# Budget and Current Account Deficits in SEACEN Countries: Evidence Based on the Panel Approach

**ABSTRACT:** In this paper, the twin deficits hypothesis was examined using data of nine SEACEN countries. To compensate for the lack of time series observations, data was polled from the nine countries into one panel. The effects of interest rate and exchange rate in the causal chain between budget and current account deficits were stressed. At the empirical level, there is enough evidence to support the view that Asian budget deficit causes current account deficit directly as well as indirectly. From the policy perspective, the statistical analysis suggests that managing budget deficit offers scope for improvement in the current account deficit. However, this finding does not support the policy of manipulating the intermediate variables to reduce the twin deficits to a sustainable level since these variables appear to be endogenous in the system.

## 1. Introduction

Most observers consider large and persistent current account deficits to be the cause of macroeconomic imbalances that have important implications on long-term economic progress. Numerous researchers have explored the possible long-run (positive) link between budget and current account deficits. The so-called 'twin deficits hypothesis' that emerged in the 1980s marked a period of strong appreciation of the dollar and an unusual shift in current account as well as fiscal deficits, not in favor of the US[1]. This close connection between current and budget deficits is not unique to the US. Countries in Europe (e.g. Germany and Sweden) faced similar problems in the early part of the 1990s where the rise in budget deficits was accompanied by a real appreciation of their national currencies that adversely affected the current accounts (see Ibrahim and Kumah, 1996).

Developing economies have also experienced the simultaneous upsurge of budget and current account deficits (Laney, 1984; Khalid and Teo, 1999; Anoruo and