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Abstract

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Key Words: Fiscal Policy, Monetary Policy, Macroeconomic Instability, Time-series and Pakistan

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Macro-Economic Policy Coordination and Macro-Economic Instability in Pakistan

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Contents

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Introduction

Economic policies are the set of instruction lines of action which planned to affect the structure and trend of economic activities to ensure the socioeconomic lives of the masses in society. These policies are typically implemented and administered by government and institutions. In the line of action of these polices government spending expenditure & taxation, controlling money supply, and affecting international transactions which can help in the

stabilization of the economy. The use of active fiscal policy was proposed by Maynard Keynes in 1930 to get rid of macroeconomic instability. He was of the view that in case of a down or fall in aggregate economic activities the active role of the fiscal side is necessary to reduce the size of the fall and to encourage aggregate economic activities. An expansion of the fiscal size or reduction in taxes may lead to increased aggregate demand which has the ability to accelerate economic growth (Hilbers 2005). Blanchard (2009) was also of the view that fiscal policy components i.e. spending and taxation have the ability to put aggregate economic activities on the right track. Some other aspects of fiscal policy i.e. fiscal deficit, government deficit and debt, tax and expenditure are also affecting the overall economic activities. Most developing economies deal with poverty, hunger, unemployment, education rates, and inefficient investment with the help of devising public expenditure and taxation. According to Abata *et al.*, (2014) Fiscal policy is necessary to care about the health of the economic activities in developing countries. On the other hand, Kraay & Seven (2008) are of the view that fiscal policy contributed comparatively low towards growth and employment in developing countries than in developed countries. The use of the expansionary fiscal policy during a recession and contractionary during a boom is known as an automatic stabilizer a type of counter-cyclical fiscal policy. Typically, a decrease in economic activity is accompanied by an increase in government size, which lowers the employment rate because other aspects of fiscal policy are less conducive to economic activity. It is also suggested that fiscal policy need not be automatic in order to stabilize business activities; in fact, the case for using discretionary fiscal policy to stabilize business cycles is made weaker by the fact that monetary policy is a far more flexible instrument than fiscal policy. Keynes argued that monetary policy is made up of three concepts: the interest rate, the marginal efficiency of capital, and the investment multiplier. Although monetary and fiscal policies are implemented by separate entities, such as central banks and national ministries of finance, they are closely related. Some economists contended that the impact of fiscal policy on future taxes will cause consumers to alter their saving behavior.

A shift in fiscal policy has an effect on how well monetary policy works, which in turn has an impact on the macroeconomic policy position as a whole. It is also true that any alteration in monetary policy affects fiscal policies, which in turn affects the macroeconomic policies' overall efficacy. To prevent conflicts and have the greatest possible effect, it is imperative to pursue a consistent mix of monetary and fiscal policy. Each policy's credibility affects the credibility of the combined set of policies. Part of the macroeconomic policy recommendations of the IMF is this mix of policies. In order to accomplish the main goals of economic policy, the central bank is responsible for managing the amount of credit available in the economy. One can exercise control over aggregates like the money supply, interest rate levels and structures, and other credit-related factors. While maintaining price stability is the primary goal of most central banks, they may also have other goals, including encouraging economic growth and development, st abilizing the exchange rate, protecting the balance of external payments, and upholding financial stability. Interest rates, the amount of money and credit available, and the exchange rate are important factors in this policy area.

The goal of this section is to suggest a framework of fiscal-monetary policy coordination in the context of the (West African Economic & Monetary Union) WAEMU. WAEMU countries conduct independent fiscal policies but have a single monetary policy. The WAEMU Commission is charged with the coordination of tax policies and monitoring fiscal convergence criteria, whereas the (Central Bank of West African States) BCEAO, the regional central bank, conducts the single monetary policy. As in any monetary union, this raises an important practical question of coordination between heterogeneous fiscal policies and a homogeneous monetary policy (Macroeconomics Policy Coordination by Alexei P Kireyev).

Table 1

Fiscal & Monetary Policy Description

POLICY	FISCAL POLICY	MONETARY POLICY

OBJECTIVE	OUTPUT & ECONOMIC GROWTH AND EMPLOYMENT	PRICE STABILITY
TOOLS	TAXATION & GOVERNMENT EXPENDITURE	INTEREST RATE

Source: Canzoneri, Cumby & Diba (2010)

