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Abstract

The aim of this article is to investigate the link between fiscal deficit and current account deficit which is the high rate of fiscal deficit budget and commonly known as twin deficit or deficits assumptions in the Pakistani economy (Khalil Mudassar, Amjad Fakher, Sajid Ali & Fozia Sarwar 2013); present economy below growing stress in the fiscal and foreign fronts as a output of huge fiscal deficit & current account balance deficit. The error rectification specification is used to find evidence of long-running connection from fiscal deficit to current account deficit. The analysis results suggest that the current account balance deficit can be determined but the fiscal deficit budget balance is very challenging and from deficit to growth rate but through strong policies of the government for imposing direct and indirect taxes which will be strong can reduce the fiscal deficit and growing towards the growth rate of the economy.

Keywords: Twin Deficits, Current Account Balance Deficit, Fiscal Deficit, Direct & Indirect Taxes

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Abstract

The aim of this article is to investigate the link between fiscal deficit and current account deficit which is the high rate of fiscal deficit budget and commonly known as twin deficit or deficits assumptions in the Pakistani economy (Khalil Mudassar, Amjad Fakher, Sajid Ali & Fozia Sarwar [2013](#)); present economy below growing stress in the fiscal and foreign fronts as a output of huge fiscal deficit & current account balance deficit. The error rectification specification is used to find evidence of long-running connection from fiscal deficit to current account deficit. The analysis results suggest that the current account balance deficit can be determined but the fiscal deficit budget balance is very challenging and from deficit to growth rate but through strong policies of the government for imposing direct and indirect taxes which will be strong can reduce the fiscal deficit and growing towards the growth rate of the economy.

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Introduction

The link between the fiscal deficit budget & current account balance is well-known in the "Twin Deficits Assumption or Hypothesis". If the twin deficit hypothesis arises, it means the nation is facing both which is fiscal deficits & current account balance deficits. It means the country's

economy is importing more than it is exporting which is called the current account balance and the government of the country is spending more money than it is generating (Sana Waheed, Muhammad Shahid Akram [2023](#)) which is called fiscal deficit budget. The variation in the fiscal budget policy can be predicted by developments



of the open economy's performance on the current account which remains a notorious problem. A vital aspect of this problem is called a twin deficit hypothesis or assumption, in which the fiscal deficits & current account deficits are very closely linked or may not be linked so that declines are both necessary and sufficient to achieve and improve their performances in the later.

The C.P.I is based on the inflation ratio, which is in April and July and the yearly output is 4.8%; and the C.A.B deficits for the years 2017 & 2018 the fiscal year came and worth was \$19896 million; and the GDP was 6.3% which was published in the surveyed of Pakistani Economic in the 2019". And Pakistan currently going towards transitioning from indirect to direct taxes; as an outcome of these reforms more research will be compulsory on the topic and these sign causes which are 1. political unrest 2. irregular macro-economic policies 3. natural calamities i.e flooding and internal uprising and those which were prohibited in the past and reflected deficits.

Fiscal budget and current account deficits have received much attention over the past decades. When both are unattended it can be extended beyond own nation and also lead to global financial instability and possibly an economic crisis (Mendoza et al., 2007).

The CFY-2024 budget, amounting to Rs 18 trillion, has been crafted with consideration of the current economic challenges both domestically and internationally. It aims to satisfy the International Monetary Fund (IMF) conditions and balance Pakistan's growing fiscal deficit through increased taxation, as the country negotiates a larger, long-term program with the IMF worth USD 6-8 billion to secure macroeconomic stability (Mian Ahmed Naem Salik et al., 2024).

During the current FY Pakistan's fiscal deficit amounted to Rs. 7.283 trillion and also certain decades Pakistan has been running a deficit budget and equally a current account deficit. A fiscal deficit is also known as and when a

government is exceeding its costs as its income. It denotes the differences between the government's total income and its total expenditure in the current financial year of 2024 and also recommends essential increases in both taxes which are direct and indirect; the direct taxes are expected to rise 48% and the other side is indirect taxes by 35% during the financial post-budget. Pakistan's current account deficit had turned "Red". According to a note by the brokerage firm Inter-market Securities a large primary income and current account deficit of \$270 million in the month of May 2024 marked the 1st deficit in a row of four months. This follows a surplus of \$499 million in April 2024. The State Bank of Pakistan (S.B.P) which is indicated that the backlog of dividends had been nearly settled and will reduce the primary income deficit which will be around \$500 million in a couple of months.

