THE ROLE OF SAVING IN THE U.S. TWIN DEFICITS

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dx.doi.org/10.18374/JIFS-15-1.4

ABSTRACT

The paper examines the role of insufficient saving as the first phase in the entire process of the twin deficits hypothesis. A simple DSGE model with two expectations components is adopted to analyze the effect of consumption, saving, private debt, government debt, interest rate on government deficit, and current account deficit. Based on the quarterly U.S. data from 1990 to 2012, results indicate that lagged by one quarter change in private saving, household consumption, and public debt are destabilizers for contemporaneous changes in U.S. federal budget deficit. However, private saving becomes a stabilizer while consumption is still a destabilizer in the case of contemporaneous changes in current account balance. In magnitude, consumption expenditure has more weight than personal saving in both deficits. Keywords: private saving, twin deficits

Keywords: *Saving deficit, DSGE*