These instruments i.e. part of different policies that affect the macroeconomic activities of a country differently in terms of implementation, impact, and suitability for addressing various economic challenges. Fiscal policy instruments include tax rates and government expenditure, which are used to countercyclical fluctuations, support growth and employment, and address long-term challenges like growth or unemployment. Fiscal deficits and surpluses have expansionary and contractionary effects on aggregate demand, interest rates, and inflation. The other side instruments of the monetary policy are the interest rate, and reserve ratio that affect the money supply. Central banks adjust interest rates to counter inflationary pressures or recession, with effects on aggregate demand, exchange rates, and inflation. Monetary policy can respond quickly to changing economic conditions, whereas fiscal policy is better suited for addressing long-term challenges. Fiscal policy can correct issues like deficit monetization, crowding out, external sustainability, and price effects, while monetary policy can address tax revenue, interest payment, deficit financing, and asset price effects. The key differences between fiscal and monetary policy lie in their implementation, impact, and suitability for addressing various economic challenges. Understanding these differences is crucial for effective economic management and policy coordination (Barro & Sala -I-Martin 1995). According to Robert Dolamore, 2014 Macroeconomic policies are those policies that deal with economic activities in totality. In detail, macroeconomic policies are those policies that ensure the existence of stable and sustainable economic growth in a conducive environment. The basic objectives of these policies are to provide employment opportunities, variety in consumption, and increase the standard of living.

This section will provide a useful backup for discussing the basic functions of macroeconomic policy in their broadest sense and considering what has become recognized as prime objectives of such policy. Economic stabilization, avoiding high rates of inflation or recession the primary known function, and until recently widely misunderstood to be the sole legitimate objective function of macroeconomic policy.

The accomplishment of wide social objectives, such as job and income class salary security, and provision of proper education and health facilities. The basic provision of a conducive and stable status is required for economic development. Harrod and Domar and later on Solow provide the dynamics of economic growth in a suitable manner.

The perception of the development and growth theorists was that economic growth is desirable but ignored its hazardous effect on the environment in the long run. The most recent theorists like Daly (1991) have expressed their views regarding growth and the environment in their writings. He was of the view that growth should be within certain limits i.e. at a certain level of sustainable scale. Furthermore, he added that exponential growth may be avoided and should be the focus and theme of the policies. Modern theorists have explored the importance of effective labor (human capital) and natural capital in growth over the long run.

In the most recent era of the economic world, many crises have been experienced like the crises of Asia & Japan.

It was supposed that the modern approach is not more suitable than the i.e. non-active role of the government intervention approach (laissez-faire-) to macroeconomic activities in any economy. Krugman (1999) has brought attention to the tendency of unrestrained capitalist economies to excessive cycles of boom and bust—a tendency that Keynes emphasized and the New Classicists rejected—in light of the Asian crisis. The significance of the second and third functions has been emphasized by Joseph Stiglitz (2000) and other critics of the structural adjustment policies of the World Bank and IMF. The poorest people suffer the most from contractionary macroeconomic policies, which have a devastating effect on social equity and income distribution. Growth that is expansionary and driven by exports is not a cure-all; rising income disparity and the dissolution of social safety nets pose a threat to the "success stories" of quickly developing countries like China. Allocation

equity and social investment are matters that need to be addressed (Barro and Sala-I-Martin 1995).

In general, we say that the contemporary world is looking for a stable economic environment. To ensure macroeconomic stability different policies are used. Different options are available to ensure stability in different sectors like goods, financial, and labor markets. Various tools of both demand changing policies and policies related to external forces to achieve stability in the macroeconomic environment of both developed and developing countries. Developed countries have gained considerable success and some of the developing has also been succeeded. These policies are still in debate. There are variant views regarding the effectiveness of these policies in different situations for different markets.

Why day by day inflation continually go up and out of control and why much a portion of the population unemployed? We see how much fiscal and monetary policy can contribute to controlling inflation and reducing unemployment in developing countries, especially in Pakistan. How we control inflation and reduce unemployment by using macroeconomic tools.

Macroeconomic Policies Trend in Pakistan

Macroeconomic policies in Pakistan during the 1970s were shaped by significant political and economic changes, particularly following the separation of East Pakistan (now Bangladesh) in 1971. The decade saw a shift towards nationalization, socialist-oriented policies, and an increased role of the government in economic management under Prime Minister Zulfikar Ali Bhutto's administration (1971-1977).

Macroeconomic Policies in Pakistan during the 1970s:

Nationalization (1972-1974)

- Bhutto implemented a policy of nationalization aimed at redistributing wealth and ensuring state control over key industries.
- The nationalization process began with the takeover of heavy industries, including iron, steel, chemicals, banking, and insurance.
- In 1974, the process extended to food processing, agriculture-based industries, and other smaller industries.
- While nationalization aimed to create a more equitable economy, it led to inefficiencies in production, mismanagement, and discouraged private investment, causing long-term negative impacts on economic growth.

Agricultural Reforms

- Bhutto introduced land reforms aimed at redistributing land to reduce inequality in rural areas.
- The ceiling on land ownership was reduced, and large landholdings were broken up and redistributed to tenant farmers.
- However, the reforms were largely ineffective, as many influential landowners found ways to bypass the regulations.

