

THE IMPACT OF BUDGET DEFICIT ON ECONOMIC GROWTH IN NORTH CYPRUS

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Abstract

Budget deficit or budget surplus is one of the most important macroeconomic factor that has an impact on economic growth (Fischer, 1993). Budget deficit or surplus is a result of fiscal policy of a government. As Fischer (1993) indicated it is not easy to use budget deficit as a representative of fiscal policy or to estimate the impact of fiscal policy effect by using only budget deficit. However, it is one of the most reliable and measurable indicator which has an impact on economic growth. On the other hand budget deficit has an impact on all the macroeconomic variables and at the same time macroeconomic indicators affects budget deficit or budget balance (Risti et. al., 2013). It is indicated by many studies that there is a relation between budget deficit and economic growth; however the impact of budget deficit on growth is directly related according to the source of budget deficit (Kneller et. al., 1999). Mainly increase at productive spending and non-productive spending will result with budget deficit but would have different impact on economic growth.

Economic instability has become one of the biggest structural problems of North Cyprus. However budget deficit has to be considered as a main problem for the economy. The source of the budget deficit could be explained either with inability of collecting taxes or high government spending or both of them. But it does not matter what would be the answer the problem is common for each case: the result is budget deficit. For North Cyprus this could be explained with being a developing country. As Brender (2008) explained in his study developing countries vote for expansionary fiscal policy, however developed countries vote for low inflation. But high government spending or budget deficit does not always result with negative impact on the economy. If the budget expenditure is too high and if the government use it for productive purposes and not for political interest then the budget deficit could result with economic growth (Gupta et. al., 2005). There is no study which analyzes the reasons of budget deficit or estimates the impact of budget deficit on economic growth or their causal relationships for North Cyprus. There are always political discussions and few academic discussions for the solutions to budget deficit problem in North Cyprus. It is not easy for a country to minimize its budget deficit with a small economy which suffers from isolations and disadvantages in competition like North Cyprus.

This study will use time series secondary data for 28 years (1983-2010). After 2010 the source of data has changed and for the reliability of the study and consistency of the results we prefer not to include 2011-2013. The causal relationship of budget deficit and economic growth in the long run is tested by Granger Causality test and with other econometric methods such as; Dickey Fuller and Augmented Dikey Fuller unit root tests. Autoregressive Distributed Lag approach is also used to estimate the relation between all other variables. While selecting the method we reviewed the literature and summarized it under a table to see the methods and findings. Most of them used panel data for a group of country and some of them analyzed only a country with similar econometric methods. Because North Cyprus has different characteristics then other countries we preferred to analyze individually by using appropriate econometric methods used by other studies.

Keywords: Budget deficit, economic growth, causality, productive expenditure, non-productive expenditure.

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