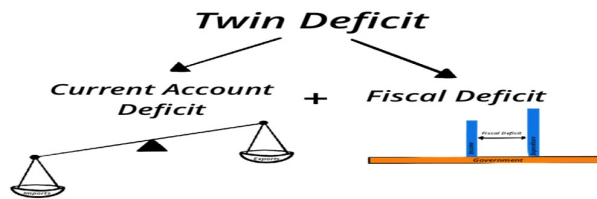
The economic theory about the twin deficits assumptions, which was affected private savings, investment, fiscal budget, and the current account balance (Olga Vyshnyak 2000). The final influence of twin deficits on saving, investment, financial budget, and current account balance depended on how the twin deficits were financed.

The twin deficits which mean fiscal & current account balance deficits, are linked and our nation facing their results in "low revenue growth". This means motionless exports, and increasing imports in other words trade deficit which represents the amount in which the cost of imports exceeds their limits and decreases the cost of exports over a certain time or period.

Fiscal's & Current Account Deficit (Twin Deficits)

The fiscal deficit which means the budget shortage and the current account deficit is speaking about the nation's transferring extra money overseas for their goods and services than it is gaining. And the other side finance experts argued that the twin deficits may be co-related or non-related.

Figure 1



Literature Review

The twin deficit assumptions were declared when the raising of fiscal budget deficit & current account balance deficits may be related or not related to each other. However the output after testing of hypothesis turns out, they be different for many other nations. Moreover, the outputs differ in many cases because of using different econometric methods (Sohail ur Rasheed & Hamna Haq, 2021) and their model specifications for the same country data. Here are the literature reviews of some studies are given:-

Researchers like (Bandy & Aneja, 2019) *Twin deficit & opposite interconnection a case study of China country*, that in this paper examines the inter-connection between the fiscal deficit & current account deficit which is called twin deficits for the Chinese economy. Using the time-chain data over the era of 1985 to 2016. We investigated an imaginary structure obtained from the methods of the Keynesian spending equation and empirically examined the assumptions when using autoregressive distributed lag (ARDL) restrictions testing and the method of Zivot and Andrew (ZA) operational breakdown for testing the twin deficits assumptions. The results of A.R.D.L assured testing approached and give a sign in support of a long-running connection between the achieved variables and authenticating the method of Keynesian assumptions for their country's economy. The outputs of the method of Granger linking examination accept the twin deficit assumptions; these output results recommended that the (-ve) amazement to fiscal deficit and the other side decreases the current account balance

and (+ve) amazement to the budget deficit increases current account balance. However, higher affect development amazements and wide variation in the interest & exchange rates; which lead to deviation of the discrepancies. The interest rates & price increases solidity should be the goal variables of the experts.

Researchers like Hussain et al. (2023) *support twin deficits which the boards of Malaysia, Thailand, Korea South, and country Singapore, and Chunming and Ruo (2015) In a B.R.I.C.S panel 2* that shows there is no connection between the two deficits. Remarkably, these revisions were confirming the Ricardian outcome, Baharumshah et al. (2019) in a board of 14 Asian republics comprising Pakistan. That the employ of bootstrap Granger connection outcome. The authors highlighted the impact of essential halts on the tie between the fiscal deficit and C.A.B. which outcome of the Asian economic disaster in the years 1997 and 1998. Formerly the disaster, the authors found direct interconnection running from the fiscal budget to the C.A.B., and after the disaster, found the reverse interconnection flowing from the C.A.B. to the fiscal budget. In consideration, the analysis demonstrates how the investment and savings influxes which is considerable focus on C.A.B before the crisis, and how fiscal balance hit both investment and savings arrivals in the post-crisis outcome. The influence of the fiscal spillovers on the direction of the links among both deficits has been recently revealed by Gays-set et al. (2019). The board of southern Europe, Middle East, and also North Africa (M.E.N.A) areas. The revision validates the straight opinions of the assumptions in the example of Europe whereas the

