic consumer oriented industries; (II) The transfer of benefits to the banking industry and consumer oriented industry because of increase in the lending rate of interest and prices of the consumer oriented products; (III) Changing in the patterns of consumers spending by higher spending on luxurious and consumers durables- which are usually not produced locally- leads the lower demand of locally produced non luxury goods. The disinvestment and unemployment in domestic economy are the natural outcome of this process.

Another interesting aspect of monetary mechanism belongs to the adverse effects of disappearance of small coins on the charity. The small coins which do not have much purchasing power are usually used in the developing and poor nations to pay charities to beggars. In the present inclination of globalization the small coins are being replaced by higher denomination paper currency. This strategy may adversely affect the level of poverty to some extent. All these effects of monetary policy and mechanism require an extensive study, while in this study we tested the effects of quantitative easing on the rate of inflation and GDP growth.

The change in assets pricing, yield on the financial assets and shifting in the level of risk are the usual topics in the contemporary literature of monetary economics (Errunza: 1985, Fama:1975, Fia and Monacelli: 2006, Fischer: 1984, Glichrist and Leahy: 2002, Ronald: 2004, Wieland: 2010, and Woodford: 2003). The contemporary literature on monetary economics focuses on the effects of monetary policy on the wealth of the peoples – the objective of the present study is to focus on the poverty of the peoples.

To study the policy factors and implications of poverty, the root causes of poverty can be classified into two categories:

(I) Economic policies can be attributed for the higher level of poverty in a region. Patterns of international trade and monetary and fiscal policies are included in these policies which can badly affect the patterns of income distribution and the living conditions of the lower income groups in an economy. Regressive taxation, diversion of the banking facilities, access to financing, interest rate structures, and health and educational policies are included in the policy related causes of poverty and rich-poor disparities. Such policies determine the level of unemployment and inflation in the economies and changing in the magnitude of poverty by shifting the purchasing power of the peoples is the ultimate consequence of these policies. Economic policies hit the level of poverty through inflation and unemployment. So, desirable achievements in the determination of inflation and unemployment are the natural way to control over the policy-led poverty.

(II) The other class of root causes of the poverty is directly link with the role of nature and individual's conditions. Natural disasters, health problem, family

structure, inheritance, individuals working habits and efforts, risk taking behavior and many other factors may be responsible for non-policy causes of poverty. This second type of the causal factors of poverty is not part of the macroeconomic policy and it purely depends on the individual characteristics and natural consequences. It is very common that different types of social security nets deal such types of poverty, though these types of poverty may not be necessarily transit or temporary conditions; Sometimes individual factors and natural disasters may shift the families into long time (or even permanent) poverty conditions. However, solving the problem of this type of poverty through social security networks has two adverse aspects: (a) The social security networks are not available for all the peoples on uniform basis. Sometimes such networks in the developing countries (and even in industrialized countries) are serving on community or religion basis. They provide social security against poverty to the peoples who belong to the certain communities or religions or ethnic groups. This situation may lead and strengthen the ethnic disparities. (b) A serious academic issue in economics is also concerned with the importance and deep rooted philosophy of such networks. It was commonly observed in the literature of heterodox economics that religious based charities (like Zakat in Muslim countries) have been recommended the only and sufficient solution of the poverty issue. Religious scholars strictly emphasize that charity and such social networks are the only solution of poverty and no other economic policies or public finance mechanism is required to fight against poverty. This opinion was favored by the pluralism school of thoughts and the heterodox economists. It corroborates that such opinions nullify the well establish economic theory and it is against the considering of economics as a science. However, to analyze this class of the causes of poverty is not included in this study.

