

BUSINESS ECONOMICS – STAGE-1**SECTION – 'A'****Q. 2 (a) UTILITY:**

Utility denotes satisfaction. More precisely, it refers to how consumers rank different goods and services. Utility is a scientific construct that economists use to understand how rational consumers divide their limited resources among the commodities that provide them with satisfaction.

DIFFERENCE BETWEEN TOTAL UTILITY AND MARGINAL UTILITY:

The expression 'marginal' is a key term in economics and always means 'additional' or 'extra'. Marginal utility denotes the additional utility you get from the consumption of an additional unit of a commodity.

Consuming the first unit of ice cream gives you a certain level of satisfaction or utility. Now imagine consuming a second unit. Your total utility goes up because the second unit of the good gives you some additional utility. What about adding a third and fourth unit of the same good? Eventually, if you eat enough ice cream, instead of adding to your satisfaction or utility, it makes you sick!

This leads us to fundamental economic concept of marginal utility. When you eat an additional unit of ice cream, you will get some additional satisfaction or utility. The increment to your utility is called *marginal utility*.

LAW OF DIMINISHING MARGINAL UTILITY:

A century ago, when economists thought about utility, they enunciated the *law of diminishing marginal utility*. This law states that the amount of extra or marginal utility declines as a person consumes more and more of a good.

The law of diminishing marginal utility states that, as the amount of a good consumed increases, the marginal utility of that good tends to diminish.

NUMERIC EXAMPLE:

(1) Quantity of a Good Consumed 'Q'	(2) Total Utility 'U'	(3) Marginal Utility MU'
0	0	
1	4	4
2	7	3
3	9	2
4	10	1
5	10	0

The last column, column (3) measures marginal utility as the extra utility gained when 1 extra unit of the good is consumed. Thus when the individual consumes 2 units, the marginal utility is $7 - 4 = 3$ units of utility (call these units 'utils'). Focus next on column (3). The fact that marginal utility declines with higher consumption illustrates the law of diminishing marginal utility.

BUSINESS ECONOMICS – STAGE-1

!

(b) LARGE SCALE PRODUCTION:

The modern factory system, with its extensive use of machinery and division of labour, is responsible for large scale production. Large scale production seems to be the order of the day and small businesses are being constantly thrown into the background. This is due to the fact that large scale production happens to be much more economical.

ADVANTAGES (ECONOMIES) OF LARGE SCALE PRODUCTION:

The following are the chief advantages of large scale production:

1. Efficient Use of Capital and Equipment:

There is a large scope for the use of machinery, which results in lower costs. A larger producer can install up to date and expensive machinery. Specialized machinery can be installed for each job. He can also have his own repairing unit. A small producer, with a small market, cannot keep the machinery continuously working, whereas, a large producer can do so.

2. Division of Labour:

In a big concern, there is ample scope of division of labour. Specialized labour produces a larger output and of better quality. It is only in a large business that every person can put to the job that he can perform 'the best'.

3. Better Utilization in Management:

A capable manager is obviously under utilized in small concern. As, therefore, the scale of production is enlarged; there is fuller use of manager's time and ability. Also in large scale production, he can delegate his less important duties to his assistant and increase his efficiency where his ability required.

4. Economy of Advertisement:

A big concern can afford to spend large amounts of money on advertisement. The amount spent on advertisement per unit comes to low figure when production is on a large scale.

5. Salesmanship:

A big concern can afford to spend huge money on salesmanship. A big concern's salesmen can make a careful study of individual markets; and thus, acquire a hold on one market or strengthen it on the old ones. Thus, a large scale producer has a greater competitive strength.

6. Lower Rate of Credit Facility:

A large scale concern can secure credit facilities at cheap rates. Its credit in the money market is high and the banks are also switching to give advantages. Low cost of credit reduces cost of production.

7. Better Resistance in Adversity:

A big concern can show better resistance in the time of adversity. It has much larger resources, which help in bearing the losses.

BUSINESS ECONOMICS – STAGE-1**8. Economies of Buying and Selling:**

While purchasing raw material and other accessories, a big business can secure favourable terms on account of its large customer. While selling its goods, it can attract customers by offering a greater variety and by ensuring prompt execution of the orders placed with it.

9. Economies of Overhead and Rent Charges:

The expenses of administrative and distribution per unit of output in a big business are much low. Other charges are the same whether production is one a large scale or small scale. All these advantages are detained by the big concern in case of rent. This means a smaller amount of charges per unit because production is more in big concerns.

10. Experiments and Research:

There is a huge stock of capital in big concern and a big concern can afford to spend liberally on research and experiments. Successful research may lead to the discovery of a cheaper process. This may bring a large profit. Only large concerns can incur such expenses.

DISADVANTAGES (DISECONOMIES) OF LARGE SCALE PRODUCTION:

Although there are many advantages of a large scale business, yet they also suffer from serious disadvantages. Some of these are:

1. No Personal Element:

Paid employees generally manage a big concern. The owner is usually absent. The sympathy and personal touch, which ought to exist between the master and the employees, is missed. This leads to misunderstanding and ultimate results are strikes and lockouts. This is harmful to the business.