observations were reverse causality in the case of M.E.N.A areas. The revision and their extra proof that the significance of fiscal spillovers from the fiscal merging in the additional regions are 1. Germany 2. European Monetary Union is the deficit region of southern Europe and the M.E.N.A areas. The arrangement of South Asian countries and Rajakaruna et al. (2021) examine the effect of a country's community debts on its deficit connection. In those studies, they validate a statistically significant which is a non-linear connection between the fiscal deficit and the C.A.B; which will be conditional on the public debt levels.

Researchers like, *Tahir Mukhtar et al. (2007) Observed Research which was on The Twin Deficits assumptions In Pakistan*, the studies showed that the query of the connection between budget and current account balance deficits started to draw the attention of researchers in the era of the 1980s, which they recorded the fiscal budget deficit (F.B.D) & the current account balance deficit (C.A.B.D) begun in many countries and also United States was included. Both fiscal and current account deficit assumptions when they increase in the budget deficit then also cause parallel increases in the current account deficit. However, the outcome of testing these assumptions turned out differently for the other countries. Furthermore, the outcomes were differing even in the case of using different econometric methods and model specifications for the similar country's data(s). The existing study does not comprise all studies of the twin deficits difficulties, but we could see that the issues were interesting and had different outcomes for different countries when different econometric methods. After that as much investigating is needed whether the statistical link between the fiscal deficit & current account balance deficits in Pakistan. After showing that both are unidirectional or bidirectional and both variables did not influence each other to recognize the

linkage among both time series, long-run equilibrium (cointegration) and Granger link examinations were engaged.

Methodology:

Research Design and Data Sources

This research or investigation is based on secondary data collection which is centered on utilizing essential and additional information. The essential and additional information is gathered from national and international data banks and also various diaries, websites, books, and so on to facilitate this research study and develop the graph of models to analyze the Current Account Deficit and Fiscal (Income & Expenditure) Deficit time series data.

Methodology

The annual time series data is used for study from an international data bank because annual data provides more significant results. The time series data is selected in percentage of GDP.

Model Specification:

Current Account Balance

The scientific equations allowed defining the deficit of current account balances. Which will be expressed to us via the current account is in excess or in deficit (credited or debited). After that will support an understanding of where some differences are shown and may be curtailed and how expedient may be simplified to acknowledge an improved functioning of the economy.

Data taken from year 2000 to 2023 from World Bank data;

$$C.A.B=(X-M)+(NY+NCT)$$

Whereas:

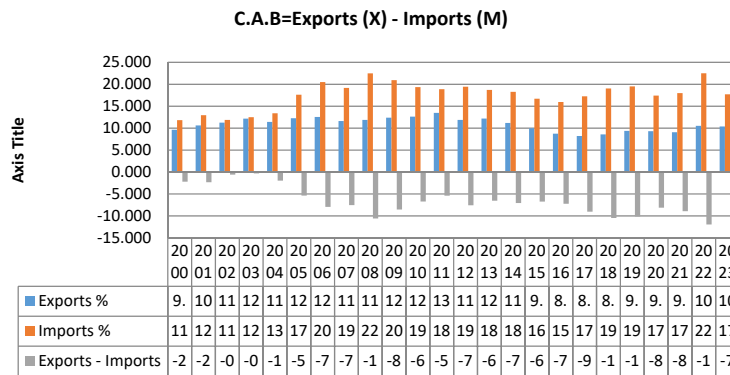
X=LessExports of goods & services

M=MoreImports of goods & services

N.Y=Abroad Net income

N.C.T=Net current transfers (only abroad)

Figure 2



"Essentially, explore is sought after to break down numerical data points for the most part about the current account balance which is explained in the examination and concerning that the Exports and Imports after applied the equation of the current account balance which was $(X-M)$ where the X shows Exports & M shows Imports then the result of government's imports are higher and the result of government's exports are very low; which means exports is lower than the imports.

