

FISCAL POLICY AND ITS EFFECT ON PAKISTAN`S ECONOMY

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Abstract

Purpose - This research examines the impact of fiscal policy on economy of Pakistan as Pakistan economy is key factor that has fanatical importance. This study spotlights the fiscal policy and its effects on Pakistan economy. This study inspected the past and present situation of economy of Pakistan.

Design/ Methodology/ Approach - The secondary data is used from 1975 to 2014. OLS Model, Correlation and Descriptive statistics are used to show the relationship between variables. In this study we have checked the impact of gross domestic product, government expenditure, inflation, unemployment on budget deficit.

Findings - This result concludes that the budget deficit showed positive effect with gross domestic product and government expenditure and negative relationship with inflation and unemployment.

Implications - This study highlighted different issues related to economy of Pakistan and suggested some measure to make Pakistan a better economy.

Originality Value - Researchers in Pakistan have tried to investigate the relationship of overall fiscal policies with economy of Pakistan which has not been done before according to researcher best knowledge.

Keywords Budget Deficit, Gross Domestic Product, Government Expenditure, Inflation Rate, Unemployment Rate.

Research Type Research Paper

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1.0 INTRODUCTION

The importance of fiscal policy in implementation of a government's principal economic objective of seeking rising levels of prosperity for all members of the society by achieving high, sustainable and equitable economic growth cannot be overemphasized. However, formulation and implementation of fiscal policy is a complex subject with eventual outcomes of policy measures at times being clearly different from their short term effects and even opposite to the very objectives that fiscal policy seeks to achieve.

Fiscal policy is important for economic development especially in developing countries. Financial approach has a positive macroeconomic impact over the long period of time. It is utilized to back additional capital spending that prompts an increment in the load of national resources, higher spending on the vehicle framework enhances the supply-side limit of the economy advancing long run development and expanded open segment interest in wellbeing and training can bring beneficial outcome on work efficiency and job. Government can and ought to utilize financial approach to keep genuine national yield closer to potential Gross domestic product with the goal that we stay away from a huge negative yield. Keeping up an abnormal state of interest help to support development and keep unemployment low.

2.0 LITERATURE REVIEW

The literature helps to know about the past study of topic concerned and also recommends about the further study on topic concerned. It helps researcher to know about the problem regarding that topic and possible solution of research problem. The researcher enable him /herself through literature that how past researchers' analyzed data and what econometric techniques were applied for the expected results. Empirical studies conducted in the past on this research problem are discussed below.

Harberger (1963) starts in his research on Chile economy that a direct relation exists between general price level and production level, and money growth increases general price level.

Keho (1988) conducted study on "Budget deficit and economic growth causality evidence and policy implication for West African Economic and Monterey Union countries". The objective of the study was to investigate the causality along with the budget deficit and

economic growth in the associate countries of the West African Economic and Monetary Union. Time series data used for the period of 1980 to 2005. Research data has examined through Granger Causality Test developed by Toda and Yamamoto in 1995 to find the relationship between variables. Estimated facts showed varied results. In three cases no causation have been found between deficit of budget and growth. While budget deficit found to have great impact on growth in case of other four countries. They recommend that government should obtain positive total surplus to achieve economic growth and real convergence within the fiscal union.

Barro(1989) investigated a positive and noteworthy effect of spending plan shortage on the development. This effect is because of positive relationship between the budget deficit and the inflation.

Engle in 1989 broke down the budget deficit inflation relationship in diverse nations. He found that the nations with high expansion have solid connection among swelling and spending plan shortage. Fischer noticed that high expansion has diminishing impact on assessment income which is known as Tanzi-Olivera Impact. Likewise, high rate of expansion expands spending plan shortage by declining in seignior age income.

Balanchord and Fisher (1989) did examination work to figure out the impact of spending plan shortfall on speculation. The relationship between the monetary allowance shortage and venture was investigated with the assistance of Johansen Juselius Co joining system and quarterly information was inspected for the time of 1947-1992. There is a crowing an effect of the financial backing shortfall on the genuine venture, which is acceptance of contentions of the Keynesian with respect to the expansionary impact of the monetary allowance shortage on the speculation.