2. Lack of Coordination:

As a firm becomes large scale concern, it faces difficulty in coordinating the various departments of production. The lack of coordination in the production, planning, marketing, personnel, accounts, etc., results in lower efficiency of the factors of production. The average cost of production begins to rise.

3. Loose Control:

Management loses control over the productive activities because the size of plant increased. The misuse of delegation of authority brings diseconomies and this leads to higher average cost of production.

4. Lack of Proper Communication:

The lack of proper communication between the top management and the supervisory staff and a little feedback from the subordinate staff, causes disadvantage of large scale and causes in the average cost to go up.

5. Move to other Business:

A large scale production unit finds it very difficult to switch on from one business to another. In a depression, small concerns are able to move away from declining trades to flourishing one easily. In this way they are able to avoid losses. Such adaptability is lacking in a large scale business.

BUSINESS ECONOMICS – STAGE-1**6. Possibility of Depression:**

Large scale production may result in over production. Production may exceed demand and cause depression and unemployment. On the other hand, a large scale business normally depends upon markets. The foreign markets may be cut off by war or some other reasons. This makes the business risky.

SMALL SCALE PRODUCTION:

On account of diseconomies of large scale business it becomes necessary and economical to run business on small scale.

ADVANTAGES (ECONOMIES) OF SMALL SCALE PRODUCTION:

There are some advantages of small scale, which give it importance. These are as follows:

1. Personal Contact with Customer:

Personal contact with the customers sounds them well satisfied and is productive of good results. Customer is stable and demand is steady, it results in absence of risk. The producer of small scale concern is in a position to contact directly with the customer and listen to their grievance personally. He is in a position to consider customers' demand.

2. Personal Contact with Employees:

In small scale concern, the employer knows each and every employee because they are in close contact. Employer can look after each employee and make their problems (if any) right. These will ultimately lead to efficiency.

3. Close Supervision:

Small scale concern helps the higher management to supervise the staff closely. The producer and other official can instruct each and every part of production facility. This will help the officials to close inspection. This will lead to proper utilization of material, carefully handling of material etc. This reduces the cost of production.

4. Personal Interest:

In small scale concern, as the owner is normally one, makes a sense of personal interest. The employer knows that the profit is entirely belonging to him; therefore, he makes his best efforts for the betterment of the business.

5. Frequent Decisions:

In small scale concern, frequent decisions are normally taken because there is no any tradition of redcaps etc. The employer is all in all and he takes the decisions quickly.

DISADVANTAGES (DISECONOMIES) OF SMALL SCALE PRODUCTION:

The small scale producer cannot reap those economies, which are available to a big concern. Its disadvantages are:

1. Lack of Modern Technology:

There is lack of modern technology usage. Normally, the small scale concern has not much funds, so, it cannot acquire modern technology. This results in increases per unit cost. Backward technology spoils human / labour power.

2. Research and Experiments:

Small scale concerns faces lack of funds, therefore, it is not in a position to make research and experiments for the reduction in per unit cost.

BUSINESS ECONOMICS – STAGE-1**3. Division of Labour:**

There is no concept of division of labour. There is limited staff with limited production and capital in small scale business. So, there is no question of division of labour.

4. High Rate of Credit:

The feasibility of small scale business is risky. Therefore, the financial institutions charge high rates of interest from them. This ultimately increases per unit cost.

5. Poor resistance in Adversity:

Small scale business is not in a position to face and bear any unforeseen event. It has poor resistance in adverse situation.

Both small scale and large scale businesses are very much necessary for the economy and business market. Both have certain advantages and disadvantages. In this question advantages of larger scale concern are the disadvantages of small scale concern and disadvantages of large scale are the advantages of small scale concern.

Q. 3 (a) DIFFERENCE BETWEEN PERFECT COMPETITION AND IMPERFECT COMPETITION:**Perfect Competition:**

This technical term refers to a market in which no firm or consumer is large enough to affect the market price. For example, the wheat market is perfectly competitive because the largest wheat farm, producing only a minuscule fraction of the world's wheat, can have no appreciable effect upon the price of wheat.

The invisible-hand doctrine applies to economies in which all markets are perfectly competitive. Perfectly competitive markets will produce an efficient allocation of resources, so the economy is on its production-possibility frontier (PPF). When all industries are subject to the checks and balances of perfect competition, markets will produce the bundle of outputs most desired by consumers using the most efficient techniques and the minimum amount of inputs.

There are many ways that markets can fall short of efficient perfect competition. The three most important ones involve imperfect competition, such as monopolies; externalities, such as pollution; and public goods, such as national defense and lighthouses. In each case, market failure leads to inefficient production or consumption, and government can play a useful role in curing the disease.

Imperfect Competition:

One serious deviation from an efficient market comes from *imperfect competition* or *monopoly* elements. Whereas under perfect competition no firm or consumer can affect prices, *imperfect competition* occurs when a buyer or seller can affect a good's price. For example, if the TV company or a labour union is large enough to influence the price of TV service or labour, respectively, some degree of imperfect competition has set in. When imperfect competition arises, society may move inside its PPF. This would occur, for example, if a single seller (a monopolist) raised the price to earn extra profits. The output of that good would be reduced below the most efficient level, and the efficiency of the economy would thereby suffer. In such a situation, the invisible-hand property of markets may be violated.