Fiscal Policy

- Pakistan's fiscal policy during the 1970s aimed at increasing government revenue to support social programs and infrastructure development.
- The government imposed higher taxes on the wealthy and on industrial production, though tax collection remained inefficient.
- Public spending increased, particularly on defense, social programs, and large public-sector projects.

Monetary Policy

- The State Bank of Pakistan (SBP) implemented expansionary monetary policies to support industrial and economic development.
- Low interest rates were maintained to encourage borrowing and investment, but inflation surged during the decade, driven by deficit financing and the global oil crisis in 1973.
- By the mid-1970s, inflation rates were quite high, leading to concerns about price stability.

Trade and External Sector Policies

- Pakistan faced a significant trade deficit in the 1970s, partly due to the global oil crisis.
- The government imposed tariffs and trade barriers to protect domestic industries.
- There was an emphasis on import substitution industrialization (ISI) to reduce dependency

on imports, but this led to inefficiencies and lower competitiveness.
- The depreciation of the Pakistani rupee in 1972 (after the break-up of East Pakistan) was aimed at improving the country's balance of payments but increased the cost of imports.

Economic Growth

- Economic growth during the 1970s was inconsistent, with a slowdown in industrial output due to the nationalization policies and the global oil crisis.
- Real GDP growth averaged about 3-4%, but this was lower than the growth rates experienced in the 1960s.
- Unemployment and underemployment remained significant issues, particularly in urban areas.

Social Welfare Programs

- The Bhutto government focused heavily on social welfare, including expanded education, healthcare, and housing initiatives for the poor.
- These programs were part of Bhutto's populist agenda but placed a heavy strain on government finances, contributing to rising budget deficits.

Military Spending

- A significant portion of the budget continued to be allocated to defense, particularly in the aftermath of the 1971 war with India.
- This further limited the government's ability to invest in development and poverty alleviation programs.

General Zia-ul-Haq's Era (1977–1988)

During the 1980s, Pakistan's economic policies reflected a shift toward economic liberalization, privatization, and market-oriented reforms after the nationalization policies of the 1970s. The state aimed to reduce its direct involvement in the economy and encourage private sector development. Pakistan also received significant foreign aid, especially from the U.S., due to its strategic involvement in the Afghan-Soviet War.

Privatization and Economic Liberalization

- Zia's government partially reversed the nationalization policies of the 1970s.
- Some industries were denationalized, particularly in small- and medium-scale enterprises.
- The government encouraged private sector participation in banking, industry, and agriculture.
- Foreign investment was promoted through incentives such as tax exemptions and simplified procedures for foreign companies.

Monetary Policy and Inflation Control

- The State Bank of Pakistan adopted tight monetary policies to control inflation.
- The government introduced Islamic banking reforms, which included the gradual phasing out of interest-based banking to align with Islamic principles, though this had limited economic impact in the early years.
- The rupee was pegged to a basket of currencies, and exchange rate policies were relatively stable, supported by foreign aid and remittances.

Fiscal Policy and Foreign Aid

- The government ran large fiscal deficits, funded through external borrowing and foreign aid.
- Pakistan received substantial aid from Western countries, especially the U.S., due to its involvement in the Afghan War. This aid helped finance Pakistan's defense and economic programs.
- Defense spending remained high during this period, which constrained spending on social and infrastructure development.

Trade Policies

- Import substitution industrialization (ISI) was gradually phased out in favor of export promotion.
- Tariff barriers were lowered, and policies were introduced to encourage exports, especially textiles and agriculture.

Agricultural Sector Focus

- Agriculture remained a priority, with a focus on increasing food production and exports (e.g., cotton, and wheat).

- The Green Revolution continued to influence agricultural growth through better irrigation, fertilizers, and mechanization.

Growth and Economic Performance

- Pakistan's GDP grew at an average rate of 6% during the 1980s, supported by remittances from overseas Pakistani workers, foreign aid, and moderate industrial growth.
- Inflation was relatively low, and poverty rates declined modestly.

Islamization of the Economy

- Zia's regime introduced several measures to Islamize the economy, such as zakat (mandatory almsgiving) and the elimination of interest (riba) from the financial system. However, these measures had limited long-term economic effects and were not fully implemented by subsequent governments.

The Era of Transition to Civilian Rule and Structural Adjustments

The 1990s were marked by frequent changes in government, alternating between Benazir Bhutto and Nawaz Sharif, alongside persistent political instability. Pakistan also began implementing structural adjustment programs (SAPs) under the guidance of the International Monetary Fund (IMF) and World Bank, which aimed at reducing fiscal deficits, stabilizing the economy, and promoting private sector-led growth.

