Fiscal Solvency and Currency Crises: 
The Short-Term Debt Flows Perspective

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Abstract

This paper analyzes the mechanism of the price level determination (the nominal exchange rate) over Turkish currency crises of 2001 and within the fiscal theory of price level (henceforth FTPL) framework emphasizing the role that the nature of the fiscal regime played by the intermediation of short-term debt inflows. We assess whether the latter has an impact on the determination of the price level and we show that the interdependence between international capital markets make national fiscal policies dependent on international investors' expectations and hence leads to fiscal regimes of non-Ricardian nature. This type of fiscal rule has an impact on the determination of the price level. We discuss the destabilizing role of debt flows even if the national fiscal policy has the Ricardian nature. Our approach differs from previous studies in the following respects: (i) the inclusion of the link between the short-term debt flows and the public debt relative to FTPL literature, (ii) the specification of the emerging market economy relative to the currency and financial crises literature, (iii) the distinction between the foreign and domestic bond holders in the setting of the model relative to the open-economy applications of the FTPL literature.

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