BUSINESS ECONOMICS – STAGE-1

Imperfect competition leads to prices that rise above cost and to consumer purchases that are reduced below efficient levels. The pattern of too high price and too low output is the hallmark of the inefficiencies associated with imperfect competition.

In reality, almost all industries possess some measure of imperfect competition. Airlines, for example, may have no competition on some of their routes but face several rivals on others.

Imperfect competition prevails in an industry whenever individual sellers have some measure of control over the price of their output. Imperfect competition does not imply that a firm has absolute control over the price of its product.

KINDS OF IMPERFECT COMPETITION:**Monopoly:**

The most extreme case is *monopoly*: a single seller with complete control over an industry. (It is called a 'monopolist', from the Greek words *mono* for 'one' and *polist* for 'seller'.) It is the only firm producing in its industry, and there is no industry producing a close substitute.

True monopolies are rare today. Most monopolies persist because of some form of government regulation or protection. For example, a pharmaceutical company that discovers a new wonder drug may be granted a patent, which gives it monopoly control over that drug for a number of years.

Oligopoly:

The term *oligopoly* means 'few sellers'. Few, in this context, can be a number as small as 2 or as large as 10 to 15 firms. The important feature of oligopoly is that each individual firm can affect the market price. In the airline industry, the decision of a single airline to lower fares can set off a price war which brings down the fares charged by all its competitors.

Monopolistic Competition:

The last category of imperfect competition is *monopolistic competition*; this occurs when a large number of sellers produce differentiated products. This market structure resembles perfect competition in that there are many sellers, none of whom have a large share of the market. It differs from perfect competition in that the products sold by different firms are not identical. *Differentiated products* are ones whose important characteristics vary. Personal computers, for example, have differing characteristics such as speed, memory, hard disk, modem, size, and weight. Because computers are differentiated, they can sell at slightly different prices.

Product quality is an increasingly important part of product differentiation today. Goods differ in their characteristics as well as their prices. Most personal computers can run the same software, and there are many manufacturers. Yet the personal computer industry is a monopolistically competitive industry, because computers differ in speed, size memory, repair services, and ancillaries like CDs, DVDs, Internet connections, and sound system. Indeed, a whole batch of monopolistically competitive computer magazines is devoted to explaining the differences among the computers produced by the monopolistically competitive computer manufacturers!

BUSINESS ECONOMICS – STAGE-1**(b) AGGREGATE DEMAND:**

Aggregate demand (or AD) is the total or aggregate quantity of output that is willingly bought at a given level of prices, other things held constant. AD is the desired spending in all product sectors: consumption, private domestic investment, government purchases of goods and services, and net exports. It has four components.

1. Consumption:

Consumption (C) is primarily determined by disposable income, which is personal income less taxes. Other factor affecting consumption are longer-term trends in income, household wealth, and the aggregate price level. Aggregate demand analysis focuses on the determinants of real consumption (that is, nominal or dollar consumption divided by the price index for consumption).

2. Investment:

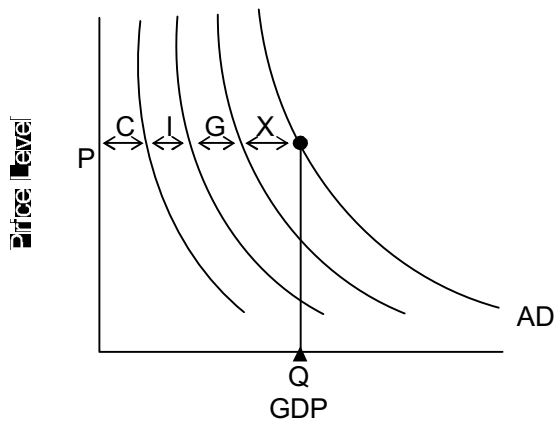
Investment (I) spending includes purchases of buildings, software, and equipment and accumulation of inventories. Analysis showed that the major determinants of investment are the level of output, the cost of capital (as determined by tax policies along with interest rates and other financial conditions), and expectations about the future. The major channel by which economic policy can affect investment is monetary policy.

3. Government Purchases:

A third component of aggregate demand is government purchases of goods and services (G): purchases of goods like tanks or road-building equipment as well as the services of judges and public-school teachers. Unlike private consumption and investment, this component of aggregate demand is determined directly by the government's spending decisions; when the Pentagon buys a new fighter aircraft, this output directly adds to GDP.

4. Net Exports:

A final component of aggregate demand is net exports (X), which equal the value of exports minus the value of imports. Imports are determined by domestic income and output, by the ratio of domestic to foreign prices, and by the foreign exchange rate of the dollar. Exports (which are imports of other countries) are the mirror image of imports, determined by foreign incomes and outputs, by relative prices, and by foreign exchange rates. Net exports, then, will be determined by domestic and foreign incomes, relative prices, and exchange rates.

BUSINESS ECONOMICS – STAGE-1

Aggregate demand (AD) consist of four components – consumption (C), domestic private investment (I), government spending on goods and services (G), and net exports (X).

