**Final Exam**

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 Course: Macroeconomics

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**Question:**

What is Budget and how Budget is formulated? Critically analyze budget 2020.

**Answer**

**Budget**

 Budget in Brief is a synopsis of the Federal Budget 2020-21, which is being published to provide concise information in simple manner for understanding of readers.

budget is a document prepared by the [government](https://en.wikipedia.org/wiki/Government) and/or other political entity presenting its anticipated [tax revenues](https://en.wikipedia.org/wiki/Government_revenues) (Inheritance tax, income tax, corporation tax, import taxes) and proposed [spending/expenditure](https://en.wikipedia.org/wiki/Government_expenditures) (Health care, Education, Defense, Roads, State Benefit) for the coming financial year.

**Three types of government budgets**

A government budget is an annual financial statement which outlines the estimated government expenditure and expected government receipts or revenues for the forthcoming fiscal year. Depending on the feasibility of these estimates, budgets are of three types -- balanced budget, surplus budget and deficit budget. Mentioned below are brief explanations of these three types of budgets:

**BALANCED BUDGET**
a government budget is said to be a balanced budget if the estimated government expenditure is equal to expected government receipts in a particular financial year. Advocated by many classical economists, this type of budget is based on the principle of “living within means.” They believed the government’s expenditure should not exceed their revenue.
Though an ideal approach to achieve a balanced economy and maintain fiscal discipline, a balanced budget...

**SURPLUS BUDGET**
a government budget is said to be a surplus budget if the expected government revenues exceed the estimated government expenditure in a particular financial year. This means that the government’s earnings from taxes levied are greater than the amount the government spends on public welfare. A surplus budget denotes the financial affluence of a country. Such a budget can be implemented at times of inflation to reduce aggregate demand.

**DEFICIT BUDGET**
a government budget is said to be a deficit budget if the estimated government expenditure exceeds the expected government revenue in a particular financial year. This type of budget is best suited for developing economies, especially helpful at times of recession, a deficit budget helps generate additional demand and boost the rate of economic growth. Here, the government incurs the excessive expenditure to improve the employment rate.

**THE BUDGET FORMULATION PROCESS**

Budget formulation differs among countries and levels of government. The budget formulation process typically starts economic analysis and prediction for government revenue. The process follows sets of budget rules during a budget calendar that includes a broad set of financial information.

Government budget planning begins during the fiscal year and leverages historical and current revenue and expenditure information.  Budget planning processes align, in the World, with economic forecasting, debt management and treasury systems. Liquidity and cash management is critical to understanding the expected revenue and expenditure variations in government.

* Analysis: government budgeting is transitioning from a ceremony where more time was spent [creating a budget than analyzing it](http://www.pmsquare.com.au/assets/Uploads/PDFs/Bestpracticesbudgeting.pdf) to more rigorous thinking to rethink action plans including techniques such as [macro-fiscal frameworks](http://siteresources.worldbank.org/INTDEBTDEPT/Resources/468980-1170954447788/3430000-1327423997641/Day2_1MacroFiscalFramework.pdf), [zero-based budgeting](http://en.wikipedia.org/wiki/Zero_Based_Budgeting) and spending reviews
* Benchmarking: many government agencies began emulating private-sector best practices by integrating benchmarking activities into planning and budgeting processes
* Decentralization: enabling bottom-up budget proposals from those who are closer to citizens
* Multiple year: use of [multiple-year planning](http://www.mfdr.org/rt3/Glance/Documents/P%26B_final.pdf) to develop more credible budgets
* Performance: Budget formulation and execution was traditionally [focused primarily on resource allocation and input control](http://www.imf.org/external/pubs/ft/wp/2003/wp0333.pdf) is maturing “[towards a focus on results](http://www.oecd.org/dataoecd/13/2/37714836.pdf)” or government performance.
* Participation: use of [participatory budgeting](http://en.wikipedia.org/wiki/Participatory_budgeting) outreach to citizens and civil society, particularly at the local and regional levels of government
* Policy: techniques that align government policy and objectives to budget categories
* Transparency: use of open data and budget reports throughout the budget cycle to be more [responsive to citizen needs](http://internationalbudget.org/who-we-are/) by encouraging advocacy

**Budget 2020**

Total expenditures are budgeted at PKR. 7.137 trillion, and gross revenue receipts are targeted at PKR. 6.573 trillion. The net revenues will be PKR. 3.7 trillion, which is 56.3 per cent of the total expenditure, after adjusting the provincial share of PKR. 2.874 trillion

