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**Final Term Assignment**

**Q1 (a): What is Budget and how Budget is formulated? Critically analyze budget 2020**

**Answer (a):** A budget is an estimation of revenue and expenses over a specified future period of time and is usually compiled and re-evaluated on a periodic basis. Budgets can be made for a person, a group of people, a business, a government, or just about anything else that makes and spends money.

A budget is a microeconomic concept that shows the trade-off made when one good is exchanged for another. In terms of the bottom line—or the end result of this trade-off—a surplus budget means profits are anticipated, a balanced budget means revenues are expected to equal expenses, and a deficit budget means expenses will exceed revenues.

**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.

**Analysis:** government budgeting is transitioning from a ceremony where more time was spent creating a budget than analyzing it to more rigorous thinking to rethink action plans including techniques such as macro-fiscal frameworks, 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 to develop more credible budgets

**Performance:** Budget formulation and execution was traditionally focused primarily on resource allocation and input control is maturing “towards a focus on results” or government performance.

**Participation:** use of 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 by encouraging advocacy

**Critically analyze budget 2020**

he budget proposals for 2020-2021, prepared by the Adviser on Finance and Revenue, Dr. Hafeez Shaikh — against the backdrop of potentially the biggest public health emergency and economic downturn in generations — and presented on the floor of the House by Minister for Industries and Production Hammad Azhar, boldly announced, “There are no new taxes in this budget.” This could be termed as an activity of an ordinary salesman rather than that of a hardcore finance manager. He was sounding as if the Pakistan economy was flying on animal spirits: he presented a fiscal plan based on irrational calculations showing an increase in tax revenue by over 27 per cent to Rs4.963 trillion, without levying any additional tax – a job, only a magician who can make a pigeon appear from his hat can do.

Even a man with average intelligence would say that under such unprecedented situation, targeting a tax collection that is 27 per cent higher without any sound strategy is simply ludicrous. Dr. Hafiz Pasha, economist, author and former federal minister, commenting on the budget ,said, “Even if we assume that the economy will grow by 2 per cent and inflation remains 6.5 per cent, we can expect only 8.5 per cent increase in taxes. Are we expecting the FBR to deliver a miracle next year? The actual fiscal deficit will balloon to 10 per cent of GDP this year against the projection of 9.1 per cent.”

Needless to emphasize that nutritious food and comprehensive health are the two basic necessities of life. As such, allocations for health and food security should have been the top priority of our finance managers. Though the allocation to health has been doubled to Rs25 billion, it translates to barely Rs125 per head in a country where the health infrastructure is simply insignificant and, above all, is miserably hit by COVID-19. The pandemic emergency fund of Rs70 billion is also very small, keeping in view the unending disaster.

It goes without saying that nothing is more important for Pakistan right now than flattening the COVID-19 curve and, therefore, the most disappointing aspect of the budget is the allocation of just Rs25.5 billion for health at the federal level. Since we don’t know when the epidemic curve would flatten out, there is a dire need to ramp up health services expenditure now. During his speech, Azhar explained that the funds would be used to improve health services and digitize the framework – a pretty costly deal. Though health allocations for the next year have been doubled to Rs25.5 billion from last year’s Rs11 billion, keeping in view the worsening health situation, this is merely a drop in the ocean.

**Q1 (B): What is Fiscal Policy and what are the channels of Revenue in Fiscal Policy?**

**Answer (B):** 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 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**.**

**There are two channels of revenue in fiscal policy**

**Non Tax Revenue:-**

Non Tax Revenue definition: While taxation is a primary source of income for the government, it also earns some recurring income other than tax, which is called non-tax revenue. While sources of tax revenue consist of few but bulk direct and indirect taxes, the number of sources of non-tax revenue are very large with wide variance in the quantum of collections per source. Although there are large sources of non-tax revenue, the quantum of collection per source is much less than that of tax collections. For instance, when people avail services offered by the government, like electricity, telecommunication, DTH, broadband etc, they pay bills, which include the share of non-tax revenue as the government provides infrastructure support to facilitate the services. The government also collects interest as non-tax revenue on the loans and funds advanced to states for various purposes. So, the government collects non-tax revenue in return for providing/facilitating any goods or services

**Sources of Non Tax revenue of State Government**

Like the central government, the state governments also provide various services such as:

Police services

Home guards

Electricity

Administrative services

Municipal services

Jobs through state public services boards

Sale of stationery

Gazettes

**Components of Non Tax Revenue**

There are several services provided by the government that creates the sources or components of non-tax revenue. Here are examples of some components of non-tax revenues are as follows:

Interest, Dividends and profit, Petroleum license, Power supply fees, Fees for communication services, Broadcasting Fees, Road Bridges usage fees, Examination Fees, Fee for police services, and Fee for Administrative Services.