Aggregate demand shifts when there are changes in macroeconomics policies (such as monetary-policy changes or changes in government expenditures or tax rates) or when exogenous events change spending (as would be the case with changes in foreign output, affecting X, or in business confidence, affecting I).

Figure shows the AD curve and its four major components. At price level P, we can read the levels of consumption, investment, government purchases, and net exports, which sum to GDP, or Q. The sum of the four spending streams at this price level is aggregate spending, or aggregate demand, at that price level.

SECTION – 'B'**Q. 4 (a) BALANCE OF PAYMENT (BOP):**

“It is a systematic record of a country’s receipts and payments in international transaction in a given year”

In balance of payment, each transaction is entered on the credit and debit side of the balance sheet. If the total receipts from outside country exceed total payments, the balance of payment is said to be favourable. On the other hand, if the total payments exceed the total receipts, the balance of payment is unfavourable.

REMEDIES TO CORRECT BALANCE OF PAYMENT:

Pakistan cannot afford to run a persistent deficit in balance of payments on current account as Pakistan does not have unlimited reserves of gold and foreign currencies. It can neither persistently borrow from the rest of the world. The adverse balance of payments can be decreased by the following measures:

1. Diversification of Exports:

Pakistan’s exports since Independence have been showing heavy concentration on a few primary commodities. If there is a recession in the international market for cotton and rice or nature is not kind, the production declines and exports are greatly reduced and have a damaging effect on the balance of payments. We shall, therefore, have to diversify our exports and produce value added goods for gaining competitive strength in the international market.

BUSINESS ECONOMICS – STAGE-1**2. Development of Industries having Low Capital Output Ratio:**

Pakistan with low foreign exchange earning cannot afford to import heavy machinery. If Pakistan, like China, Korea, Taiwan, Hong Kong, Singapore, taxes up line of production, having a low capital ratio. It can lead to fast growing export. The export of carpet and rug industry, cigarette industry, sports industry, leather industry, etc., has considerably increased the export earnings of Pakistan in the past few years and has decreased strain on the balance of payments.

3. Decrease in Consumption:

In spite of rapid in prices, there is a greater increase in national consumption of various commodities product at home and imported from abroad. The higher consumption of locally manufactured goods is reducing the exportable surplus and consequently the foreign earnings to the country. People shall have to be motivated to adopt simple living.

4. Restoration of Sick Industries:

The sick industries in the nationalized public sector should be transferred to their owner. The private sector has the capacity to reactivate the dying industrial units and increase production of items, which are used at home. It can, thus, increase exports to earn the much-needed foreign exchange.

5. Reducing in Export Duties:

Reduction in export duties, publicity of locally manufactured goods in the foreign markets, adequate provision of credit to the private sector for development of industries etc., can greatly help in increasing export earnings and relieving the pressure of balance of payments.

6. High Quality Goods:

In order to capture foreign markets, it is necessary that high quality goods at minimum cost should be produced in the country.

7. Packing:

For promoting exports, high quality of packing is essential. If packing is not attractive and durable, it will not capture foreign markets.

8. Reduction in Imports:

In order to correct the adverse balance of payments, the Government of Pakistan shall have to reduce the import of consumer goods, which amount to about 50% of total imports. The raw material, which can be produced in the country at a cheaper cost, should not be imported. The decline in the import of consumer goods and industrial raw material can greatly reduce the deficit gap.

9. Reduction in Invisible Imports:

The payments on invisible imports like shipping, insurance, banking services, payments to technocrat working in various establishments, expenses on diplomats etc., have been on the increase. It has to be curtailed down.

BUSINESS ECONOMICS – STAGE-1

!

(b) DIFFERENTIATE BETWEEN INFLATION AND DEFLATION:

Inflation occurs when the general level of prices is rising. Today, we calculate inflation by using price indexes – weighted averages of the prices of thousands of individual products. The consumer price index (CPI) measures the cost of a market basket of consumer goods and services relative to the cost of that bundle during a particular base year. The GDP deflator is the price of GDP.

The rate of inflation is the percentage change in the price level:

$$\frac{\text{price level} - \text{price level}}{\text{price level}}$$

$$\text{Rate of inflation (year } t) = \frac{(\text{year } t) - (\text{year } t - 1)}{(\text{year } t - 1)} \times 100$$

The opposite of inflation is *deflation*, which occurs when the general level of prices is falling. Deflations were rare in the late twentieth century. In the United States, the last time consumer prices actually fell from one year to the next year was 1955. Sustained deflations, in which prices fall steadily over a period of several years, are associated with depressions, such as those that occurred in the United States in the 1930s and the 1890s. More recently, Japan experienced a deflation in the late 1990s as its economy suffered a prolonged recession.

A deflation occurs when prices decline (which means that the rate of inflation is negative). Price stability is important because a smoothly functioning market system requires that prices accurately and easily convey information about relative scarcities. History has shown that high inflation imposes many costs – some visible and some hidden – on an economy. With high inflation, taxes become highly variable, the real values of people's pensions are eroded, and people spend real resources to avoid depreciating rubles or pesos. But declining prices or deflation is also costly. Hence, most nations seek the golden mean of stable or slowly rising prices as the best way of encouraging the price systems to function efficiently.