. • The government is targeting PKR. 5.464 trillion (83.1 %) from taxes and PKR. 1.109 trillion (16.9 %) will be non-tax revenues

. • The targeted revenues for the year 2020-21 are 19.4 % higher than the revised target for the year 2019 -2020

• Total current expenditures for the year 2020-21 are estimated at PKR 6.344 trillion. The major contributors are mark-up payments (PKR. 2.946 trillion), pensions (PKR. 470 billion), defense affairs and services (PKR 1.289 trillion), grants and transfers (PKR. 905 billion), subsidies (PKR. 209 billion), and running the civil government (PKR. 476 billion).

 • Total development expenditures for the year 2020-21 are estimated at PKR. 792 billion, out of which PKR. 650 billion are allocated to the federal PSDP.

 • The fiscal deficit is budgeted at PKR. 3.195 trillion, which forms 7% of the GDP as compared to 9.1% for FY20’s revised estimates

. • The deficit will be financed from external borrowing (PKR. 810 billion), capital receipt (PKR. 1.396 trillion) bank borrowing (889 billion), privatization proceeds (PKR. 100 billion), and surplus from the provinces (PKR. 242 billion).

 • The government aims to finance 75% of the deficit from domestic resources.

**Question**

What is Fiscal Policy and what are the channels of Revenue in Fiscal Policy?

## **Answer**

## Fiscal Policy

Fiscal policy refers to the use of government spending and tax policies to influence[economic conditions](https://www.investopedia.com/terms/e/economic-conditions.asp), especially [macroeconomic](https://www.investopedia.com/terms/m/macroeconomics.asp) conditions, including aggregate demand for goods and services, employment, inflation, and economic growth.

**Components of fiscal policies**

The four main components of fiscal policy are

1. expenditure, budget reform
2. revenue (particularly tax revenue) mobilization
3. deficit containment/ financing
4. Determining fiscal transfers from higher to lower levels of government.

 Fiscal policy works through both aggregate demand and aggregate supply channels. Changes in total taxes and public expenditure affect the level of aggregate demand in the economy, whereas, the structure of taxation and public expenditure affect, among others, the incentives to save and invest (at home and abroad), take risks, and export and import goods and services.

* Fiscal policy refers to the use of government spending and tax policies to influence economic conditions.
* Fiscal policy is largely based on ideas from John Maynard Keynes, who argued governments could stabilize the business cycle and regulate economic output.
* During a recession, the government [may employ expansionary fiscal policy](https://www.investopedia.com/ask/answers/040115/what-are-some-examples-expansionary-fiscal-policy.asp) by lowering tax rates to increase aggregate demand and fuel economic growth.
* In the face of mounting inflation and other expansionary symptoms, a government may pursue contractionary fiscal policy.

Fiscal policy is largely based on the ideas of British economist[John Maynard Keynes](https://www.investopedia.com/terms/j/john_maynard_keynes.asp) (1883-1946), who argued that economic recessions are due to a deficiency in the consumption spending and business investment components of aggregate demand. Keynes believed that governments could stabilize the[business cycle](https://www.investopedia.com/terms/b/businesscycle.asp) and regulate economic output by adjusting spending and tax policies to make up for the shortfalls of the private sector. His theories were developed in response to the Great Depression, which defied classical economics' assumptions that economic swings were self-correcting. Keynes' ideas were highly influential and led to the[New Deal](https://www.investopedia.com/terms/n/new-deal.asp) in the U.S., which involved massive spending on public works projects and social welfare programs.

In [Keynesian economics](https://www.investopedia.com/terms/k/keynesianeconomics.asp), aggregate demand or spending is what drives the performance and growth of the economy. [Aggregate demand](https://www.investopedia.com/terms/a/aggregatedemand.asp) is made up of consumer spending, business investment spending, net government spending, and net exports. According to Keynesian economists, the private sector components of aggregate demand are too variable and too dependent on psychological and emotional factors to maintain sustained growth in the economy.1﻿

Pessimism, fear, and uncertainty among consumers and businesses can lead to economic recessions and depressions, and excessive exuberance during good times can lead to an overheated economy and inflation. However, according to Keynesians, government taxation and spending can be managed rationally and used to counteract the excesses and deficiencies of private sector consumption and investment spending in order to stabilize the economy.

