

Causal Relationships between Current Account Imbalances and Budget Deficits in Pacific Island Countries: A Panel Cointegration Study

T.K. Jayaraman
School of Economics
Faculty of Business and Economics
The University of the South Pacific
Fiji Islands

Evan Lau
Department of Economics
Faculty of Economics and Business
Universiti Malaysia Sarawak
Malaysia

Abstract

Resorting to panel data investigation, this study seeks to test the causal relationships between current account imbalances and budget deficits in Pacific island countries. The study findings are that current account imbalances and budget deficits are cointegrated, although there is no long run causality relationship between current account deficit and budget deficit and money supply. However, in the short run, there is a bi-directional relationship between current account deficit and budget deficit. The study suggests some policy measures.

Keywords: budget deficit, current account deficit, panel data analysis, Pacific island countries.