Structural Adjustment Programs (SAPs)

- Pakistan implemented SAPs in response to growing external debt, fiscal imbalances, and macroeconomic instability.
- The SAPs involved fiscal austerity, public sector reforms, trade liberalization, and market-based pricing policies.
- The programs sought to reduce subsidies (particularly in energy and agriculture), control inflation, and privatize state-owned enterprises (SOEs).
- These measures often led to public discontent due to cuts in social spending and price increases in essential commodities.

Privatization and Deregulation

- Nawaz Sharif's government (1990-1993, 1997-1999) pursued aggressive privatization policies, especially in banking, telecommunications, and industrial sectors.
- Privatization was aimed at improving efficiency, but it was often criticized for lack of transparency and favoring politically connected individuals.
- Deregulation in the financial sector increased competition but also led to banking crises later in the decade.

Monetary Policy and Inflation

- The State Bank of Pakistan was given greater autonomy in managing monetary policy.
- Inflation remained high throughout the 1990s, fluctuating between 8-12%, driven by fiscal deficits, external shocks, and rising debt servicing costs.
- Pakistan experienced a foreign exchange crisis in the mid-1990s due to its high external debt and trade deficits, leading to the devaluation of the rupee.

Fiscal Policy and Debt Accumulation

- Public debt surged in the 1990s as governments continued to run large budget deficits.
- Pakistan faced difficulties in revenue generation, with tax collection remaining low, resulting in a growing dependence on external borrowing and IMF support.
- Military and defense spending remained high, limiting the scope for public investment in infrastructure and social development.

Trade Liberalization

- Pakistan opened up its economy by lowering tariffs and removing quotas, aiming to integrate into the global market.
- The textile sector, in particular, benefited from these policies, becoming a key driver of export growth.
- However, trade liberalization also exposed domestic industries to foreign competition, and many inefficient firms struggled to compete.

Social and Development Challenges

- Political instability and economic mismanagement resulted in slow human development progress.
- Poverty levels increased, particularly during periods of economic adjustment, while unemployment remained a persistent challenge.
- Social sector spending, especially on education and healthcare, was inadequate to meet the needs of a growing population.

Nuclear Sanctions and Economic Crisis (Late 1990s)

- In 1998, after Pakistan conducted nuclear tests, the country faced international sanctions, particularly from the U.S., leading to a sharp decline in foreign aid and foreign direct investment.
- The economic situation worsened, and Pakistan faced near-default conditions, relying heavily on IMF support to stabilize the economy.

The Era of Economic Performance (1990s)

- Economic growth slowed during the 1990s, averaging around 4% per year, lower than the previous decade.
- Pakistan's macroeconomic situation worsened, with rising fiscal deficits, increasing debt, and higher inflation.
- Political instability, corruption, and governance issues further compounded economic problems, leading to a decline in investor confidence.

Economic Reforms, Growth, and Challenges:

Fiscal Policy and Deficit Management

- Throughout the 2010s, fiscal policy was characterized by persistent fiscal deficits due to high public spending, particularly on defense, subsidies, and debt servicing.
- Successive governments struggled to broaden the tax base, and tax revenues remained low. Tax reforms were initiated, especially under the PML-N and PTI governments, to improve collection through the Federal Board of Revenue (FBR).
- The fiscal deficit, averaging 6-7% of GDP in much of the decade, led to growing public debt, reaching unsustainable levels.

Monetary Policy and Inflation Control

- The State Bank of Pakistan (SBP) shifted between accommodative and tight monetary policies to manage inflation, which fluctuated due to external shocks, including oil price volatility.
- Inflation ranged between 5-10% during the 2010s, with periods of higher inflation driven by exchange rate depreciation and rising import costs.
- Interest rates were adjusted frequently to contain inflation, particularly during economic downturns.

IMF Programs and External Financing

- Pakistan entered multiple IMF programs during the 2010s to stabilize its economy and address its balance of payments crisis. Key programs included the 2013 Extended Fund Facility (EFF) under Nawaz Sharif and another EFF agreement in 2019 under Imran Khan.
- The IMF programs required Pakistan to implement structural reforms, including reducing subsidies, increasing tax revenues, and liberalizing exchange rates.
- External debt increased significantly as Pakistan relied on IMF and other multilateral financing, as well as bilateral loans from China (under the China-Pakistan Economic Corridor - CPEC) and other countries.

Exchange Rate and Trade Policies

- For much of the decade, Pakistan maintained a managed exchange rate policy, which contributed to the overvaluation of the rupee and hurt export competitiveness.
- The PML-N government devalued the rupee several times between 2017-2018 to address the growing trade deficit and boost exports. The PTI government allowed a more flexible exchange rate under IMF guidance in 2019.
- Trade deficits remained a challenge due to higher imports (particularly oil and machinery for CPEC projects) and relatively weak export performance.