When private sector spending turns down, the government can spend more and/or tax less in order to directly increase aggregate demand. When the private sector is over optimistic and spends too much, too fast on consumption and new investment projects, the government can spend less and/or tax more in order to decrease aggregate demand.

This means that to help stabilize the economy, the government should run large budget deficits during economic downturns and run budget surpluses when the economy is growing. These are known as [expansionary](https://www.investopedia.com/terms/e/expansionary_policy.asp) or [contractionary](https://www.investopedia.com/terms/c/contractionary-policy.asp) fiscal policies, respectively.

## Expansionary Policies

To illustrate how the government can use fiscal policy to affect the economy, consider an economy that's experiencing a [recession](https://www.investopedia.com/terms/r/recession.asp). The government might issue tax stimulus rebates to increase[aggregate demand](https://www.investopedia.com/terms/a/aggregatedemand.asp) and fuel economic growth.

The logic behind this approach is that when people pay lower taxes, they have more money to spend or invest, which fuels higher demand. That demand leads firms to hire more, decreasing[unemployment](https://www.investopedia.com/terms/u/unemployment.asp), and to compete more fiercely for labor. In turn, this serves to raise wages and provide consumers with more income to spend and invest. It's a virtuous cycle, or [positive feedback loop](https://www.investopedia.com/terms/p/positive-feedback.asp).

Rather than lowering taxes, the government may seek economic expansion through increases in spending (without corresponding tax increases). By building more highways, for example, it could increase employment, pushing up demand and growth.

Expansionary fiscal policy is usually characterized by[deficit spending](https://www.investopedia.com/terms/b/budget-deficit.asp), when government expenditures exceed receipts from taxes and other sources. In practice, deficit spending tends to result from a combination of tax cuts and higher spending.

**Question**

What is Trade? Differentiate between Balance of Payment and Balance of Trade

**Answer**

**Trade**

Trade is a basic economic concept involving the buying and selling of goods and services, with compensation paid by a buyer to a seller, or the exchange of goods or services between parties. Trade can take place within an economy between producers and consumers

* Trade broadly refers to exchanging goods and services, most often in return for money.
* Trade may take place within a country, or between trading nations. For international trade, the theory of comparative advantage predicts that trade is beneficial to all parties, although critics argue that in reality it leads to stratification among countries.
* Economists advocate for free trade between nations, but protectionism such as tariffs may present themselves due to political motives, for instance with 'trade wars'

**Difference between Balance of Payment and Balance of Trade**

The balance of payment takes into account all the transactions with the rest of the world i.e. visible, invisible, and capital transfers.

The balance of trade takes into account all the trade transactions with the rest of the world i.e. visible items only.

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| **Balance of Trade** | **Balance of Payments** |
|                                                                 Definition |
| Balance of Trade or BoT is a financial statement that captures the nation’s import and export of commodities with the rest of the world | Balance of Payment or BoP is a financial statement that keeps track of all the economic transactions by the nation with the rest of the world |
|                                                             What does it deal with? |
| It deals with the net profit or net loss that a country incurs from the import and export of goods | It deals with the proper accounting of the transactions conducted by the nation |
|                                                         Fundamental difference |
| Balance of Trade (BoT) is the difference that is obtained from the export and import of goods | Balance of Payments (BoP) is the difference between inflow and outflow of foreign exchange  |
|                                                           Type of transactions included |
| Transactions related to goods are included in BoT | Transactions related to transfers, goods and  services are included in BoP |
|                                                           Are capital transfers included? |
| No | Yes |
|                                                             What is its Net Effect?  |
| Net effect from BoT can be either positive, negative or zero | Net effect of BoP is always zero |

**Question**

What are the major macroeconomic challenges of Pakistan?

**Answer**

Pakistan has been facing different challenges regarding its economy. The economic situation of Pakistan is very critical and people are looking towards the solution of these challenges. Pakistan has different opportunities which can help it to solve its economic problem

**Some Major challenges are**

#### Inflation

#### The Trade Cycle

#### Economic Growth

#### The Exchange Rate and the Balance of Pay­ments

#### Employment and Unemployment

There is almost a consensus that the major economic challenges facing Pakistan are rising poverty and unemployment, heavy external and domestic indebtedness, high fiscal deficit and low investment. The debate has so therefore focused on the means to face these challenges and particularly on the ways to bring about economic recovery.