Hondroyiannis and Papapetrou (1997) contemplated on the immediate and backhanded impact on the financial backing of spending plan on expansion in Greece and discovered the outcome that financial plan shortage has aberrant raising impact on swelling. In any case they likewise expressed that an increment in swelling results in an increment in spending plan shortage.

Metin (1998) dissected the long run relationship among spending plan deficiency and swelling in Turkish economy between the years 1950-1987. Toward the end of his study, he inferred that an adjustment in spending plan shortage reason to change in swelling on the same

bearing. He likewise highlighted that has spending plan deficiency expansion winding is a standout amongst the most vital issue of Turkish Economy.

Cato and Terrones (2005) took a shot at the relationship in the middle of expansion and spending plan shortfall by utilizing information from diverse nations. The outcome that they came to is being feeble relationship in created nations and being solid positive relationship in creating nations.

Chaudhry and Shabbir (2005) research the part of expansion in the administration spending and spending plan for shortfall for creating nations with high swelling. The distinguishing proof of causal connection between government use and income gives understanding in respect to how distinctive arrangements may help control the development of the administration use. On the off chance that the causality keeps running from government income to consumption, the burden on extra assessments to confine the measure of deficiency spending plan will expand it. Opposite, if the easygoing connection keeps running from government consumption to income, then limiting government spending ought to confine the monetary allowance deficiency. These are the significance of analyzing the causality of government use and income on the monetary strategy execution for getting ideal financial development.

Research was conducted on foreign sector of Pakistan in order to examine the effect of budget deficit by Agha and Khan in 2006. The study showed positive relationship of money supply with international reserves, commercial bank credit and government borrowing from banking system for financing budget deficit and negative relationship of money and demand with interest rate positive relationship with income .On the anther hand out put his positive relationship with expended credit of commercial bank foreign severs and public expenditure .

The increased money supply trough expended credit of commercial bank has an impact on balance of payment throughout put ultimately brings changes in international reserves. Increase in deficit financing through expended credit of commercial bank creates excess in supply of money over demand, resulted in outflow of international reserves. On the other hands, public sector borrowing can lead to crowed out private sector credit which can effect growth and balance of payments. Study also showed positive relationship of export with real income, relative prices and nominal exchange rate. Income elasticity of export is greater than one, indicating that export growth will be more than the growth in output. Relationship of import is

also positive with income and foreign reserves and negative with relative prices and foreign exchange rate. The study concludes that government should reduce budget deficit by cutting down unnecessary expenditure. This will lead to improve balance of payment deficit and control the expended domestic credit. Monetary policy is dependent to fiscal policy so there should be close link between two policies for achieving external and internal balance.

Boariu and Bilan (2007) state in their exploration on the impact of financing spending plan shortage in contemporary economy that if governments look for supplying their financial plan deficiency through expanding cash supply, the reason will be high expansion rate.

Khan, Khattak, Hussain and Jehanzeb (2008) took a shot at "jamming as a result of spending plan shortfall proof from Pakistan, An utilization of two stages slightest square strategy "The point of the study is to examine the effect of nonstop budgetary shortage on private and open venture for the period 1960 to 2005. Result demonstrated that the variables are co incorporating and they have long run relationship. They found that cash supply is absolutely identified with bank credit, to private divisions, obtaining from saving money parts i.e residential wellspring of financing the monetary allowance shortage and remote store. They additionally found that interest for cash is absolutely identified with yield and contrarily to premium rate. The assessed result demonstrated that the general population speculation and private venture is emphatically identified with yield. They prescribe that financial and fiscal variables are essential to focus the private and open interest in Pakistan. In the event that the administration offers significance to fund spending plan shortage through household sources and stretched out credit to private area, it can enhance the limit of the economy.

Werring and Tossy Khan's survey (2010) on Indonesia economy indicates that money extension is affected by inflation, rate through cabinet budget, and a cause-effect relation between money supply and price level is acknowledged. Vamvoukas (2000) states there is a positive meaningful relation between actual GDP, money demand budget deficit, money demand, budget deficit and inflation rate in Greece economy.

