

Fiscal Deficits, Current Deficits and Investment: A Panel Cointegration and Error
Correction Approach

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June, 2010

Abstract

This paper applies recent panel data techniques to investigate the relationship between fiscal deficits, current account deficits and investment spending using annual data for 20 OECD countries for the 1975-2008 period. The application of tests for cointegration in heterogeneous panels and panel causality reveals evidence of a long-run relationship and with bidirectional causal effects. Additional estimation is performed using the Pooled Mean Group estimator, which constrains the long run coefficients to be identical, but allows the short run coefficients and error variances to differ across groups, as would be expected in the context of a dynamic heterogeneous panel. The estimation results in two main findings: first, budget deficits are associated with higher current account deficits in the long run; and second, countries that invest more on average, tend to run larger current account deficits.