Energy Sector Reforms

- The 2010s saw a focus on resolving Pakistan's chronic energy crisis, which was a major bottleneck to growth. Energy shortages led to frequent blackouts, affecting industrial productivity.
- The PML-N government initiated energy projects under CPEC, including the construction of power plants, to increase electricity generation.
- However, circular debt in the power sector, due to inefficiencies and subsidies, remained a significant challenge for public finances.

CPEC and Infrastructure Development

- The China-Pakistan Economic Corridor (CPEC), launched in 2015, was a flagship initiative for infrastructure development, aimed at improving connectivity and energy supply.
- CPEC led to significant investment in transport infrastructure, energy projects, and special economic zones, contributing to economic growth.
- However, concerns were raised about Pakistan's rising external debt to China and its capacity to repay loans associated with CPEC projects.

Growth and Economic Performance

- Pakistan's GDP growth averaged around 4-5% in the 2010s, with higher growth rates (5-6%) during the mid-decade, particularly under the PML-N government.
- Growth was driven by construction, services, and industrial sectors, although agriculture remained a key contributor.
- By the end of the decade, economic growth slowed due to external financing constraints, fiscal imbalances, and structural weaknesses.

COVID-19, Recovery, and Economic Reforms:

Fiscal Policy and Pandemic Response

- In response to the COVID-19 pandemic, the government increased public spending on healthcare and social protection programs under the Ehsaas program, designed to support vulnerable populations.
- Pakistan launched a stimulus package to support businesses, workers, and households affected by the pandemic. The fiscal deficit widened due to increased spending and reduced tax revenues during the economic slowdown.
- However, the government sought to maintain fiscal discipline by reducing unnecessary spending and implementing tax reforms to improve revenue collection in the post-pandemic period.

Monetary Policy and Support for Economic Recovery

- The SBP adopted an expansionary monetary policy during the pandemic, cutting interest rates and providing liquidity support to businesses and financial institutions.
- A Temporary Economic Refinance Facility (TERF) was introduced to provide low-cost loans to businesses, encouraging investment and supporting economic recovery.
- Inflation remained a challenge in the early 2020s, with supply chain disruptions and exchange rate volatility driving price increases.

IMF Programs and Structural Reforms

- Pakistan continued its engagement with the IMF under the Extended Fund Facility (EFF) during the 2020s, focusing on fiscal consolidation, exchange rate flexibility, and structural reforms.
- The IMF program required Pakistan to reduce subsidies, particularly in the energy sector, and enhance tax collection to reduce fiscal deficits and debt accumulation.
- The government implemented reforms in the energy sector to address circular debt, but political challenges and public resistance to rising energy prices slowed progress.

Trade and Exchange Rate Policies

- Pakistan maintained a flexible exchange rate policy in line with IMF recommendations, which led to further depreciation of the rupee but helped improve export competitiveness.
- Trade deficits persisted, though remittances from overseas Pakistanis helped stabilize external accounts. The government focused on diversifying exports and promoting sectors

such as information technology (IT) and textiles.

Debt and External Financing

- Pakistan's external debt continued to rise in the 2020s, driven by a combination of fiscal deficits, CPEC-related obligations, and IMF loans.
- Debt sustainability remained a critical concern, with the government seeking debt relief and restructuring through international forums such as the G20's Debt Service Suspension Initiative (DSSI).

Inflation and Price Stability

- Inflation surged in the early 2020s due to global supply chain disruptions, rising fuel and food prices, and exchange rate depreciation.
- The SBP raised interest rates in 2022 to control inflation, although this created a trade-off between price stability and economic recovery.

Post-COVID Economic Growth

- Economic growth rebounded in 2021-2022, driven by agriculture, services, and remittances, although growth remained below pre-pandemic levels.
- The government introduced policies to promote industrialization, digitalization, and job creation, particularly targeting export-oriented sectors and technology.

Political Instability and Policy Uncertainty

- In 2022, Imran Khan's government faced political challenges, leading to his ouster and the formation of a new government under Shehbaz Sharif.
- The change in government created policy uncertainty, although the economic agenda remained focused on stabilizing the economy, continuing IMF reforms, and addressing rising inflation.

Outcomes of Macroeconomic Policies

The policies of the 1970s had a mixed impact on Pakistan's economy. While there were efforts to address inequality and poverty through nationalization and land reforms, the inefficiencies in the public sector, high inflation, and reduced private sector confidence hampered economic growth. The industrial sector particularly suffered, and the private sector was reluctant to invest due to fears of further nationalization. By the end of the decade, the economy was characterized by sluggish growth, rising debt, and persistent poverty.