Tiwari (2011) made a study about unevenness between open spending and open income in Country. They highlighted that the administration funds spending plan shortfall by utilizing transient cash propels. It additionally brings about the cash supply to converse which brings about expansion to go up. They inferred that high spending plan shortage drives high expansion in Economy.

Ammama, Mughal and Khan (2011) took a shot at "Monetary shortfall and its effect on expansion, causality and co-combination". Con-combination and Granger causality test are utilized as systems. The point of this paper is to analyze the effect of monetary deficiency on swelling and discover the relationship between spending plan shortage and CPI (shopper value file) for the period 1960 to 2010. The outcome co-reconciliations demonstrated that there is a long run positive noteworthy relationship between spending plan deficiency and swelling rate. They additionally found through Granger causality test that monetary shortfall because expansion if there should arise an occurrence of Pakistan. They suggested that the administration ought to take after the strides; initial one is that national bank ought to be freer and the other is that national bank fiscal arrangement goals ought to be clear. Right to give a lawful certification for the autonomy of the national bank will help cut the monetary allowance shortfall and the cash supply of the interior relations, in this manner constraining the Legislature straightforwardly through the national bank the likelihood of an overdraft to cover the deficiency. in this manner, our administration ought to exhibit the execution of judicious monetary strategy as an open door, through the foundation of a sound advanced assessment gathering framework, streamline the Structure of government spending and accelerate the change of spending plan administration framework and different intends to make conditions for the slow re-teaching of financial shortfall.

Rauf and Khan (2011) dealt with " An observational study to discover the relationship between exchange shortage and spending plan shortfall if there should be an occurrence of Pakistan" They utilized Granger causality test to discover causality between exchange deficiency and spending plan deficiency while for basic relapse, Customary minimum square strategy is utilized as a part of the study. The period is 1980 to 2009. Result demonstrated that financial plan deficiency does not granger reason exchange shortage but rather exchange shortfall granger reason spending plan shortfall. They discovered critical relationship between variables. They recommend to the powers that arrangement with financial order of Pakistan minimize spending plan shortage and exchange deficiency.

Fatima, Ahmed and Rehman (2012) chipped away at "The considerable impacts of spending plan deficiency on financial development of Pakistan" An utilization of the normal minimum square procedure" The point of the learn at examining the genuine effect of spending plan shortfall on the monetary development of the nation. They took Pakistan Gross domestic product as depended variable and swelling, genuine swapping scale, genuine premium rate,

spending plan deficiency and gross venture as autonomous variables from the time of 1978 to 2009. They found that the customary slightest square results demonstrated the ices speculation has noteworthy positive effect on the financial development, the monetary allowance deficiency has a critical negative on the monetary development and the swelling has negative effect on the monetary development. The prescribed polices that the legislature of Pakistan must take measure to control the shortage in the nation to accomplish the certain level of financial development. The legislature of Pakistan must use its underutilized assets to evacuate the issue of the financial backing deficiency. Government takes advance to control spending plan shortage yet they suggest that this is not the arrangement it is unforeseen. They additionally suggest that the legislature can build the proportion of the immediate charges the aberrant assessments. Presentation of new types of the expenses are additionally one of the answer for expansion the incomes of the administration.

3.0 THEORETICAL FRAMEWORK

The savers spenders' theory of fiscal policy

The macroeconomic examination of financial strategy is normally in light of one of two sanctioned models the Barro-Ramsey model of limitlessly lived families or the Precious stone Samuelson model of covering eras. This paper contends that neither one of the models is acceptable and recommends an elective. In the proposed model, a few shoppers arrange ahead for themselves and their relatives, while others live paycheck to paycheck. This model is simpler to accommodate with the crucial certainties about purchaser conduct and riches amassing, and it yields some new and shocking decisions about monetary approach. Both the Barro-Ramsey model and the Precious stone Samuelson model expect that all family units use budgetary markets to cover utilization up time. There is much motivation to be suspicious about this supposition. Consequently, different papers have affirmed the colossal impact of current wage on shopper spending. Market analysts use straightforward models to create and sharpen their instinct. For the macroeconomic investigation of financial arrangement, the two predominant models have been the Barro-Ramsey model of 12 intergenerational benevolence and the Jewel Samuelson model of covering eras. In my view, nor is agreeable. A superior model would recognize the considerable heterogeneity in buyer conduct that is evident in the information. A few individuals have long time skylines, as confirm by the colossal centralization of riches and the significance of estates in total capital aggregation. Other individuals have brief time skylines,

