

## Chapter 3

# RELATIONSHIP BETWEEN TWIN DEFICIT AND ECONOMIC GROWTH IN TURKEY

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### Introduction

The balance of the current account, which indicates the public sector income-expenditure balance and the external balance, is two important indicators in terms of macro economical in an economy.

At the beginning of the 1980s, 1990s, and 2000s, the US economy had major foreign trade deficits. In the financing of trade deficit, it was decided to borrow from abroad (or selling US assets abroad) due to accounting identities and thus the United States which is the world's largest creditor has turned into the world's biggest borrower. When major foreign trade deficits were experienced during Reagan's presidency, Country economy witnessed the largest budget deficits in the history of the country due to the expanding fiscal policies implemented (Mankiw, 2009: 141-143). The simultaneous budget deficit and foreign trade deficit problem in the American economy was similarly seen in European countries and many developed countries, and so the relationship between these deficits has often started to be questioned (Marinheiro, 2008: 1042).

The budget deficit and foreign trade deficit, which started in the US economy in the 1980s, and which appeared at the same time and had the same direction, caused these problems to be called "twin deficits" in the literature (Baharumshah, et al., 2006: 332).

The balance of the economic system in an open economy is realized at the point of national savings-national investment equality. The twin deficit is the deficit of both budget and foreign trade simultaneously due to the inadequacy of private sector savings (Bocutoğlu, 2011: 44).

Budget deficit and current account deficit are among the most important indicators in terms of the macroeconomic balance of a country's economy. The deficit of the current account balance leads to the economy spending more than income, and means that the deficit of current account balance is financed by foreign capital entry or reserve declines. The importance of the current account position stems from the

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increases as the economy grows, the rate of exports meeting imports is low, and the pressures of the currency deepen the problem of current account deficit.

In order to keep the economic growth stable and at high rates, Turkey must first implement measures for providing the use of domestic inputs in production, as well as taking steps in order to increase the export revenues. It is also important to reduce dependence on speculative inflows of foreign currencies by establishing an investment-saving balance. The improvement of the current balance together with the improvement in the budget balance, will contribute to the sustainable growth of the Turkish economy by reducing its vulnerability.

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