Nilüfer ŞİMŞEK

THE TWIN DEFICITS HYPOTHESIS

A Review of the Turkey

ABSTRACT

The Twin Deficits Hypothesis expresses that there is a linear relationship between budget deficits and current account deficits. Two approaches are available for the twin deficits hypothesis. These approaches are; the Keynesian approach supporting the validity of the relationship between two deficits and the Ricardian approach supporting that there is no relationship between them.

The aim of this study is testing the validity of the Keynesian approach supporting the validity of the relationship between budget deficits and current account deficits for Turkey in 1996-2013 period.

The time series approach has been used to examine the existence of a relationship between budget deficits and current accounts in our study. The direction between variables has been determined by means of Granger Causality test as part of multivariable (Current account deficit, Budget deficit, Currency, İnterest) regression models by using quarterly (three-month) data between for the 1996-2013 years in Turkish economy and a long term relationship between variables has been tested by means of the Engle-Granger Cointegration test.

As a result of the analysis, there has been determined a statistically significant long-term relationship between current account deficit and budget deficit. The direction of causality relationship toward from budget deficits to current account deficits. Results obtained support the Keynesian Twin Deficits Hypothesis depending on the methods applied and the period examined. Apart from all these inferences a statistically significant Granger Causality relationship has been determined towards from the interest and exchange rates to current account deficits.

KEY WORDS: Twin Deficits, Budget Deficits, Current Account Deficits, Granger Test, Equivalence Hypothesis.