as confirm by the disappointment of utilization smoothing and the commonness of families with close to zero total assets. The savers-spenders hypothesis outlined here makes a little stride toward incorporating this microeconomic heterogeneity in macroeconomic hypothesis, and it yields some new and astounding decisions about monetary arrangement.

4.0 METHODOLOGY

Description of the Variables:

Budget Deficit: A budget deficit is an indicator of financial health in which expenditures exceed revenue. The term budget deficit is most commonly used to refer to government spending rather than business or individual spending, but can be applied to all of these entities.

Gross domestic Product: GDP includes earnings of goods and services of the peoples which live in boundary of a country.

Government Expenditure: Government expenditures are used by the government sector to undertake key functions, such as national defense and education. These expenditures are financed with a combination of taxes and borrowing.

Inflation Rate: Inflation means the average and consistent rise in the prices.

Unemployment: Unemployment is a phenomenon that occurs when a person who is actively searching for employment is unable to find work.

Table 1. Descriptions of variables

Variables	Description of variables	Units of measurement	Expected sign
Dependent variable			
BD	Budget Deficit	In percentage	
Independent variables			
GDP	Gross Domestic Product	In current Billions of US Dollar's	Positive
GE	Govt Expenditure	In current Billions of US Dollar's	Positive
INF	Inflation	In percentage	Negative
UNEMP	Unemployment Rate	In percentage	Negative

Model Specification

General specification of the model

The model is specified with one dependent variable and the rest of the independent variables are given below.

$$Y = f (X_1, X_2, X_3, \dots, X_i) \text{ --- (1)}$$

Empirical specification of the model:

$$BD = f (GDP, GE, INF, UNEMP) \text{ --- (2)}$$

Mathematical specification:

$$GDP = \beta_0 + \beta_1(GDP) + \beta_2(GE) + \beta_3(INF) + \beta_4(UNEMP) \text{ --- (3)}$$

Econometric specification:

$$BD = \beta_0 + \beta_1(GDP) + \beta_2(GE) + \beta_3(INF) + \beta_4(UNEMP) + \mu \text{ --- (4)}$$

Where,

BD=Budget Deficit

GDP=Gross Domestic Product

GE=Government Expenditure

INF=Inflation Rate

UNEMP=Unemployment

μ =Error Term

5.0 RESULTS AND DISCUSSIONS

Table 2 Descriptive Analysis

Mean	Maximum	Minimum	Skewness	Kurtosis	J-B	Prob.	
BD	-5.99	4.00	-10.0	1.74	6.83	42.60	0.000
GDP	4.90	10.22	1.01	0.24	2.4858	0.80	0.66
GE	8.14	25.46	1.45	1.36	3.91	13.09	0.66
INF	8.53	20.30	2.90	0.72	4.05	5.06	0.07
UNEMP	6.4	9.70	4.00	0.51	2.44	2.30	0.33

Source: Author`s Calculation E-views 7.0

The above table shows the descriptive statistics of all the variables included in the study. We can see the average value of Budget deficit (BD) -5.99, the maximum and minimum value of Budget deficit (BD) through the studied year max. 4.00 and min. -10.00, Standard deviation of Budget deficit (BD) during the studied years (2.79) kurtosis of Budget deficit (BD) through the studied year 6.83 which shows that the variables are leptokurtic, jarque-bera test of normality shows combined results of skewness and kurtosis, the computed probability value of Budget deficit (BD) is 0 which is not normally distributed.

The average value GDP is 4.90, the maximum and minimum value of GDP through the studied year max 10.22, and min 1.01, standard deviation of GDP during the studied years (2.16) kurtosis GDP through the studied year (2.48) which shows that the variables are leptokurtic, jarque-bera test of normality shows combined results of skewness and kurtosis, the computed probability value of GDP is greater than 0 which is normally distributed.