Macroeconomic policies in Pakistan during the 1980s and 1990s reflected significant shifts, primarily moving from state-led interventionism and nationalization (1970s) toward economic liberalization, deregulation, and structural adjustments. The two decades were dominated by the military regime of General Zia-ul-Haq (1977-1988) and subsequent civilian governments (1988-1999), including those of Benazir Bhutto and Nawaz Sharif. In the 1980s and 1990s, Pakistan experienced significant shifts in its macroeconomic policies. The 1980s were marked by gradual liberalization, supported by foreign aid, while the 1990s were characterized by structural adjustments, privatization, and fiscal austerity under civilian governments. However, political instability, governance challenges, and rising debt constrained long-term economic development and led to mixed results. The policy choices of these decades laid the groundwork for future economic reforms in the 2000s.

Macroeconomic policies in Pakistan during the 2010s and 2020s were shaped by significant economic challenges, including fiscal deficits, rising debt, and the need for structural reforms. The country faced external shocks, political transitions, and international financial dependencies, particularly through support from the International Monetary Fund (IMF). The policy focus shifted between stabilization measures, structural reforms, and growth-oriented initiatives. The 2010s in Pakistan were marked by efforts to stabilize the economy after the global financial crisis and address long-standing structural issues. Various governments, including those of the Pakistan People's Party (PPP) under Asif Ali Zardari and the Pakistan Muslim League-Nawaz (PML-N) under Nawaz Sharif, attempted to manage fiscal and external imbalances while fostering growth. Toward the latter half of the decade, the Pakistan Tehreek-e-Insaf (PTI) government under Imran Khan took power, further focusing on structural reforms. During the 2010s and 2020s, Pakistan's macroeconomic policies were largely shaped by the

need to manage fiscal deficits, debt sustainability, and external imbalances. While the 2010s focused on infrastructure development through CPEC and reforms under IMF programs, the 2020s were marked by the economic shock of the COVID-19 pandemic, necessitating expansionary policies and recovery measures. However, structural challenges, political instability, and rising inflation continued to pose risks to long-term economic stability.

Methodology:

Theoretical Framework

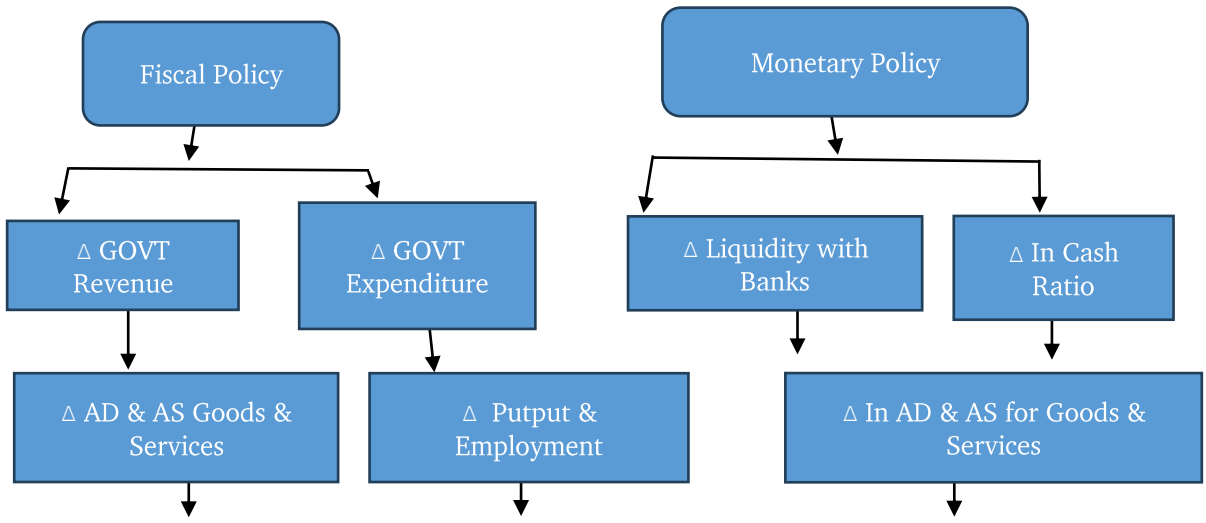
Kraay & Seven (2008) are of the view that fiscal policy contributed comparatively at low towards growth and employment in developing countries than in developed countries. Monetary policy instruments include interest rates, money supply, and reserve Central banks adjust interest rates to counter inflationary pressures or recession, with effects on aggregate demand, exchange rates, and inflation. Monetary policy can respond quickly to changing economic conditions, whereas fiscal policy is better suited for addressing long-term challenges. While Fiscal policy can correct issues like deficit monetization, crowding out, external sustainability, and price effects, while monetary policy can address tax revenue, interest payment, deficit financing, and asset price effects (Canzoneri, Cumby & Diba 2010).

Fiscal policy will affect jobs by government spending and taxation. When the government increases its spending, it can create jobs directly or stimulate demand for goods and services leading to lower unemployment. Reducing taxes increases disposable income for consumers and businesses, encouraging spending and investment, which can also reduce unemployment. Conversely cutting government spending or increasing taxes can reduce demand in the economy potentially leading to higher unemployment.