THREE STRAINS OF INFLATION:

Inflation exhibit different levels of severity. It is useful to classify them into three categories: low inflation, galloping inflation, and hyperinflation.

Low Inflation:

Low inflation is characterized by prices that rise slowly and predictably. We might define this as single-digit annual inflation rates. When prices are relatively stable, people trust money because it retains its value from month to month and year to year. People are willing to write long-term contracts in money terms because they are confident that the relative prices of goods they buy and sell will not get too far out of line. Most industrial countries have experienced low inflation over the last decade.

Galloping Inflation:

Inflation in the double-digit or triple-digit range of 20, 100, or 200 percent a year is called *galloping inflation* or "very high inflation". Galloping inflation is relatively common, particularly in countries suffering from weak governments, war, or revolution. Once galloping inflation becomes entrenched, serious economic distortions arise. Generally, most contracts get indexed to a price index or to a foreign currency like the dollar. In these

BUSINESS ECONOMICS – STAGE-1

conditions, money loses its value very quickly, so people hold only the bare-minimum amount of money needed for daily transactions. Financial markets wither away, as capital flees abroad. People hoard goods, buy houses, and never, never lend money at low nominal interest rates.

Hyperinflation:

While economies seem to survive under galloping inflation, a third and deadly strain takes hold when the cancer of *hyperinflation* strikes. Nothing good can be said about a market economy in which prices are rising a million or even a trillion percent per year.

Hyperinflations are particularly interesting to students of inflation because they highlight its disastrous impacts. Consider this description of hyperinflation in the Confederacy during the Civil War.

Q. 5 (a) FEDERAL BUDGET:

Every government plans various economic activities and for undertaking these activities, it has to first raise revenues and then incur expenditures.

Federal budget is the annual statement of the expenditures and revenues of the federal government with the laws and regulations that approve and support those expenditures and taxes. The main objectives of the federal governments of the developing and developed countries of the world are:

- (i) to finance the activities of the federal government and;
- (ii) to encourage economic growth in an atmosphere of stability.

The first purpose of the federal budget is to finance the business of the government by raising revenues through direct and indirect taxes. after the Great Depression of 1930's, the federal budget is used through the fiscal policy to achieve macro economic objectives such as sustained long-term economic growth, higher level of employment, price stability etc.

Budget is very often divided into revenue and capital budget. The *revenue* budget covers items of recurring nature. The government raises revenue from direct and indirect taxes such as income tax, excise duty, custom duty etc. The *capital budget* includes those items which are meant for acquiring and disposal of capital assets. The development expenditure includes expenditures on construction of roads, railways, parts, industrial projects, irrigation projects etc.

Generally the budget paper shows (i) the financial accounts of the previous year, (ii) the budgeted figures and revised estimates for the current year, (iii) the budget for the coming year.

The Federal Budget consists of two components:

- (a) The Revenue Budget and (b) The Development Budget

(a) The Revenue Budget:

The revenue budget is prepared by the Finance Division in collaboration with the various administrative ministries/divisions of the Federal Government. The administrative ministries send their requirements of funds to the Finance Division

BUSINESS ECONOMICS – STAGE-1

where they are mutually discussed and tentatively finalized for inclusion in the budget proposals.

(b) The Development Budget:

The development budget, on the other hand, is prepared by planning and development division in collaboration with the Finance Division, other administrative divisions/ministries and the provincial governments. For this purpose, the planning and development division circulates guidelines regarding resource availability as well as plan and national priorities and strategies to the Federal Ministries and divisions as well as to the provincial governments for submitting their proposals for inclusion in the national budget. The proposals received by the P & D divisions are then finalized in consultation with the Finance Division and the other concerned ministries and divisions. A similar exercise is carried out at the provincial level by the planning and development departments and the proposals finalized are then forwarded to planning and development division for incorporation in the federal development budget.

The budget proposals are developed by the finance and planning and development divisions are then consolidated in the federal budget which is further discussed in the meetings of the Priorities Committee and Executive Committee of the National Economic Council. The budget as cleared by the executive committee of the National Economic Council and is then submitted to the National Economic Council for approval. Thereafter the budget is presented to the National Assembly for consideration and approval.

(b) (i) National Income:

Income refers to the flow of wages, interest payments, dividends, and other things of value accruing during a period of time (usually a year). The aggregate of all incomes is *national income*. The biggest share of national income goes to labour, either as wages or salaries or as fringe benefits. The remainder goes to the different types of *property income*: rent, net interest, corporate profit, and proprietors' income. This last category basically includes the returns to the owners of small businesses.

The earnings in a market economy are distributed to the owners of the economy's factors of production in the form of wages, profits, rent, and interest.

(ii) Investment:

Investment consists of the additions to the nation's capital stock of buildings, equipment, software, and inventories during a year. The national accounts include mainly tangible capital (such as buildings and computers) but omit most intangible capital (such as research-and-development or educational expenses).