II) The Methodology: Effects of Quantitative Easing on Poverty

This study is mainly concerned to analyze the effects of monetary policy on poverty. The study discusses that how quantitative easing and other monetary policies affect the poverty. Monetary policy is a part of overall economic planning and strategies, which are responsible to provide an environment to the public for their economic development and well being. The main concern of this study is to explore that how the chain and mechanism of monetary policies affect the poverty. Here, it is important to note that it was assumed in this study that poverty is a natural outcome of the unemployment and inflation. There are several disagreements and issues in the measurement of the level of poverty and unemployment. The measurement of poverty either through locally estimated poverty lines or through a fixed amount in terms of an international currency (like US dollar) do not reflect the level of poverty in its true sense. Such estimates can not assess the needs and minimum required income which are varied from society to society. Not only the level of minimum requirement but also the types of foods and shelters are varied from society to society and obviously such localized requirements cannot be incorporated in the globally defined measurements of poverty. However, the only acceptable reality is that poverty level must be affected by the change in the level of unemployment and inflation. So, it was assumed that any policy instrument which affect the inflation or unemployment, will also affect the level of poverty. Another issue is concerned with the measurement of unemployment. The measurement of unemployment is closely associated with the population distribution by

age, gender, literacy, willingness to work and underpaid or unpaid working because of social requirements and coercion. To avoid from the issues involved in the assessment and measurements of unemployment, it was assumed that higher economic growth in terms of GDP will reduce the unemployment. (Baily and Okun: 965). The following propositions have been established to incorporate the association of poverty with unemployment and inflation.

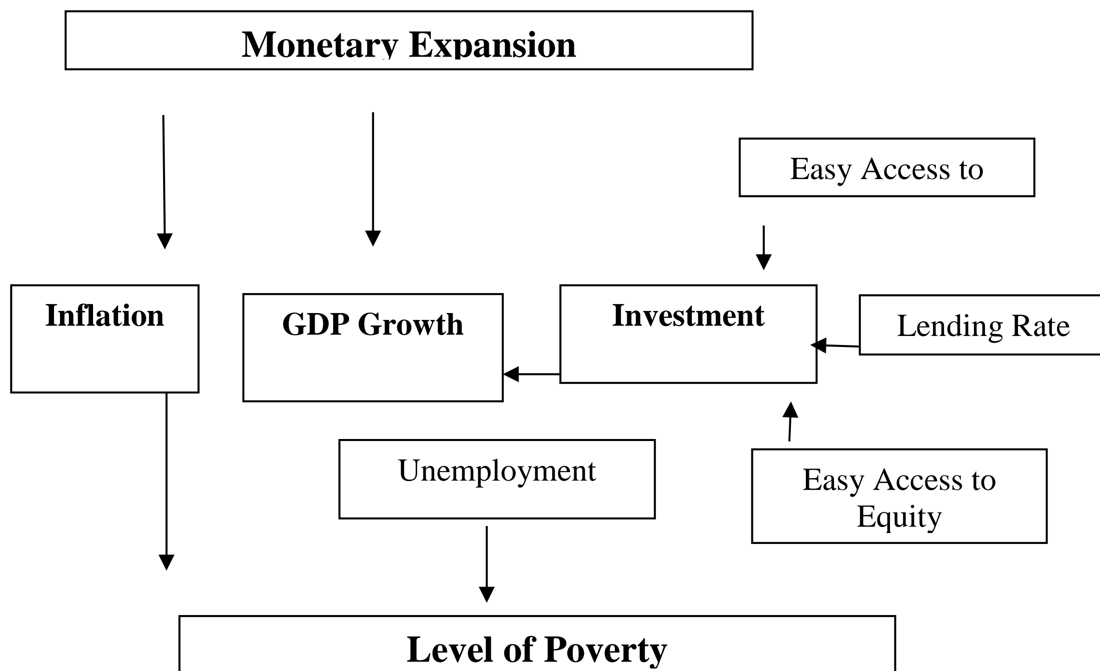
Proposition I: Poverty is a natural consequence of price acceleration and unemployment in a country.

Proposition II: The level of unemployment reduces by the economic growth (Okun's Law)

To study the chain relations between monetary easing and poverty, a model has been constructed. The model is consists of three equations. The simultaneity in the model has been presented in figure: I.