Where:- $(NY+NCT)$

"Explore sought after the break down numerical data for the most part about the current account balance which is explained after the

examination concerning that the income of government is in downward (negative) but the Net-current transfer to the government is higher than its net-income showing in the above column graph after applied the equation of the current account balance which is $(N.Y+N.C.T)$ where the $N.Y=$ Net-income & $N.C.T=$ Net Current Transfer then the results of the government's Net-income is very lower and also showing in the graph downward which is "negative" than it is very much higher Net Current Transfer which is in "positive".

Then now $C.A.B=(X-M)+(N.Y+N.C.T)$

Figure 3

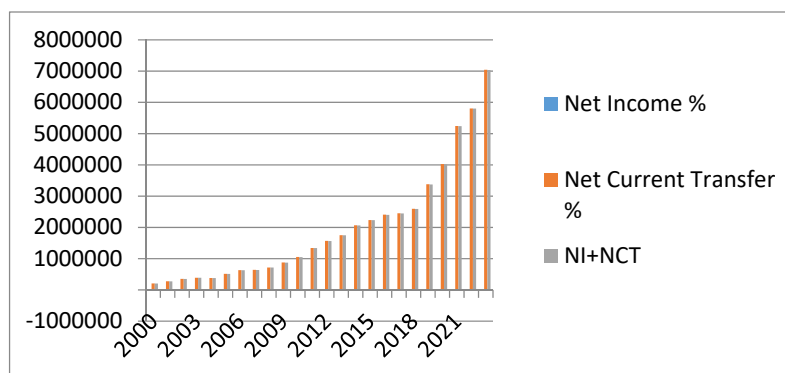
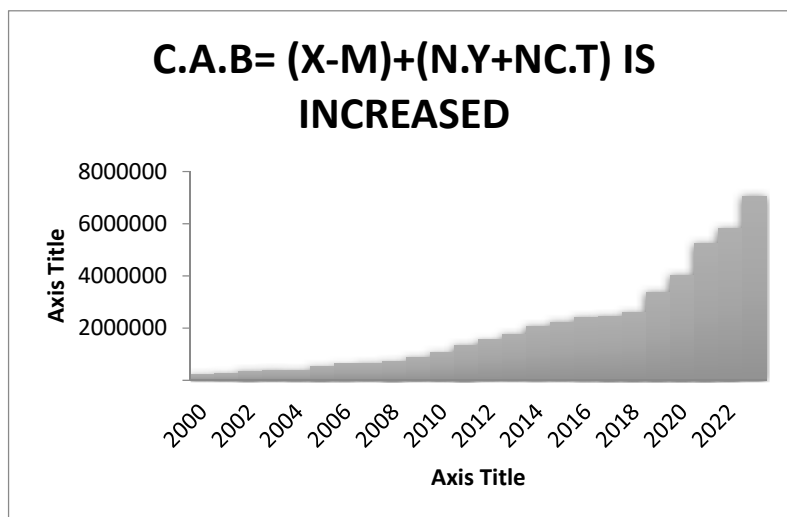


Figure 4



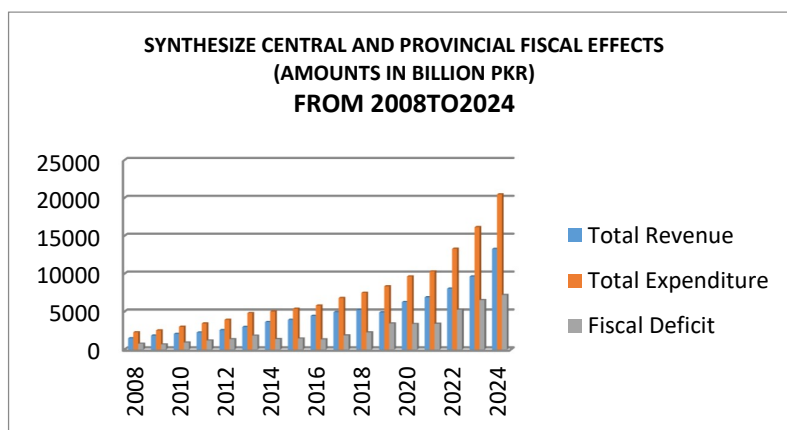
“Explore is sought after to break down numerical data for the current account balance which is explained after the above two different parts of equation's the examination concerning that the current account balance of government is positive/increase.