The average value Govt Expenditure (GE) is (8.14), the maximum and minimum value of GE through the studied year max 25.46, and min 1.45, standard deviation of GE during the

studied years (6.21) kurtosis GE through the studied year(3.91) which shows that the variables are leptokurtic, jarque-bera test of normality shows combined results of skewness and kurtosis, the computed probability value of GE is greater than 0 which is normally distributed.

The average value Inflation (INF) is (8.53), the maximum and minimum value of INF through the studied year max 20.30, and min 2.90, standard deviation of INF during the studied years (3.65) kurtosis INF through the studied year(4.05) which shows that the variables are leptokurtic, jarque-bera test of normality shows combined results of skewness and kurtosis, the computed probability value of INF is greater than 0 which is normally distributed.

The average value Unemployment rate (UNEMP) is (6.48), the maximum and minimum value of UNEMP through the studied year (max 9.700, And min 4.00), standard deviation of UNEMP during the studied years (1.57) kurtosis UR through the studied year (2.44) which shows that the variables are leptokurtic, jarque-bera test of normality shows combined results of skewness and kurtosis, the computed probability value of UNEMP is greater than 0 which is normally distributed.

Table 3 Correlation matrix

BD	GDP	ER	INF	UNEMP
BD	1			
GDP	-0.009	1		
GE	0.15	-0.41		
INF	-0.25	-0.27	1	
UNEMP	-0.28	0.07	0.18	0.24
				1

Source: Author's Calculation E-views 7.0

The correlation matrix shows the relationship of all the variables with each other. The relationship of GDP and budget deficit (GDP and BD) is -0.009 which shows negative relationship. The relationship of govt expenditure and budget deficit (GE and BD) is 0.15 which shows positive relationship while the relationship of inflation with budget deficit (INF with BD) is -

0.25 which shows negative relationship and the relationship of unemployment rate and budget deficit (UR and BD) is -0.28 which shows the negative relationship.

Table 4 Regression Analysis

Variable	Coefficients	T-Statistics	Prob.
C	3.04	-1.35	0.05
GDP	0.11	0.52	0.60
GE	0.15	0.08	0.06
INF	-0.23	0.13	0.08
UNEMP	-0.43	0.08	0.15

R-Square=0.1908 Adj. R-Square=0.09 Durbin Watson=1.40 F-Statistics=1.94 Prob(F-Statistics)= 0.12

In the above table-4 the results of regression model has been shown. The model is best fit as the adjusted R-square is near 1 (i.e. 0.19). The probability of Govt Expenditure is 0.66 and the t-statistic shows the negative figure which is less than two (1.89) so we can easily conclude that Govt Expenditure have the insignificant negative relationship with budget deficit (BD).

6.0 CONCLUSIONS AND RECOMMENDATIONS

Conclusions

The main objective of the study was to examine the impact of government expenditure on Pakistan's Economy. Data on variables was examined for the period 1975 to 2014. From this data we compute the results of the OLS model. The result of Descriptive statistics, Correlation Matrix and Regression model. The result shows the negative relationship between budget deficit and Gdp. The result suggests that there is long run positive relationship between government expenditure and gross domestic product. Further it investigated a long run negative relationship between government expenditure and unemployment. Similarly it is also found that government expenditure has short run and long run relationship with inflation. Causality analysis suggests that model was in equilibrium when government expenditure was taken as dependent variable.

Recommendations

Since a reality has been built up that there is an awesome effect of government use in connection to the financial matters of Pakistan. It could subsequently be suggested that administration ought to advance proficiency in the allotment of improvement assets through accentuation on private area cooperation and privatization\commercialization. Government need to take step about the improvement in vocational training skills; provide loans to public and private sector, special attention need to energy requirement to production. Public expenditure need to be allocated for the development project. Monetary policy should be like this to control inflation by enhancing private saving. Investment and human resources, and exportation of final goods should be encouraged. Government should subsidies industries which may need financial support to decrease unemployment. Governments also inject extra spending into the macro-economy, to help achieve increases in aggregate demand and economic activities.

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