Monetary policy can affect the level of poverty by different ways. Expansionary monetary policy normally involves a lowering of the interest rates by the central bank. However, when the interest rates are either at or close to zero, normal monetary policy can no longer perform. In this case, quantitative easing may be used by the monetary authorities in order to further stimulate the economy. Quantitative easing by the central banks to support the investment activities in the recessionary period to stimulate their economy is one of the major tools which were largely applied in the recnet past. The central bank creates money which it uses to buy government bonds and other financial assets, in order to increase the money supply and the excess reserves of the banking system; this also raises the prices of the financial assets bought by the central banks, which lowers their yield. QE can reduce interbank overnight interest rates, and thereby encourage banks to loan money to higher interest-paying and financially weaker bodies. It can fail if banks are still reluctant to lend money to small business and households in order to spur demands. Such policy was used unsuccessfully by the Bank of Japan (BOJ) to fight domestic deflation in the early 2000s. More recently, similar policies have been used by the United States, the United Kingdom and the Eurozone during the financial crisis of 2007–2010.

Figure: 1 The Simultaneity in the Model Effect of Monetary Expansion on Poverty



Qualitative easing is another workable option of expansionary monetary policy, which provides wider access to credit by relaxing the regulatory environment and shifting investment portfolio to buy private sector assets including residential mortgage-backed securities. In qualitative easing the access to credit becomes easier for the small businesses and common peoples in the economy. It is obvious that this option can provide direct access to the lower income groups and may reduce the level of poverty through higher employment opportunities.

Both the types of expansionary policies- quantitative and qualitative easing – have different consequences, almost in opposite direction from the controlling over poverty point of view.

It was hypothesized in this study that growth in money supply affects directly to the economic growth and the inflation. This hypothesis has been established in the following equations of the model:

GGDP= a0 + a1 ITOGDP + a2 GM2 ------- (1)

Infl= b0+b1GM2 ------- (2)

Where,

GGDP is annual growth in Gross Domestic Product in percentage

ITOGDP is Investment to GDP Ratio

GM2 is the annual growth in Money Supply (M2), and

Infl is annual rate of inflation

For desirable outcomes of monetary expansion, the rate of GDP growth should be greater than rate of inflation. In case of lower rate of growth, the higher growth in investment is the only option to improve the GDP growth. Though, it is considerably difficult to determine the factors of investment in a common equation, because of the complexity and variations in determining the investment in different economies. The lending rate of interest and the access to capital are the common factors in determination of the level of investment. So, it was hypothesized in this study that investment is determined by the lending rate of interest and easy access to the capital. To test this relation, the following equation has been estimated:

ITOGDP= c0 +c1LRAT + c2EACR +c3EAEQ------- (3)

Where,

ITOGDP is Investment to GDP Ratio

LRAT is Rate of Interest on Lending

ECAR is the Index indicates the easy access to credit, and

EAEQ is the Index indicates the easy access to equity

The above-mentioned indexes have been constructed by the World Economic Forum (2010). The data on the above variables has been extracted from the World Economic Forum (2010) and World Bank (2010). The World Bank data is consists of 139 countries and the data extracted from the World Economic Forum covers 57 countries. However, the data on some variables were not available in case of some countries. The deletion of those countries from regression analysis was the only option; consequently number of observations is not same for all the above-mentioned equations. The parameters estimated by regression analysis have been shown in the table: 4 to 6.

According to the models, growth in money supply (M2) – either by public sector or private sector credit - will affect the growth and inflation in the country. The growth and inflation jointly determine the effect of monetary policy on the level of poverty. The credit expansion in both the cases – financing budget deficit and credit to private sector - will lead the growth in money supply (M2) while price acceleration because of shifting the demand of goods and services will be a natural consequence of this monetary expansion. However, a parallel increase in the supply of goods and service may lead the higher economic growth. An increase in the supply of goods and services may lead the more utilization of capital and labor in the economy. If the effect of monetary easing on inflation is stronger than its effect on growth, it will lead the higher level of

poverty in the economy, while a stronger effect on growth may lead the reduction in poverty. It is a precondition that no obstacle should be involved in the tickle downing of the effect of growth on employment level. Here, it is noteworthy that sometimes credit easing and banking policies may create obstacles in the transformation of desirable effects of economic growth to the lower income groups. This situation will be discussed in the next section with details.

