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The Link Between Budget Deficits and Income Inequality in Turkey

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ABSTRACT

Turkey has had an episode of rapidly increasing public debt to GDP ratios due to roaring budget deficits throughout the 1990s and the early 2000s. Bonds issued by the government to finance annual budget deficits drove down the price of bonds and increased interest rates because of the inverse relation between the two. Increased supply of bonds have made them both increasingly affordable (due to the resulting decline in their prices) and attractive (due to increasing returns) for the wealthy with high savings. As a result, wealthier sections of the society became even wealthier because of the high interest income and high returns to the bonds they purchased. After the restoration of fiscal discipline through the stabilization program introduced after the 2001 crisis, there has been a remarkable contraction in budget deficits leading to a significant decline in debt to GDP ratios and interest rates thereby causing a reduction in the interest earnings of the wealthier sections. It appears as though the restoration and maintenance of fiscal discipline have facilitated an improvement in income equality, albeit as an indirect consequence of the stabilization program. The purpose of this paper is to fill a gap in the literature by studying the link between income inequality as measured by the Gini coefficient and the public debt to GDP ratio empirically in the context of Turkish stabilization experience of the 2000s. The analysis is based on the raw data provided by the National Household Labor Force Survey (HLFS) and the National Household Budget Survey (HBS) published by the Turkish Statistical Institute (TURKSTAT) and the Central Bank of Republic of Turkey from 2000 to date. The paper concludes with a discussion of the policy implications of the results, and suggestions for further research.

KEYWORDS Budget Deficit; Income Distribution; Stabilization

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