If people are using part of society's production possibilities for capital formation rather than for consumption, economic statisticians recognize that such outputs must be included in the upper-loop flow of GDP. Investments represent additions to the stock of durable capital goods that increase production possibilities in the future.

BUSINESS ECONOMICS – STAGE-1**SECTION – I (C)****Q. 6 (a) OBSTACLES TO ECONOMIC DEVELOPMENT IN PAKISTAN:**

Pakistan inherited an extremely narrow economic base at the time of Independence in 1947. Since then, the Government of Pakistan has been making rigorous efforts to build up infrastructure and productive potential of the economy through the process of development planning. The start for preparing the country for future advancement was made by launching a Six Year Development Programme (1951–57) named as Colombo Plan. The Plan was suspended two years before its completion due to the repercussions of Korea War. In addition to the Colombo Plan, Five other Five Year Development Plans were drawn up and implemented.

If the economic performance since 1947 is evaluated, the overall results are not very encouraging. The per capita income at market price is only 1946 dollars per year in 2009 in Pakistan. The major portion of the population is just above the poverty line (22.6% growth has been achieved, it is accompanied by unequal distribution of wealth. This has created social tension in the country and has slowed down the rate of economic growth. Pakistan has devised various strategies to quicken the tempo of economic development but it has not been able to break the various circle of poverty and enter into take off stage. The main obstacles which have affected the rate of growth in Pakistan are grouped under following heads: (1) Economic Obstacles, (2) Social and Cultural Obstacles, and (3) Administrative Obstacles. These obstacles are now discussed in brief:

(1) Economic Obstacles:

- **External debt:** There was a rising trend in external debt *which posed a serious threat to the economic future of the country.* During the last few years, serious efforts have been made to reduce the external liabilities as far as possible.
- **Fiscal deficit:** Another serious constraint on economic development is the higher levels of budget deficits. The large fiscal deficits reduce the capacity of the government to spend on key development activities.
On the revenue side, the tax GDP ratio stands at around 10% during the last several years. It is mainly attributable to narrow tax base, inelastic tax system, complex tax laws, heavy reliance on foreign trade taxes, large tax exemptions and incentives, tax evasions, weak tax administration etc.
- **Banking and financial sector in crisis:** The second economic impediment to economic development was that the public sector banks and development financial institutions (DFI's) were mainly in crisis. Excessive bank credits, large scale defaults in payment of loans were great fault lines of the economy. The poor performance of the financial sector had adversely affected development in various sectors of the economy till 2000. However, due to rapid economic growth from 2000 onward, the banking sector is earning profits. The investment of the banks is mostly on consumer products.
- **Persistent deficit in balance of payments:** Another important obstacle to economic development is the persistent deficit in the balance of payments over the years.

BUSINESS ECONOMICS – STAGE-1

- **Financing the budgetary gap:** One of the serious factor distorting the fiscal system and obviously economic growth is the huge amount of borrowing to finance the budgetary gap. The budgetary gap is financed through three sources (i) External borrowing, (ii) Domestic non bank borrowing, (iii) Borrowing from the banking system. Excessive bank borrowing creates inflationary pressure in the economy.
- **Deficiency of capital:** Deficiency of capital is an important obstacle in the way of economic development. If a country is to achieve rapid rate of economic development, it must save at least 25% of GDP year. In Pakistan, the rate of national saving is very low.
- **Scarcity of foreign exchange:** Pakistan, like other developing countries, is foreign trade orientated. It is concentrating mainly on the export of cotton, carpets and manual labour leather, rice, sports goods. The excessive dependence on export of a few items has made the economy unstable and is a great obstacle to economic growth, which are mainly primary commodities. The increase in the prices of imported goods and their rising flow in the country is a big strain on the foreign exchange resources.
- **Rapidly growing population:** The population is growing at the rate of about 1.8% annually in Pakistan. As a result of the rapid increases, the proportion of dependants below the age of 15 years and above the age of 60 has gone up to 73% which is a great burden on the meager recourses of the country and a big obstacle to economic development.
- **Low level of technology:** One of the obstacles to economic development in Pakistan is the use of low level of technology in various sectors of the economy. We do not stress and even do not recommend that Pakistan should adopt most modern and sophisticated technology.
- **Dualistic economy:** Dualism is an another important obstacle to economic development in Pakistan. There is a vast regional disparity in income. The use of technology differs from sector to sector and region to region.

(2) Social and Cultural Obstacles:

The socio-cultural attitudes of the people also stand in the way of economic development of our country. In Pakistan, more than 50% of the people are illiterate. They are ignorant of the development taking place in their own country as well as in the world. The majority of the people are extravagant. Ours is in fact a consumption oriented society. The people are mostly conservative in their habits. They fell pride in the native culture and are generally not receptive to foreign method of production. People lack self confidence and initiative. The joint family system, though on the decline, has also killed the sense of initiative and the incentive to work. The caste system functioning mostly in terms of occupation tailors, carpenters, goldsmiths, etc., restrict occupational and geographical mobility. The occupational classification which is mostly village centred impede the economic development. The religious beliefs of the people condemning the accumulation of wealth, dependence upon fate and the will of God only are also obstacles to economic growth.