It was also hypothesized that investment is an important determinant of economic growth. The above mentioned model explores that how growth in investment affect the growth of GDP. Here, it was proposed that growth in investment will lead to reduction in the unemployment. So, if desirable effect of monetary policy on GDP growth is less than its effect on inflation, the higher investment activities is the only option to increase rate of growth.

Monetary policy is also a key determinant of investment. Equation (III) explains that interest rate for lending from banks and the easy access to credit is the important determinant of investment. Both, the lending rate of interest and easy access to credit are the parts of monetary policy. So, again monetary policy can affect the poverty by generating employment opportunities through boosting the investment activities in the economy.

It was further proposed that simultaneous investment activities are required in all sectors for overall economic development including transport, energy, communication, water and sanitation, trading activities, education, art and cultural activities, printing and publishing, heavy machinery and engineering, construction, foods and hotels and consumers durables etc. A particular sector can not be grown without simultaneous growth in the complementary sectors. This proposition can be described in the following statement:

Proposition III: Simultaneous growth in the complementary economic sectors is required to provide a catalyst for investment growth activities. To develop a sector without parallel development in the other sectors will not be succeeded even in the presence of favorable interest rate for lending and easy access to capital.

It was commonly observed in case of developing countries that the access to capital by the smaller sectors is ignored by the planning authorities. Monetary policy should address this issue to develop the small and medium businesses to derive the demand of the large industrial products. The estimated results indicate that easy access to credit is an important and significant determinant of the investment, and the investment activities in isolation cannot be succeeded unless parallel investment activities are not available in the associated sectors. The qualitative easing is a required policy to make access of credit easy for the lower income peoples and small businesses. The small and medium business provides catalyst for the development of large scale businesses. In most of the cases small and medium businesses create demand of the products of large scale business; they also provide raw material and services to the large scale businesses. So, they cannot be ignored in the monetary policy transformation mechanism. The qualitative tightening in monetary policy can adversely affect the small and medium businesses and ultimately to the poor and lower income groups in the economy.

The access of poor and small businesses to the bank financing shows a drastic picture in the global economies. In majority of cases, a negligible part of the poor people in a country can access to the banks for financing. Table: I indicate that Bangladesh is an exceptional case, where financing to poor and small business has a significant portion. Morocco, Vietnam, Mexico, Indonesia, Peru and Jordon are the other appropriate examples, and it has been observed by the country analysis that these countries have significant controlled over the poverty issue. Table: II shows that majority of business

enterprises do not have a loan. The more important is that more than 87 percent business enterprises did not apply for loan. Another important 'misleading' thought is that majority think that they do not need for a loan. This trend leads the only equity based businesses and no need of businesses (or expansion in businesses) if there is no equity. This trend is against economic rationality. No theory in the literature of finance encourages the absence of debt from business enterprises. The optimal combination of debt and equity is an important consideration in the wealth maximization theories (Barrow: 1964, Errunza:1985, Fama: 1975, Mehar: 2005)