Fiscal Deficit

The fiscal or budget deficit differences between the total revenue and total expenditure of a government in a current financial year the fiscal deficit arises when the expenditure of any government is more than the generated revenues by the government is called fiscal deficit or budget deficit. Our country is associated with the lawful

divisions of taxation rules between the National Government and 04 provinces and the revenue sector of the Central Government is the Federal Board of Revenue which collects more than 80 percent of the total national levy collection sector. The government's revenue largely came from two sources of collection 1. taxation and 2. Non-taxation revenue. Levy in which income taxes, sales taxes, and customs duties but Non-tax revenue collection is strong matches since state enterprises and excess profits since the State Bank of Pakistan's & royalties which was on oil & gases and supplementary pay considerably to the government's defined rules and ideologies.

Figure 5



"Explore is sought after to break down numerical data for the most part about the fiscal deficit which is explained after the examination concerning that the Total Revenue of government is much lower than its Total Expenditure, and the total expenditure is more than its total revenue so we can say that government is in fiscal deficit.

Furthermore, the overall revenue incomes were raised at a moderate speed of 10.1 percent in the F.Y. of 2021 as related to the outstanding growth of 28.0 percent in the F.Y. of 2020. That decline in the revenue growth which was recognized as the acute decline in non-tax collection reasonable to levy revenues throughout the stages is following under revisions

Table 1

Financial Year	Overall, Fiscal Deficit.	Overall Expenditure			Overall Revenue.		
		Total	Current	Development/ ¹	Total Rev.	Tax/ ²	Non-Tax/ ⁻¹
F.Y2016	4.10	17.70	14.30	4.0	13.60	10.40	3.20
F.Y2017	5.20	19.10	14.60	4.70	13.90	10.40	3.50
F.Y2018	5.80	19.10	14.90	4.10	13.30	10.80	2.50
F.Y2019	7.90	19.10	16.20	2.80	11.20	9.70	1.50
F.Y2020	7.10	20.30	17.90	2.50	13.20	9.30	3.90
F.Y2021	6.10	18.50	16.30	2.40	12.40	9.40	2.90
F.Y2022B.E	6.30	22.60	19.20	3.50	16.30	12.0	4.30

Source: Pakistan Economy Survey 2021-22, P#63

Hypothesis

1. The fiscal budget and current account deficit are correlated yes or no.
2. How the twin deficit impact on our economy.
3. How the twin deficit will be financed.

Conclusion

The objectives of this revision were to research the "pros and cons" (Sumaira Saeed, M. Arshad Khan, 2012) of the twin deficit assumptions and highlight their issues regarding Pakistan's economy and take necessary steps and imposed strong policies, uncertainty the C.A.B is in deficit then the basic reason is that to reduce on the domestic consumptions and more spending on imports it means a tight fiscal policy or higher taxes have arisen; then must apply crosswise strategies to increase the cheapness of our domestic industries and exports items (Daniel Sakyi, Eric Evans Osei Opoku 2016). The second

one is the fiscal deficit in Pakistan which means the basic direction is to promote economic growth; where economic growth is a fundamental solution to the debt problems. Policies should focus on enhancing skills in Information Technology, productivity, innovation, and access to the international markets, as these factors contribute to increasing the government's revenues and reducing the relative size of the debt as a percentage of GDP. And now Pakistan's GDP expected at the end of year 2024 will be \$347.17 billion according to the "Trading Economics Global Macro Models" and specialists expectations. Furthermore, the Pakistani currency has been depreciating since the 1970s in the international market, and also exports have not increased due to several limitations. After the key policy implications in the duration of the twin deficit assumptions that can be a strong need our exports will be more competitive when we access the international markets.

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