

Abstract

Fiscal Policy is one of economic stabilization policy, which helps to promote the economic growth of country, as Pakistan is facing fiscal deficit from its independence with exception of three years and tax to GDP ratio is low. Pakistan is also facing trade deficit due to all these reasons, we have tried to investigate the effect of Fiscal Policy stance at economic growth of Pakistan in world inflation perspective. To capture the effect of world inflation we have taken into account the trade share of Pakistan with our trading countries. Accordingly, this paper shall investigate the effect of world inflation at fiscal policy stance and economic growth of Pakistan. The data set of 40 years (1973-2013) years shall be taken from World Development Indicators (WDI) and Economic Survey of Pakistan. Since the expected length of data is substantial, we have applied Vector Error Correction model, Variance Decomposition Analysis, Impulse Response Function, Granger Causality Test and Johanson Co integration technique to find out long run and short run relationship. Structural breaks are a highly likely feature of the long run time series. Variables are Gross domestic product, Trade deficit, Total investment, Worker remittances, Tax revenue, Total expenditure and World inflation. The results shall try to draw the attention of the policy makers towards the issue that during the period of trade they should be well aware of the inflationary situation of the trading country.

Key Words: GDP, Fiscal Policy, Trade deficit, Johanson cointegration, Structural breaks, Granger Causality, World inflation.