Monetary policy performance in unemployment growth and inflation Unemployment: Increase in money supply Can reduce unemployment by making more funds available for lending, encouraging investment and consumption. A decrease in money supply can increase unemployment by reducing funds available for lending, discouraging investment and consumption. An increase in money supply can lead to inflation if the increase in money supply outpaces economic growth, leading to too much money chasing too few goods. A decrease in the money supply can reduce inflation by restricting the amount of money available for spending. An increase in money supply can promote growth by providing more liquidity to the economy and fostering investment and consumption. Decrease in Money Supply can slow down growth by reducing liquidity, discouraging investment and consumption.

Conceptual Framework

Figure 1



△ In Overall Prices and Output & Employment (△ Macroeconomic Stability)

The Model

Based on the theoretical and empirical framework of the study, the following model is to achieve the required objective. The model of the present study is based on past studies i.e. Liao et al., (2023), Ullah et al., (2023), Wahid et al., (2021), and Ilyas & Ali (2023) defined it as:

$$MEI = \int(\text{MP}, \text{FP}, \text{GDI}, \text{TRV}, \text{FDI}) \quad (1)$$

Where

MES= Misery Index (combination of Unemployment and inflation)

FP = Fiscal Policy (GEXP Proxy by Fiscal Deficit)

MP= Monetary Policy (Proxy by Interest Rate)

TRV= Trade Volume

FDI=Foreign Direct Investment

GDI= Gross Domestic Investment

Econometric Techniques

This study deals with time series data for the period of 1990 to 2022; therefore, compatible econometric techniques are used. These techniques are stationarity tests and estimation techniques i.e. ADF, PP, and ARDL.

Results and Discussions

Unit Root Test Results

Stationary testing is required because, as previously mentioned, this study works with time series data. The most widely used test is i. E. The order of integration of stationary is examined using PP and ADF. The two tables that follow display the outcomes of both tests. E. The Tables 1 and 2.

Table 2

Unit Root Test Results

Variable	T-Statistics	P Value	t-Statistic	P Value	Decision
MEI	-2.989	0.048	-7.79	0.000	I (0)
IR	-2.20	0.477	-5.09	0.000	I (1)
GEXP	-2.088	0.254	-6.08	0.000	I (1)
GDI	-1.75	0.391	-5.36	0.001	I (1)
TOP	-1.702	0.4205	0.00	-5.19	I (1)
FDI	-0.17	0.615	-5.58	0.000	I (1)

Table 3

PP Test Results

Variables	PP Test Outcomes				Decision
	Level		FIRST DIFFERENCE		
	T-statistics	P- value	T-statistics	P- value	
MEI	-3.016	0.042	-8.01	0.0000	I (0)
IR	-1.26	0.184	-5.11	0.000	I (1)
GEXP	-2.09	0.243	-6.27	0.000	I (1)
GDI	-1.75	0.394	-5.36	0.000	I (1)
TOP	3.25	0.994	-4.14	0.000	I (1)

The outcomes of the unit root tests are presented in Tables 1 & 2. These tests are ADF & PP tests. The values of the t-test and probability values are presented in columns 2, 3, 4 & 5. The outcomes revealed regarding MEI, GOV-EXP, IR, FDI, TOP, and GDI. From the results, it is clear that all the variables are stationary at first difference except the MEI variable.

ARDL Results

The results of the stationarity tests confirmed the compatibility of the ARDL technique for the estimation of the parameters of the variables under consideration. The results of the ARDL are presented in table-3 as under.

Bound Test Outcomes

The outcomes of the bound test are given in the following table below:

Table 4

Bound Test Results

F. Bounds Test	Null Hypothesis No levels of Relationship		
F-statistic= 5.467	Signif.	I(0)	I(1)
K=05	5%	2.41	3.89

It is clear from the value of the Bound test i.e. F-statistic is 5.467, which is greater than the upper bound critical value at 5 % i.e. 3.89, this means that there is a long-run relationship between the variables of the model of the present study.

Table 5

Long Run Parameters Estimates

Variable	Coefficient	Std. error	t-Statistic	Prob
GEXP	-0.97	0.108	-8.98	0.000
IR	0.36	0.092	3.99	0.016
TR	0.16	0.150	1.06	0.019
FDI	0.042	0.053	0.792	0.805
GDI	-0.28	0.051	-5.490	0.000
C	7.2	4.01	1.75	0.093