Table: I Bank Financing to Lower Income Peoples

Country	No. of borrowers from Microfinance Institution as % of Poor population (MFI)	Number of firms having bank financing as % of total Firms (FBKFIN)	Average size of bank financing per business (Million US $) (BUSLON)	Average size of bank financing per listed company (Million US $) (COMLON)
Bangladesh	41.22	40.6	192.1	0.8
Vietnam	29.03	25.4	740.7	2.0
Morocco	22.64	19.4	1238.1	
Mexico	20.96	2.6	2722.8	0.1
Indonesia	19.66	22.8	761.0	1.1
Peru	17.6	28.6	125.7	
Jordan	12.45	8.6	114.8	
Philippines	11.03	21.9	388.6	
Malaysia	7.77	48.6	266.4	
Egypt	7.16	8.5	234.4	0.5
Colombia	6.46	30.6	830.4	0.2
India	4.8	46.7	142.4	1.1
South Africa	4.1	30.9	1290.9	1.1
Kazakhstan	3.37	26.9	457.1	0.9
Pakistan	2.61	12.2	98.7	
Brazil	1.62	38.1	3448.1	0.3
Panama	1.56	19.2	885.8	
Argentina	0.81	6.9	1115.0	0.6
Ukraine	0.64	21.3	240.3	0.1
Venezuela, RB	0.62	35.7	880.2	
Russian Fed.	0.54	19.0	1161.6	0.1
Poland	0.25	34.0	695.5	0.4
China	0.19	28.8	4883.8	
Korea, Rep.	0.07	39.9	525.0	
Thailand	0.06	74.6	769.1	1.4
Turkey	0.03	27.9	960.3	0.4

Table: II Identifying credit constraints: Enterprises Survey

Enterprises do not have a loan	58.7%
Enterprises did not applied for a loan	87.2%
Why not applied for a loan?	
No need for a loan	55.70%
Higher interest rates	14.70%
Complex procedures	11.20%
Higher collateral requirements	07.20%
No expectation for approval	05.40%
Other reason	05.90%

Source: The World Bank's Enterprise Surveys (WEF: Financial Development Report 2010)

Table: III Correlation Matrix

	MFI	FBKFIN	BUSLON	COMLON
MFI	1			
FBKFIN	-0.12953	1		
BUSLON	-0.15319	-0.05638	1	
COMLON	0.377845	0.418006	-0.32899	1

In the analysis of use of financing facilities by the small enterprises and poor peoples, the data was extracted from database file of the Microfinance Information Exchange, Inc. (World Bank: 2010). In table: II and III FBKFIN indicates the firms using banks to finance their investment activities as the percentage of total firms in the economy (World Bank: 2010), while microfinance institution (MFI) is the total number of borrowers from microfinance institutions (MFIs) as a percentage of country's poor population. Surprisingly a negative correlation has (0.12953) been observed between the percentage of poor population have success to bank loan facility and the percentage of business entities have success to bank loans. It indicates that loaning to businesses can divert the objectivity of helping the poor by use of a monetary policy. Surprisingly, this relation is not valid for listed companies.

Table: IV

Average Growth in GDP (Dependent Variable)

Variable	Coefficients	T-statistics
Intercept	0.203104	0.251089
Investment to GDP	0.097964	3.010557
Growth in M2	0.118154	6.709202
Adjusted R Square	0.357728	
No. of observations	109	

Table: V

Rate of Inflation - CPI (Dependent Variable)

Variables	Coefficients	T-statistics
Intercept	0.241663	0.360352
Growth in M2	0.377659	11.12834
Adjusted R Square	0.532144	
No. of observations	109	

Table: VI

Investment to GDP Ratio (Dependent Variable)

Variable	Coefficients	T-statistics
Intercept	23.06329	4.762319
Lending Rate	-0.20301	-2.12476
Easy Access to Credit	3.205361	2.358166
Easy Access to Equity	-2.13681	-1.66191
Adjusted R Square	0.12179	
No. of observations	36	

The estimated results of the model have been shown in table: 4 to 6. All the parameters are statistically significant except ‘Easy Access to Equity’ in the determination of investment. It indicates that investment depends significantly on rate of interest for lending and easy access to credit. Both the determinants are the parts of monetary policy and they do not belong to quantitative easing. So, it was concluded that for higher investment and for higher growth in GDP the credit easing is required. Particularly, it is a required policy when quantitative easing has been adopted, which may lead the higher inflation and consequently higher level of poverty.

