
Lessons from Thailand's Fiscal Policy*

Bhanupong Nidhiprabha

Faculty of Economics
Thammasat University
2 Prachan Road
Bangkok 10200
Thailand
bhanupong@econ.tu.ac.th

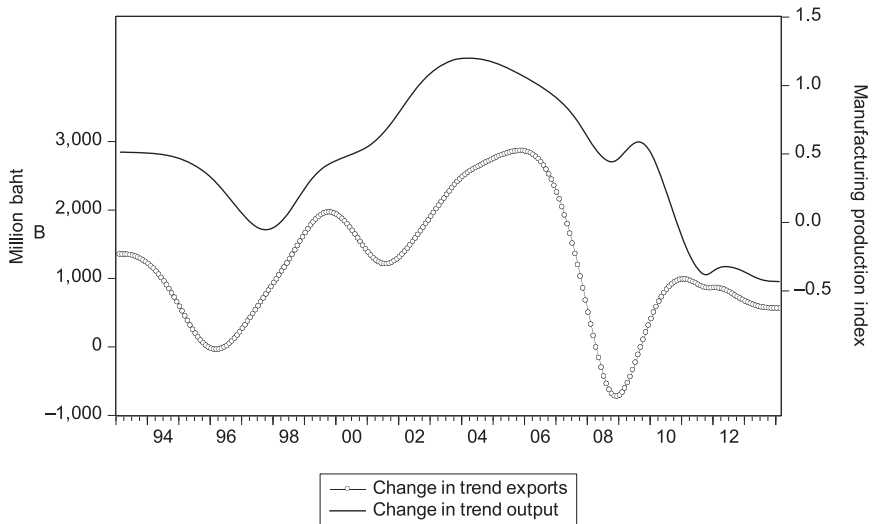
Abstract

If rules of fiscal sustainability are observed, available fiscal space permits effective countercyclical fiscal programs. The importance of automatic fiscal stabilizers should not be underestimated. The discretionary impact of increased public spending and tax cuts can be amplified if implemented when consumer confidence investor sentiments are high. There is no evidence to support non-Keynesian effects of fiscal policy in Thailand. Unwarranted fears of unsustainable public debt and ultra-conservative fiscal policy has cost the country a lost opportunity for achieving high growth. After the military coups in 2006 and 2014, the Thai economy experienced the lowest economic growth among ASEAN countries. The budget spent on economic services was diverted into defense, increases in public sector's wages, and income transfer payments. The opportunistic political budget model predicts higher fiscal spending by incumbent democratic governments before an election to gain votes. In the case of Thailand, such spending comes after military coups, akin to a military business cycle spending.

I. Introduction

Most export-led-growth Asian countries that suffered from the global financial crisis between 2007 and 2009 used expansionary fiscal policies to counteract the shortfall in exports. In developing countries where monetary policy instruments have some limitations, fiscal stimulus is the only policy measure available to compensate for declining exports. In 2008, Thailand's exports increased 16 percent, despite the ongoing global recession that began in 2007, because of a temporary commodity boom and the global food crisis. Thus, from 2002 to 2008, Thailand's exports trended upward. When the global financial crisis (GFC) finally hit the Thai economy, however, exports declined 14 percent in 2009, when domestic investment and consumer spending were also subdued. Thus the contraction of external and internal demand reduced Thailand's real GDP growth to 2.3 percent in 2009, the lowest growth rate since the massive output contraction of 10 percent in the aftermath

* The author wishes to thank Maria Monica Wihardja and Taeyoon Kim for their helpful comments.

Figure 1. Changes in trends of exports and manufacturing output index

Source: Bank of Thailand.

of the Asian financial crisis (AFC). The 1998 recession was short-lived, despite the massive drop in the value of financial assets during the meltdown of financial institutions. It was the rapid growth of exports spurred by currency depreciation that restored growth. Because the AFC did not spread to the rest of the world, Thailand was able to export its way out of recession through massive currency depreciation. But the global trade environment was different in 2009, when developed economies reduced their imports from Asia. Households in high-income countries were trying to restore wealth through raising saving and subsequently reducing imports. Furthermore, appreciation of the baht caused by quantitative easing in the United States made it difficult for Thai exporters to reap the same benefits used in the aftermath of the AFC. During the 2009 GFC, there were doubts about the Asian traditional model of export-led growth as it was recommended that Asian countries should depend less on exports and pay more attention to the role of domestic demand to reduce the negative impact of world business cycles.

Deviation from the long-term growth path is shown in Figure 1. The boom and bust cycles are depicted as changes in trends of exports and manufacturing output index. The boom in the early 1990s was followed by growth collapse after the 1997 AFC. It took seven years before the output regained its pre-shock level in 2004. Since then, output had risen above the trend path until it contracted by 0.7 percent in 2008. A V-shaped recovery of exports by 27 percent in 2010 led to GDP growth of 7.5 percent. Export growth continued sliding down to 3 percent in 2012, contracting by 0.1 and 0.3 percent in 2013 and 2014,

respectively. Because of the poor export performance, GDP growth declined to 2.8 and 0.6 percent during the same period. The gyrating growth rate seems to suggest a failure of macroeconomic policy in stabilizing the growth path. The average growth rate of GDP between 2000 and 2008 was 5.1 percent, compared with 3.1 percent between 2009 and 2014. Thus macroeconomic policy, in particular fiscal policy, failed to stabilize growth and maintain a high growth path.