**Tax revenue**

Tax revenue is defined as the revenues collected from taxes on income and profits, social security contributions, taxes levied on goods and services, payroll taxes, taxes on the ownership and transfer of property, and other taxes. Total tax revenue as a percentage of GDP indicates the share of a country's output that is collected by the government through taxes. It can be regarded as one measure of the degree to which the government controls the economy's resources. The tax burden is measured by taking the total tax revenues received as a percentage of GDP. This indicator relates to government as a whole (all government levels) and is measured in million USD and percentage of GDP.

**Types of Taxes**

**Direct Taxes**

**Indirect Taxes**

**Direct Taxes:** A direct tax is paid directly to the government by an individual or organization. For example, a homeowner pays personal property taxes directly to the government, and a family pays its own federal income taxes. Direct taxes cannot be shared or passed onto other parties.

Here are some examples of direct taxes:

**Income tax**

An individual pays income tax based on their taxable income during the financial year. Federal, state, and local governments levy income taxes on personal wages and business profits.

**Property taxes**

Buildings and landowners must pay property tax to the state and local governments so that local public services such as police and fire departments, schools, libraries, and roads can be financed. How much the owner pays depends on the size of the land or building.

**Capital gains taxes**

Capital gains taxes are collected when assets e.g. real estate, artwork, stocks, etc. are being sold. The tax is calculated depending on the price of the item when it was first bought, and the price it is worth at the point of sale.

**Indirect taxes**

Indirect taxes are collected by someone in the supply chain (i.e. a producer or retailer) and then paid to the government. The consumer essentially pays the tax by paying more for a product, since the tax is added on top of the price. The difference therefore between direct and indirect taxes is that in the case of direct taxes, the individual pays the tax directly to the government, but when it comes to indirect taxes, the individual pays the tax to someone else, who then pays it to the government: a bit like a middleman.

**For Example**

**Sales taxes**

When you go grocery shopping, you’re given an amount to pay at the cash register. This amount actually includes a percentage of the purchase, usually between 4% and 10%, which is the sales tax. The sales tax is sent to local, state, and federal agencies, where it is used for different programs and projects. Sales tax is also imposed on larger goods such as homes and vehicles.

**Q2: (a) 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. International trade allows countries to expand markets for both goods and services that otherwise may not have been available to it. It is the reason why an American consumer can pick between a Japanese, German, or American car. As a result of international trade, the market contains greater competition and therefore, more competitive prices, which brings a cheaper product home to the consumer.

**Main Differences between Balance of Trade and Balance of Payments**

Balance of Trade is the difference in the monetary values of a country’s export and import whereas Balance of Payment is the difference in the monetary values of transactions within the country and the rest of the world.

Balance of Trade is also known as commercial balance or net balance whereas Balance of Payments is also known as Balance of International Payments.

The former is abbreviated as NX and the latter is abbreviated as BOP or B.O.P.

Currencies of traded countries are involved in calculating the Balance of Trade whereas the currency of that particular country is involved while estimating the Balance of Payments.

 The country exports more when there is a trade surplus and the country’s currency starts appreciating when there is a BOP surplus. Both surpluses boost the country’s economy with enhanced internal production or services.

NX is formulated as Country’s (Export-Import) whereas BOP is formulated as Country’s Fund flow (Within the country – rest of the world).

If there is a deficit in the Balance of Trade, then it is better to save more &consume less foreign goods to bring it to surplus. Similarly, when there is a deficit in BOP, supporting healthy competition within the local manufacturers or industry can help to improve it.

The government usually imposes a higher import tax to reduce the imports and thus to improve the Balance of Trade. Also, an encouragement to use domestically manufactured goods can improve BOP.

The net effect of the former can be positive or negative or zero whereas the latter is always zero.

**Q2: (B) What are the major macroeconomic challenges of Pakistan?**

**Answer: (B)** 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. But without tackling long term challenges and problems decisively, the country will no longer be able to take advantages of opportunities. Increase in debt and import and decrease in export, saving, investment, tax collection and lack of policy implementation, excessive taxation are some of the challenges faced by Pakistan’s economy.

Decentralization is one of the factors which can help increase the economy of the country. Local government should report to the provincial government about its activities and the provincial government should report to the federal government. If our government does this, we can do more by the same resources which are being wasted today by its direct involvement.

Interest rate is one of the factors which can increase the economy of the country. The government can offer low-interest rate to the public so that it becomes easier for the investors to borrow money from the banks and invest it in their business. Borrowing at a low-interest rate and investing money will increase the level of demand in the economy. It will increase the demand for the labor force to meet the high production level. GDP and living standard of people will improve.

Tax collection can play a vital role to improve the economy of Pakistan. The government should allow the Federal Board of Revenue (FBR) to work impartially, independently and transparently which will make FBR an efficient and effective tax administration. This will increase the confidence of taxpayers in FBR and increase tax collection in a fair manner. This higher collection of tax can be used for the development of infrastructure. It will help to create jobs by reducing unemployment and generate income for the millions. While there is a crucial need to fix persistent challenges, more innate reforms are required to improve and attract talent to serve in the businesses and public sector. Instead of politicians, the academics, intellectuals and community leaders should come forward and play their role in social revolution.