The following corollaries are established on the basis of the above-mentioned hypothesis and results:

Corollary I: The creation of money – either to finance the budget deficit or credit to private sector – will always lead the inflation. This principle is not associated with the disbursement and utilization of debts without change in monetary expansion. A debt without monetary expansion will change the patterns of priorities of demand for goods and service. This situation may lead the changes in the prices of several commodities in both the directions. However, it will not be responsible for aggregate change in price level.

Corollary II: The upward changes in the prices of some goods may lead the changes in the prices of other goods in the same direction. The higher cost of inputs and maintaining the real profits are the causes of this type of price movement.

Corollary III: An upward change in the supply of goods and services may defuse the demand pull inflationary pressures; this is possible if growth in investment activities by utilization of capital and labor. The credit easing can attract the investment activities in the economy.

Corollary II: A parallel Credit Easing Monetary Policy is always required with the Quantitative Easing for tuning the rate of GDP growth, investment, inflation, unemployment and level of poverty.

III) Consequences of Conflicting Policies: South Asian Experience

Despite of sufficient arguments in favour of Quantitative Easing (QA) policies in recessionary period and their effectiveness, the adverse effects in terms of inflationary pressures and dropping in the soundness of money are considerable consequences. These policies may also be considered as a step against the economic freedom. The application of QE policies adopted by United Kingdom, Japan, and the countries in Euro zone have considerable justifications and the policy makers in these industrialized countries can formulate the remedial policies to absorb the adverse effects of QE polices. The darkest side of the picture is the implementation of such monetary policies in the lower middle income countries. The QE policy in such countries may be a harbinger of the severe economic disasters and ultimate collapse of the macroeconomic structure.

An empirical analysis of aggressive 'Quantitative Easing' in Pakistan, credit easing and monetary liberalization in India, credit easing in Bangladesh and surplus liquidity in China show that objectives and consequences of monetary expansions do not have uniformity. This study may be useful for the statesmen, economic policy makers and monetary authorities to determine the consequences of monetary expansion in broader term.

It is an interesting aspect of the monetary policies adopted in the context of developing countries during the last decade that they have been emphasizing on the quantitative easing in the parallel presence of qualitative tightening. Such conflicting money policies have commonly been adopted during the last three years due to political constraints. These policies neither can be classified as monetary tightening because they discouraged the private sector credit facilities by several ways including higher policy interest rates, qualitative tightening, higher reserve ratios, unplanned implementation of BASEL I and II during the recessionary periods, introducing prudential regulations and several risk management mechanisms to maintain the financial stability. By the same time, heavy quantitative easing and printing of currency have also been observed to facilitate the government to run their businesses. These conflicting policies created several problems in the developing economies: They created inflation because of quantitative easing and higher printing of currencies to finance public expenditures and in the other hand they discouraged the investment because of monetary tightening in private sector by qualitative control and credit tightening.

Table: VII Financial Access and Stability

Factor\ Country	Bangladesh	India	Pakistan	USA	China
Ease access to credit (Index: 7 is best)	3.70	4.04	3.51	2.75	3.97
Financing through equity market (Index: 7 is best)	4.47	5.04	4.22	4.38	3.89
Domestic Credit by Banks as % of GDP	59.4	71.6	45.9	216.1	126.2
NPL as % of total loans	13.00	2.30	8.40	2.30	2.50
Private credit bureau coverage as % of total adults	00.00	10.50	1.50	100.00	00.00
Public credit registry coverage as % of total adults	0.90	00.00	4.90	00.00	59.00

