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Impact of Fiscal Policy on the Macroeconomic Aggregates in Turkey: Evidence from BVAR Model

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Abstract

One of the central tenets of macroeconomics is that fiscal policy can be effective in stabilizing the economy and achieving to the macroeconomic targets. Past few decades witnessed to extensive use of monetary policy tools to this end. There has been, however, a renewed interest in the use of fiscal policy as a stabilizing tool since the onset of the recent Global Financial Crisis. Macroeconomic consequences of government expenditures and revenues and their impacts on the general economic structure have been investigated by various empirical methods in case of several countries and in Turkey as well. In this paper, away from previous studies, the subject is implemented by Bayesian vector autoregression (BVAR) technique. Since it considers the prior information, BVAR method is able to give more realistic estimations compared with other VAR models. Empirical findings reveal that government expenditures and revenues have limited impact on the macroeconomic variables set which includes GDP, inflation, stock market index, external debt and interest rate.

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Keywords: Fiscal policy; macroeconomy; BVAR analysis; impulse – response function; variance.

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1. Introduction

The most important subject of macroeconomics is to develop the proper and efficient macroeconomic tools in order to reach to economic stability and targets. Since the emergence of Keynesian economic paradigm, there has been hot debate as to what these tools would be. The debate which was heavily occurred between Keynesian and Monetarist view, gradually evaluated to comparing the monetary and fiscal policies and trying to prove the advantage of one against the other[1]. There is, however, a common belief that in recent years the monetary policy overtook the fiscal policy in most economies.

After the Oil Crisis in 1970, which is devastated almost the whole world economies, both the developed and developing economies experienced the fiscal imbalance problem. In some countries those financed its deficits by borrowing, the debt-to-GDP ratio increased well beyond the 100%. Such great fiscal quakes which were historically observed only in the aftermath of major wars, forced the policy makers to find answers to the questions below (Alesina & Perotti, 1997):

- How large should the fiscal adjustment be?
- Should one cut expenditures or raise revenues, and more specifically, which components of spending and revenues should one adjust?
- Will fiscal consolidation last, or will it be reversed and will larger deficits soon reappear?
- Will the fiscal adjustment cause a recession?

For long years, Turkey struggles with the problem of the budget deficits and controlling the public expenditure. Due to burdens in tax collection which constitutes the large part of government revenues on one side and expending the large share of the revenues for external and domestic debt servicing, the government does not almost able to pay the salaries. Throughout the 90's, the years full of economic and political instabilities, budget deficits were financed by loans.

After 1980, Turkey's economy experienced significant structural reforms and policy changes, and as a result of liberalization and openness policies the economy became more integrated to the world markets. Nevertheless, due to the lack of proper legal, bureaucratic and institutional infrastructure, the economy was deeply shaken by external shocks. In order to get out of the crises which stemmed from financial markets and then rapidly spread to whole economy, fiscal policy tools were mainly used.

Turkish economy got into the 2000's with a technical and financially supported fiscal accordance program signed with IMF. The program, which depends on exchange rate anchor and aims at to reduce the inflation rate at one digit levels, has been ended by the November 2000 and February 2001 crises that emerged just after the program came into effect, and then floating exchange rate regime has been opted. "Turkey's Transition to the Strong Economy Program" which adopted after the crises and the program signed with IMF in line with the new stand-by agreement by single party government that took power after 2002 election, have constituted the main framework for the later macroeconomic policies. Outlines of this policy can be summarized as; i) tight fiscal policy and reducing the public debt stock, ii) tight monetary policy and a Central Bank policy that depends on open inflation targets, after 2006, iii) structural reforms in banking sector, in order to provide the financial stability (Voyvoda, 2012). Main element of the economic policies that adopted in this period is to increase the noninterest surplus over 6.5% of the GDP (Şimşek, 2007; 53). By this it is aimed to raise the sovereign credit rating by improving the international credibility and reliability of the economy. A decrease in interest rates inducing consumption expenditures as well as stimulating the investments, and hence placing the economy onto a sustainable growth route has been aimed.

Implementation of contractionary fiscal balance measures in order to ensure the public fiscal balance to get rid of the crisis in 2000 and 2001, have helped to decrease the inflation by reducing public deficits and it has facilitated the exit from the crisis. However, these measures have led to a decrease in investment and employment in the real economy and have a negative impact on economic growth (Şimşek, 2007).

[1] Especially throughout the 1960's and 70's, a tough debate has been witnessed which has occured via empirical studies (see Friedman and Meiselman, 1963; Ando and Modigliani, 1965; Andersen and Jordan, 1968; Blinder and Solow, 1974)