**Q3: How COVID-19 has affected our economy and how we can recover from the economic losses?**

**Answer: Impact of covid-19 on Pakistan economy:-**

It has been reported that Pakistan has lost one-third of its revenue and exports dropped by 50% due to COVID-19 outbreak and lockdown. Economists warn of recession amid virus lockdowns in Pakistan. Similarly, the World Bank also warns that Pakistan might fall into a recession. Due to the ongoing crisis caused by the COVID-19 pandemic, Pakistan's real GDP growth in FY20 is expected to contract by 1.3% as national and global economic activity slowdowns abruptly during the last few months of the fiscal year. Further, in case the outbreak of COVID-19 deteriorates and continues longer than expected, Pakistan's real GDP growth for FY20 may contract by 2.2% before just recovering to 0.3% growth in FY21.

The biggest and most immediate impact of the lockdown is the halt in business operations. Lockdown was first announced in Sindh province from March 23, 2020. Karachi—the capital city of Sindh province—is considered as the country's largest industrial zone accounted for 30% of total exports. Due to lockdown, out of 2700 factories in Karachi less than 50 were operating on the first working day. Further, reported that there are around 05 million people in Pakistan who live just at or below the subsistence line, while there are the masses of largely unskilled or low-skilled people (such as labors, waste recyclers, construction workers, transport workers, and domestic workers) who work in different industries, services, and agriculture, and rely on daily wages to meet their needs. According to the author, around 04 million people are working on a daily wage basis in Karachi alone, besides, it is estimated that around 04 million individuals are also working in Punjab province. These daily wagers have been hardest hit by the lockdowns.

Epidemics, of the size of Covid-19, have huge economic impacts – not just from the costs of managing the health of people, but stopping them, and keeping the economy working. The 10% fall in global stock markets since it became clear that Covid-19 would not be limited to China has boldly highlighted this.

Suppressing the epidemic, but allowing the economy to still function, requires key decisions, in which central banks and finance ministries play a part.

The role of fiscal and monetary authorities in managing an epidemic economy is the scope to use monetary policy to manage the economic impact of Covid-19 is limited. The fact that the underlying cause of the shock is an infectious disease outbreak (rather than a banking crisis, as in 2008-09) and nominal interest rates are currently close to zero in most major advanced economies reduces the effectiveness of monetary policy.

However, outside broad based fiscal and monetary policies there are six ways in which finance ministries and central banks will play a critical role in responding to the crisis.

A first crucial role for finance ministries and central banks is in helping provide the best possible economic evaluation of strict containment measures (trying to isolate each potential case) versus managing the epidemic (delaying the spread of the virus, protecting the most vulnerable and treating the sick, while enabling the majority of people to get on with daily life). Given the economic consequences, they must play a full part, alongside health experts, in advising political leaders on this key decision.

Second, if large numbers of staff are required to work from home to manage the epidemic, they have the lead role in doing whatever is necessary to ensure that financial markets – and thus the wider economy – will continue to function smoothly.

Third, they need to ensure adequate funding for the public health response. Steps that can make an enormous difference to the success of containment strategies, such as strengthening surveillance, and guaranteeing the availability of testing kits and protective equipment for front line health workers, must not fail because of a lack of funding.

Fourth, they have a lead role in designing targeted economic interventions for the wider economy. Some of these are needed immediately to re-enforce and incentivize strict containment strategies, such as ensuring that employees without full or adequate sick leave cover have the financial support to enable them to report and self-isolate when they get sick.

Other interventions may help improve the resilience of the economy in accommodating moderate ‘social distancing’ measures; for example, by providing assistance to small firms to help them gear up for home working.

Yet others are needed, as a contingency, to safeguard the most vulnerable sectors (such as tourism, retail and transport) in circumstances where there is a prolonged downturn. The latter may include schemes to allow deferral of tax payments by SMEs, or steps to encourage loan extensions and other forms of liquidity support from the banking system, or by moves to underwrite continued provision of business insurance.

Fifth, national economic authorities will need to play their part in combatting ‘fake news’ through providing transparent and high-quality analysis. This includes providing forecasts on the likely economic impact of the virus under different scenarios, but also detailed information on the support and contingency measures they are considering, so they can be improved and refined through feedback.

Sixth, they will need to ensure that there is generous international support for poor countries, by ensuring the available multilateral support facilities from the international financial institutions and multilateral development banks are adequately funded and fit for purpose. The World Bank has already announced an initial $12 billion financing package, but much more is likely to be needed.

They also need to support coordinated bilateral aid where this is more effective, as well as special measures to support particularly vulnerable groups, for example, in refugee camps and prisons. Given the importance of distributing sophisticated medical equipment and expertise quickly, it is also important that every effort is made to avoid delays due to customs and migration checks.