The use of monetary policy reveals some interesting phenomena in South Asian context. Since 1997, Indian economy adopted an aggressive credit easing policy along with liberalization. The effects of this policy are clearly visible in 7 percent annualized rate of growth rate. Historically this rate of growth was about 3 percent. However, it is notable that this rate of growth reflects the qualitative easing. It is interesting to note that India's ranking (in 2009 and 2010) in easy access to credit is better than Bangladesh and Pakistan. It is much better than USA – the leader of economic freedom. Surprisingly, China has a better ranking in easy access to credit. The better ranking in easy access to credit in case of India and China has been successfully transformed in their rates of growth. Bangladesh has a better ranking than Pakistan; however, the easy access to credit in Bangladesh is mainly focused on small enterprises. The effects of credit easing in Bangladesh are visible in the poverty reduction indicators. Contrary to this practice, Pakistan – the chief political rival of India – adopted a quantitative easing to finance its budget deficit. A continuous quantitative easing in Pakistan created a severe inflationary pressure in the economy which ultimately transformed in the increasing poverty. At present, the visible evidences of poverty in Pakistan show the extreme severity of the problem.

The qualitative tightening and hard access to credit policies is adopted usually to justify the control over the non performing loans. However, no visible signs are available in favor of this justification. The higher magnitudes of non performing loans were observed in the presence of hard access to credit in some countries including Pakistan. It was observed that higher non performing loans have no significant relation with the easy access to credit (Mehar: 2010)

Interest rate spread is almost equal in South Asian economies, which is slightly higher than world average; however it is much higher than China. The reason is obvious; China's central planning experience allows it to set the interest rate spread, corporate profits and wages at minimum level, which is not possible in liberal economies. Despite of uniformity in the interest rate spread, a significant great variation was observed in the central banks' policy discount rates. The rate of interest in Pakistan is almost three times higher as compared to India and Bangladesh. In fact, policy interest rate in Pakistan is being applied by the State Bank of Pakistan as a tool of contrationary monetary policy. Consequently, Pakistan is one of the few countries in the world where policy interest rates are 15 percent or more. Interest rates in United States, China, Japan and European Union are much lower than South Asian economies, which provide the opportunities of financial expansion to the investors of those countries.

Another interesting observation for the effects of such conflicting monetary policies is available in the current scenario of Pakistan economy, where a qualitative tightening along with quantitative easing has been followed. This policy was experimented after a long duration consumer oriented monetary policy. This case study provides some interesting insights and phenomena. The consumer oriented unplanned expansionary monetary policy in the last decade provided incentives to the middle classers to spend on those products, which usually produced – partially or wholly – at abroad. The credit cards, e-money, leasing facilities and personal loans provided incentives to spend on consumer durables and luxuries. No doubt, this policy provided a mechanism to improve the quality of life in the country by means of increase in the use of mobile sets, cars, computers, domestic appliances and luxurious items, however, it had three consequences: Either it circulated the money among the middle class households or re-transferred it to the rich class, but not shifted to the poor class households. The improvement in living standard through medium-term borrowing and revolving credit facilities from banks and financial institutions added the repayment burden on middle class households, and they shifted this burden on their futures. As

a consequence they are compelled to pay a big portion of their current and future incomes to the financial institutions in the form of installment, lease rentals or repayments etc. So they do not have anything to shift to the poor segment of the economy. Moreover, they are compelled to spend more time on income generating activities to redeem their debts and to pay the interest on financial facilities they had availed to improve their living standard. They are not in a position to save or to transfer the money to the poor segments.

The most significant reason responsible for the incompletion of trickle down chain was the blockade of money at middle class stage. Incomes of those middle classers increased significantly who have been helping the higher income groups to generate money in a business boom situation. This boom was clearly observable in the stock market; export trade, banking, cement, real estate, construction and services sector. The middle class professionals and services providers have adopted the contemporary tools to update their professional skills, so changes in the economic and technological environment have been favoring them. They have succeeded to get their due share from the higher income class, but they have failed to transfer this share to the lower income segment of the economy because of two reasons: They had preferred to secure their economic future by means of additional investment in non productive activities, e.g. purchase of real estate properties, investment in stocks and deposits in non productive money making schemes or spending on services at abroad including education, traveling and tourism.