BUSINESS ECONOMICS – STAGE-1**(3) Political and Administrative Obstacles:**

For accelerating the rate of economic development, there should be political stability in the country. If there is a change in the government set up due to elections, or of dictatorship, the planning job done by the previous governments should not be altered altogether.

The planning machinery and all other involved in administrative should be loyal to the country. They should be competent, sympathetic and honest in the performance of the duties assigned to them. In Pakistan, since its inception, there have been rapid changes in governments. Each government which came into power condemned the planning work done by the previous governments. They framed their own plans, formulated their own strategies of development and left the scene without achieving the targets of the Plans. The history of planning shows that with the exception of the Fifth Five Year Plan, all other Plans have failed to achieve their targets. The overall line of the planning machinery in Pakistan is bureaucratic rather than professional. The administrative working in various departments is generally weak, incompetent and unsympathetic. Self interest is dominating over national interest which is a great barrier to economic development. Another administrative obstacle in the way of economic development is that we have not so far been able to decide about the nature of economic system to be adopted in Pakistan. Mixed economy, socialistic economy, Islamic economy all are talked about but nothing concrete has actually been practised. There should be clarity on this fundamental issue so that planning is drawn up according to the socio-economic objective of that system and a path of development laid out.

(b) FOREIGN EXCHANGE RATE:

Foreign trade involves the use of different national currencies. The *foreign exchange rate* is the price of one currency in terms of another currency. The foreign exchange rate is determined in the foreign exchange market, which is the market where different currencies are traded.

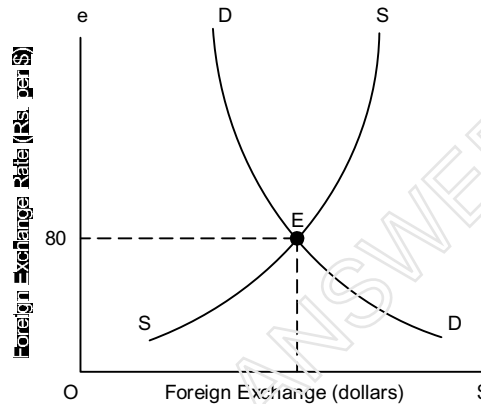
Most major countries have their own currencies – the U.S dollar, the Japanese yen, and so forth. (European countries are an exception in that they have a common currency, the Euro.) we follow the convention of measuring exchange rates as the amount of foreign currency that can be bought with 1 unit of the domestic currency. For example, the foreign exchange rate of the dollar might be Rs.80 per U.S dollar (Rs.80/\$).

When we want to exchange one nation's money for another's, we do so at a foreign exchange rate. For example, if you travelled to Canada in early 2010, you would get about 1.3 Canadian dollars for 1 U.S dollar. There is a foreign exchange rate between U.S dollars and the currency of every other country.

With foreign exchange, it is possible for me to buy an American bicycle. Suppose its quoted price is \$200. I can look in the newspaper for the foreign exchange rate for \$. I could go to the bank to convert my money. With my Pakistani money, I then can pay the exporter for my bicycle in the currency it wants. Business and touristic do not have to know anything more than this for their import or export transactions. But the economics of foreign exchange rates cannot be grasped until we analyze the forces underlying the supply and demand for foreign currencies and the functioning of the foreign exchange market.

BUSINESS ECONOMICS – STAGE-1**THE FOREIGN EXCHANGE MARKET:**

Like most other prices, foreign exchange rates vary from week to week and month to month according to the forces of supply and demand. The *foreign exchange market* is the market in which currencies of different countries are traded and foreign exchange rates are determined. Foreign currencies are traded at the retail level in many banks and firms specializing in that business. Organized markets in New York, Tokyo, London, and Zurich trade hundreds of billions of dollars worth of currencies each day.



We can use familiar supply and demand curves to illustrate how markets determine the price of foreign currencies. *Figure* shows the supply and demand for U.S. dollars that arise in dealings with Pakistan. The supply of U.S. dollars comes from people in the United States who need Rupees to purchase Pakistani goods, services, or financial assets.

Market forces move the foreign exchange rate up or down to balance the supply and demand. The price will settle at the equilibrium foreign exchange rate, which is the rate at which the dollars willingly bought just equal the dollars willingly sold.

The balance of supply and demand for foreign exchange determines the foreign exchange rate of a currency. At the market exchange rate of Rs.80 per dollar shown at point E in *figure*, the exchange rate is in equilibrium and has no tendency to rise or fall.

Q. 7 ELECTRICITY GENERATION:

The total installed capacity of electricity generation stood at 20190 MW in 2009–10. At present WAPDA, KESC, Karachi Nuclear Power Plant (KANUPP) and Chashma Nuclear Power Plant are the four main public sector organizations for transmission and distribution of electricity in the country. *The independent power projects (IPPs) are involved in power generation only.*

The total installed capacity of WAPDA stood at 11399 MW in 2009–10. Out of which hydel electricity generation was 6555 MW and thermal electricity generation 4894 MW. The Karachi Electric Supply Corporation (KESC) produced 1955 MW, KANUPP 462 MW, IPPs 6374 MW. The share of WAPDA stood at 56.5% in electricity generation.

