

Testing the Applicability of the Twin Deficits Hypothesis in Zimbabwe

Robson Mandishekwa, Midlands State University, Zimbabwe

Zachary Tambudzai, Midlands State University, Zimbabwe

Alex Marufu, Midlands State University, Zimbabwe

Corresponding author- mandishekwar@msu.ac.zw/rmandishekwa@gmail.com

Abstract

The concept of the twin deficit hypothesis is fraught with controversy. Some economists argue that there is independence between current account deficits and budget deficit while some believe that the relationship exists but the direction of causality is uncertain. While others say there is causality running from budget deficit to current account deficit and vice versa. The majority of economists trained in the Keynesian thinking are in favour of the twin deficits hypothesis while others are against it but in favour of the contrasting theory, the Ricardian equivalence. The Ricardian equivalence hypothesis, argues that the two are independent. The major objective of the paper is to test the applicability of the twin deficits hypothesis to Zimbabwe. This is premised on the argument of persistent budget and current account deficits obtaining in Zimbabwe. The majority of researches done along this line are not in Southern Africa. A Granger representation alongside co-integration analysis is used in the study. The findings indicate that the twin deficit hypothesis holds using Johansen cointegration and Granger causality based on lag two. The public expenditure overruns should be a thing of the past.

Keywords: Twin deficits, current account, budget deficit, Granger causality, Zimbabwe

1. Introduction

The concept of the twin deficit hypothesis is fraught with controversy. Some economists argue that there is independence between current account deficits and budget deficits while some say the relationship exists but the direction of causality is uncertain and still others say there is causality running from budget deficit to current account deficit. Both theoretical and empirical analyses tend not to agree.

In the Zimbabwean scenario, both economic woes are bedeviling the country. The nation has experienced persistent budget and current account deficits since the time it attained independence in 1980. Statistics revealed by the then CSO show that in that period in less than five years did Zimbabwe experience a current account surplus since it attained independence

Table 1: Five Year Averages Of Budget And Current Account Deficits For Selected Years

Years	1993-1997	1998-2002	2003-2006
Budget Deficit (US \$ million)	-4.9	-32.24	-12513.
Current Account Deficit (US \$ million)	-400.8	-345.4	-363.92

Source: Own calculations based on RBZ annual reports (2005) and (2008).

Table 1 shows that from 1993 to 2006, budget deficit in absolute figures has been going up with an average of -US\$4.9 million in the period 1993 to 1997 and then shot up to an average of -US \$12 513 million from 2003 and 2006. The current account deficit was at a high average of -US\$400.8 between 1993 and 1997 inclusive to a low of -US\$345.4 million between 1998 and 2002 but shot up again to an astounding average of -US\$363.92