It is important to note that funds acquired through borrowing from the financial institutions were not spent on locally produced goods and services; usually they spent on those products and services which have their foreign origins. Consequently, the consumer oriented monetary policy has also been causing the accelerated trade deficit. Trade statistics show the increasing imports of consumer products including electronics goods, mobile sets, domestic appliances, chocolates and candies, dry milk and its products, cosmetics and other luxuries goods, and off course petroleum products because of increasing numbers of luxurious vehicles on the roads. The soft credit policies for personal loans, credit cards, and leasing facilities have played important role to surge the demand of those imported products. The monetary policy provided incentives to the consumers to spend their income on the goods and services have their foreign origin. It induced the outflow of money to the abroad. On the other hand, it provided incentives to the banks and financial institutions to shift their portfolio from industry oriented to consumption-oriented loans. The industry has to pay the cost of this policy in terms of higher interest rates on borrowing for industrialization and investment.

Now, even in the age of liberalization, the State Bank provides a signal to the banks through announcing ‘discount rate’ in its monetary policy statement. This discount rate influences the money market equilibrium, which limits the economic growth. It is surprising that the State Bank of Pakistan justifies its action in the name of controlling inflation in the economy, but every time it was observed that inflation was always accelerated after the increase in the rate of interest. This contradiction shows the ineffectiveness of monetary policy. Another important implication of the present tightening in the monetary policy is the unusual high banking spread in Pakistan, which is contributing in a dampening effect on income inequalities and economic growth by discouraging savings.

Table: VIII Central Banks’ Policy Rates (2009)

Country	Rate (%)
Bangladesh	5.00

India	5.50
Maldives	13.00
Nepal	6.50
Pakistan	15.00
Sri Lanka	11.75
China	3.06
United States America	0.50

Policy Implications:

The accelerated growth in industrialization and investment activities is the only feasible solution to control over inflation and poverty in the presence of a quantitative easing. Enhancement in employment generating activities by promotion of industrial investment provides a mechanism to transfer the effects of macroeconomic growth to the lower segment of society. The enhancement in investment activities is significantly associated with the rate of interest on lending and easy access to credit. This is the reason that interest rate is being used by some countries as a hegemonic tool of industrial competitiveness. The parallel use of easy credit access and qualitative easing are more required in case of a quantitative easing, which may lead the higher inflation. The lower interest rate and easy access to credit is required not only for long term financing, it is also applicable for working capital financing to manage the liquidity problem of the business enterprises in the presence of inflationary policies.

In the end note, it is important to mention that several reasons can be identified for the poverty and economic problems of the common peoples. If it is assumed that their problems are consequences of their irrational behavior, dishonesty, inordinate risk taking activities, flawed planning, natural disastrous, and ill working habits, one can say that they deserve to live in the hard conditions because of their sins. However, they should not be victimized because of others' sins. It is against the natural justice that low income peoples in a society are penalized because of the sins of their high income groups. If the problems of a common man are consequence of the ill planning, inefficiencies and corruption of the others who are in the driving seat, then the burden should not be transferred to those who are not responsible for these policies. The governing authorities will have to address this important aspect of natural justice.

In physical sciences, we recognize the laws of nature in the form of solar system, gravity, laws of motion, speed of light, natural characteristics of matter, structure of atoms, DNA, and Human gens. We believe that we should not (and cannot) stop or create hindrances in the ways of the natural laws. In recognizing economics as a science we believe that laws of 'demand and supply', 'invisible hand of price mechanism', 'competitiveness', 'trickle down effects of economic growth', 'quantitative relation between money supply and inflation', 'relations between prices and unemployment', 'self-determination of exchange rates', 'wealth maximization process', 'market equilibrium' and other laws of nature in explaining human economic behaviors have been created by God. Man should not interfere in these laws of nature. To fight against the nature will always be disastrous. It should be believed that God who created solar system, structure of atoms, and laws of nature for matter has also created laws of economic behavior. A man can get maximum benefits by understanding and utilizing these laws of nature, but he cannot achieve prosperity by creating hindrances in the working of the laws of nature.

This is simplest way to explain the "liberal economics". The monetary policies have no exemption from the laws of nature.

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