The results in Table are about long-run parameter estimates. The coefficients are shown in the 2nd column and T-statistic and prob. Values are presented in columns 4 & 5. It is clear from the values of t-statistic & prob. Values that the objective variables are i.e. GEXP and IR are statistically significant with negative and positive respectively. The impact of GEXP is negative with a coefficient value of -0.97 with a corresponding prob. value i.e. 0.000 this means that an increase in government expenditure leads to a decrease in macroeconomic instability. The findings of this study are of the view that government expenditure is a tool of expansionary fiscal can help in generation source of employment and also increase output that might decrease the inflation rate in Pakistan. Therefore expansionary fiscal policy in the case of Pakistan can be used as a tool for decreasing macroeconomic instability. Therefore, it is suggested that the government should play its role in encouraging macroeconomic stability in Pakistan. On the other side, the use of contractionary monetary policy i.e. an increase in interest rate discourages aggregate demand and increases saving (discourages investment) which leads to decreased employment opportunities and a threat to employment (leads to an increased unemployment rate) in the case of Pakistan. The coefficient value of IR (a measure of monetary policy) is +0.36, found positive and significant in the long run with corresponding prob. value i.e. 0.016. This means that an increase in monetary policy tool i.e. interest rate leads to an increase in macroeconomic instability (increase in unemployment and inflation). The impact of policy variables is in line with the findings of the theory and consensus of the classical and Keynesian schools of thought.

The impact of the controlled variables i.e. GDI is found to be negative and significant means that an increase in Gross Domestic Investment leads to a decrease in macroeconomic instability. This

means that an increase in domestic investment encourages a productive environment which increases employment opportunities. An increase in investment leads to increased output which encourages a smooth supply of goods and services that leads to decreased prices in the economy. The finding of the study is parallel to the investment theories and consensus regarding investment in relation to output and employment.

The impact of trade on macroeconomic instability is found positive but insignificant in the long run. It means that trade doesn't affect macroeconomic instability in Pakistan. The coefficient value of foreign direct investment is 0.042 with a corresponding probability of. The value of t-stat 0.37 and their corresponding probability value is 0.805 shows that the variable is insignificant and does not considerably affect macroeconomic instability.

Table 6

Short-Run Parameters Estimates

Variable	Coefficient	Std. error	t-Statistic	Prob
D(GEXP)	-2.590	0.730	3-.547	0.002
D(GEXP(-1))	1.950	0.823	2.364	0.027
D(IR)	0.002	0.004	0.408	0.598
D(GDI)	-0.18	0.050	3.600	0.008
CointEq (-1) *	-0.922	0.174	-5.179	0.000
R-Squared	0.657	Mean dependent var		-0.123

It is clear from the estimated coefficient of the short run that the fiscal policy variable i.e. GEXP is found negative and significant at the difference and first lag level. It means that the use of fiscal policy can be used to reduce macroeconomic instability in Pakistan. Conversely, to impact of the monetary policy variable i.e. IR on macroeconomic instability is positive but insignificant (ineffective) in the short run. The impact of domestic investment is negative and significant in the short run which is consistent with the theory and past literature. The findings are consistent with the concept of Keynesian i.e. active government policy can reduce the impact on macroeconomic instability. Therefore, it is suggested that fiscal policy can be used to correct macroeconomic instability in Pakistan in the short run. The findings of the present study are in line with the Keynesian theory of output and employment.

Conclusion

The present study is an attempt to explore the impact of policy coordination on macroeconomic instability in Pakistan over the period of 1990 to 2022. As per the nature of the data of the study, it is necessary to test the stationarity of the data. For stationarity of the data, this study used ADF & PP tests. To estimate the parameters of the objective variables this study used the ARDL technique. The results of ARDL revealed that there is a long-run relationship between the variables of the model reported by the Bound test. The impact of objective variables (fiscal & monetary policy) is found to be significant in the long run. The impact of fiscal policy variable i.e. GEXP affects macroeconomic instability negatively means that an increase in GEXP leads to a decrease in macroeconomic instability while the impact of monetary policy variable is found positive and significant in the long run means that the impact of tight monetary policy leads to increase macroeconomic instability in Pakistan. The impact of expansionary fiscal policy on macroeconomic instability in the short run is effective in reducing it. And the impact of tight monetary policy is found ineffective. The impact of domestic investment is found to be negative and significant means that an increase in domestic investment leads to a decrease in macroeconomic instability in Pakistan.

Policy Suggestions

This study suggested some policy suggestions based on the findings of the present study.

- Fiscal policy variable is effective in both the long and short run, an expansionary policy may be used to correct macroeconomic

instability in Pakistan. Therefore, it is suggested that expansionary fiscal policy is used to reduce macroeconomic instability.

- Tight monetary policy leads to increased macroeconomic instability in the long run while the impact of tight monetary is not effective in affecting macroeconomic instability in the short run. Therefore, this study suggests that the use of tight monetary policy and an increased interest rate may not be used to increase employment and to control the increase in the general price level in Pakistan. This study suggests that a policy mix of expansionary fiscal policy and easy monetary policy can be used to reduce macroeconomic stability in Pakistan.

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