**Consume More and Save Less**

 Out of every hundred rupees of our national income, we consume 85 rupees and save only 15 rupees, which means that the amount of money which is available to invest for economic growth and advancement is too little. Because to grow by 6%, you need at least 24-25% investment rate - and if you want to rely on domestic savings, your saving rate should be 25%. India’s saving rate was about the same, but last year they recorded 34% saving rates. China’s saving rate is 50%, so this is the contrast as to why we are in serious difficulty because as a nation this is a problem which we have to recognize. We have to at least double on savings rate otherwise we will remain dependent on foreign sources.

**Import More and Export Less**

 Till 2007-2008, 80% of our imports were financed by our export earnings. This ratio has come down to only 50%, it may go up to 60% but a gap of 40% of financing needs in order to keep with the import level still exists. As a nation we prefer to use even the basic commodities of foreign countries rather than locally manufactured goods. Unless we do not change this attitude of preferring the imported goods we have to keep on relying on outsiders to fill in this gap b/w our imports and exports. Relying on outsiders’ means that there are cycles, ups, and downs i.e. when things are good, one gets financing, and when things are bad one starves for financing. No nation which strives to preserve its honor must go through this particular route. The lower is this gap between our export earnings and expenditure on imports - and that can be achieved only by expending our exports; our reliance on external sources would be reduced.

**Government spends more than it earns as Revenues**

Fiscal deficit is the difference between the revenues which are collected in a year and the total expenditure incurred by the Government. Pakistan’s government takes away 20% of national income as its own. 80% is left in the private sector and 20% in the hands of the government is spent on defense, debt servicing, development on education, health, general administration etc. The revenue generated is only 15% of the GDP at best, and in the worst days it is 12 to 13%.

**Question no 5**

How COVID-19 has affected our economy and how we can recover from the economic losses?

**Answer**

**Impacts of Covid 19 on the Economy of Pakistan**

Covid 19 has turned out to be a severe global economic threat, having the potential of destabilizing the international economic system. Pakistan was no exception as Corona virus adversely impacted the economy of the country. The immediate economic repercussions of Covid 19 for Pakistan during FY 2019-20 are highlighted as under

 **The Industry and the retail businesses all over Pakistan have been badly affected**

* Economic growth has been reduced by Rs 03 trillion which brought down GDP growth projection from 3.3% to -0.4% 2
* Projection of over-all budget deficit has been revised upward from 7.1% to 9.1% of GDP
* FBR revenue loss has been projected at Rs 900 billion
* Non tax revenue of the federal government has been reduced by Rs 102 billion
* Exports and remittances have been badly affected
* Unemployment and poverty have increased
* Large scale manufacturing and FDI have declined
* Domestic tourism in Pakistan has stalled

**Recovery**

During a recession, many businesses fail and go out of business, and many of those that survive cut back activities to reduce costs in the face of decreased demand for their output. Workers get laid off and business assets get sold piecemeal or an entire business might be liquidated. Labor and capital experience a period of unemployment until they can be hired or purchased for new uses. Most of these workers and capital assets eventually end up in the hands of other businesses, sometimes even brand new businesses that can put them to productive use. Sometimes these are very similar to their previous uses and sometimes these are totally new jobs and lines of business. This process of sorting workers and capital goods into new combinations, under new ownership, at new prices after they have been released from failed businesses or business cutbacks in the recession, is the essence of economic recovery.

We can recover our losses by making fiscal and monetary policies because [Fiscal](https://www.investopedia.com/terms/f/fiscalpolicy.asp) and [monetary policy](https://www.investopedia.com/terms/m/monetarypolicy.asp) actions taken by regulators are often guided by an economy’s business cycle. With the onset of recession, these policies are generally aimed at helping businesses, investors, and workers who have been impacted, through direct assistance or by [stimulating demand](https://www.investopedia.com/terms/e/economic-stimulus.asp), easing interest rates to encourage lending, and especially at propping up threatened financial institutions.

**Following steps should be taken to recover the losses and stable the economy**

Striking a balance between corona expenditure and fiscal deficit

 Keeping primary balance at sustainable level

 Protection of social to support the vulnerable segments of the society

 Resource mobilization without unnecessary changes in tax structure

 Carrying forward of Stimulus Package

 Keeping development budget at adequate level to stimulate economic growth.

Austerity and rationalization of expenditures should be ensured.

 Subsidy regime will be rationalized to provide targeted subsidy to the deserving segments of the society.

NFC award should be revisited.