BUSINESS ECONOMICS – STAGE-1**(a) Thermal Electricity Resources:**

Pakistan has a sufficient large base of coal. Deposits over 175 billion tonnes have been discovered in Thar deserts of Sindh. The total coal resources are estimated at 184 for generation electricity are quite bright.

(1) Coal based projects: The Government plans to induct coal industrial use by setting up 'coal based power units'. The machinery for these units is totally exempted from import duties and taxes. a coal based power plant of 150 MW has been set up near Lakhra coal field.

(2) Oil: Oil is an important liquid mineral which is used all over the world for getting power, light and heat. The Government of Pakistan is making sincere efforts to discover new oil/gas fields in the country. The policy of the Government is to attain self sufficiency because oil as a source of energy is expensive if it is imported from other countries. We do hope, that by the grace of God, Pakistan will be able to discover oil and its production will increase in subsequent years. But till the new oil fields are discovered, we cannot bank upon and bear the heavy drain of foreign exchange due to the increased import of oil. We shall have to find out cheaper alternatives of generation electricity.

(3) Natural gas: Natural gas is a precious gift of God, the Almighty to Pakistan. The deficiency of coal and oil has been greatly compensated due to the discovery of natural gas in different areas of Punjab, Sindh and Baluchistan. Natural gas is a cheaper source of energy and is consumed as motive power. It is also used as raw material in various industries. The use of gas is also increasing for domestic consumption in Pakistan.

(b) Hydel Power Resources:

The hydel power is renewable. It is produced from waterfall in Pakistan. There is a great potential of developing hydro power capacity. Since Independence, huge amounts have been allocated in all the five year development plans and there is a spectacular growth of eclectic power from 68 MQ in 1947 to 6555 MW by March, 2010 from hydel generation. The Hydel Schemes, though they are being less expensive, are very useful for the development of the country. The hydro projects not only provide energy but also improve the irrigation system of the country. The vast new areas of land are brought under cultivation and the supply of water for existing cultivated area is improved. In addition to these, the hydro projects help in controlling floods, are used for navigation purposes, breeding fisheries, recreation etc.

The Khyber Pukhtoon Khwa government has set up an exclusive organization for the development of hydel power projects. It is known as Sarhad Hydel Development Organization (SHYDO). The SHYDO has identified more than 215 sites which are capable of producing 20,000 MW of electricity per year.

(c) Nuclear Energy:

The main fuel capable of generating nuclear energy is the uranium. The developed countries of the world had nuclear reactors in the mind 50's. Since then some of the developing countries including Pakistan are trying their best to have breeder reactors for converting uranium into plutonium which is used as fuel for generating energy. Pakistan is using all its available resources for the development of nuclear power as it has vast reserves of uranium.

BUSINESS ECONOMICS – STAGE-1

Pakistan Atomic Energy Commission (PAEC) is responsible for nuclear power developments in Pakistan. It made a beginning in the field of nuclear power generation by commissioning 137 MW Karachi Nuclear Power Plant in 1971 which is in operation for the last over 30 years. The Chashma Nuclear Power Plant has also been constructed with the help of China. It has a gross capacity of 325 MW. Both the nuclear power plants are working according to the safety standards set by Pakistan Nuclear Regulatory Authority.

(d) Non-Conventional Sources of Energy:

Due to price hike of oil since 1973–74, the less developed countries are now developing other renewable sources of energy. These sources are comparatively cheaper and also have a simplified technology. The non-conventional sources of energy are (1) Biogas, (2) Solar, and (3) Wind.

(1) Biogas projects: Biogas, which is produced from animal and plant wastes, is a very cheap source of energy. Biogas can be used for cooking, domestic lighting, powering engines of irrigation and drinking purposes. As nearly 72% of our people live in villages, they can make the best use of this source of energy.

(2) Solar energy projects: Many vendors are importing solar water heaters for sale. Some local manufactures are also involving information of this technology. The Alternative Energy Development Board (AEDB) has launched a consumer confidence building programme for promotion of solar water heaters.

(3) Wind energy projects: Another cheap source of generating power is the wind. In windy areas, the windmills can be used for supplying electricity on a small scale. The windmill can be used for pumping water for crops, grinding corn, crushing sugarcane, thrashing, cutting of wood etc. AEDB has issued 4 letters of intent for wind power projects, 3 for 50 MW and one for 24 MW. The Board is also facilitating twenty (20) projects having a capacity of 50 MW each. These are at different stages of development. Another company has installed 6 MW project as a first phase of their 50 MW programme. Feasibility studies for 50 MW projects each has been completed by 2 independent power project companies.

Conclusion:

We have examined the various sources of energy and their availability in Pakistan. We in the long-run shall have to bank upon on hydel and solar energy for meeting the energy crises. The world scientists are of the view that the world is not facing a crisis of energy but a crisis of technology. The oil which is consumed in the engines uses only 17% of the energy potential and 83% of it is burnt as waste. Same is the case with nuclear reactor which exploits and harnesses 1% of the energy produced by uranium. The scientists of the world now shall have to develop the technology which uses 100% of the energy potential oil.

THE END