This paper examines whether fiscal policy could have been used to stabilize short-term fluctuations of output and maintain price stability in Thailand. It focuses on the relationship between fiscal policy and macroeconomic variables and explains why there is no evidence of the non-Keynesian effect of fiscal policy. In other words, there is room for fiscal policy to stabilize growth. Section 2 discusses the relationship between growth and fiscal variables. Section 3 highlights the role of fiscal automatic stabilizers in stabilizing growth and Section 4 examines Thailand's rules for fiscal sustainability and fiscal space. Sector 5 analyzes the short-run impact of fiscal expansion on growth and price levels. Concluding remarks and lessons from Thailand's fiscal experience are provided in the last section.

2. Thailand's fiscal stance

The role of domestic demand must be emphasized. In particular, if domestic investment and consumption are weak as a result of uncertainties and pessimism, the government must immediately stimulate output demand by applying appropriate fiscal and monetary policies. When the world economy recovers, however, public spending must return to its normal pattern observed before the GFC. The collapse of exports in 2009 can be thought of as a temporary shock and the long-term output level should not be affected once exports return to normalcy. The export shortfall in 2012 was mainly due to the supply shocks caused by floods in late 2011, disrupting the supply chain of manufacturing production. Because of political turmoil and the 2014 military coup, investment uncertainty and pessimistic consumers further aggravated the contraction in domestic demand. In 2013, the number of international tourists increased by 18.6 percent, but declined by 6.7 percent in 2014 as a result of political turmoil. The military-led government failed to spur growth because of the low speed of fiscal spending and deteriorating business and consumer confidence.

In the past decade, the Thai government did not use discretionary fiscal policy to stabilize growth. The size of the government (measured by public spending) between 1996 and 2013 averaged 18.9 percent of GDP, whereas the average public revenue was 16.6 percent of GDP. During this period, the average budget deficit was 2.4 percent of GDP, which was relatively small and manageable. The average deficit was reduced from 4.2 percent of GDP between 1966 and 2003 to 1.3 percent between 2004 and 2013. Nevertheless, public spending as a percentage of GDP increased gradually after 2003. There was no sign

of countercyclical fiscal actions, unlike the period between 1996 and 2002. During that period, there were discretionary policies applied in response to the economic recessions in 1998, 2001, and 2009. In 1999, the spike in public spending was attributed to spending on economic services. In 2002, the sharp increase was due to spending on general public services, whereas in 2009, a defense spending hike raised public spending to 19.6 percent of GDP.

Authorities have less leeway in the short-run to curb government spending as fiscal policy is more persistent than responsive to economic conditions (Afonso, Agnello, and Furceri 2010). Less discretionary and more responsive fiscal policy reflects weak institution capability. For example, unstable Thai governments are incapable of using countercyclical fiscal policy measures because the country has been in a state of political turmoil with a lack of the rule of law. Nevertheless, the lack of discretionary fiscal policy can be partly offset by automatic fiscal stabilizers.

Since 1996 Thailand's fiscal policy has been countercyclical on the revenue side. Public revenue is countercyclical because of automatic tax stabilizers. The AFC and GFC caused Thailand's growth collapse, leading to a decline in tax revenue and increased budget deficit. On the other hand, the booms were associated with surplus budget, as tax revenue increased in line with buoyant economic activities.

A severe contraction in aggregate output demand led to a deep recession in 1998, causing revenue reduction and the subsequent budget deficit. Similarly, in 2009, a mild recession resulted in an enlarged budget deficit, which is a stabilizing feature of countercyclical fiscal policy. With growth acceleration, budget deficits tend to decline. Hernandez de Cos and Moral-Benito (2013) argued that successful fiscal consolidation to reduce budget deficits and public debt requires growth-enhancing policies and cuts in public wages. If the government raises public wages in line with the rising price level, it will be difficult to curb the budget deficit.

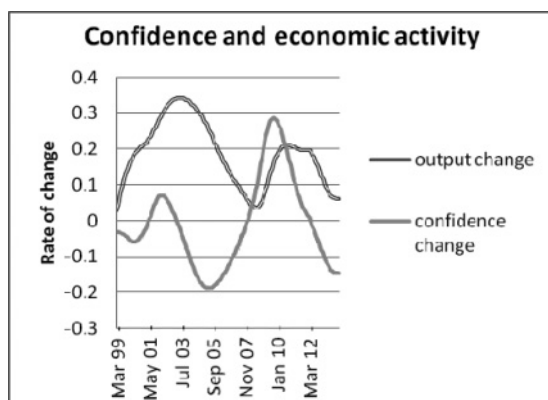
In general, price stability is not a major concern for Thai policymakers. Between 2000 and 2014, headline inflation averaged 2.6 percent. Inflation exerts its impact on public revenues and expenditures. Therefore, the fiscal budget moves in line with inflation, as illustrated in Table 1 where the inflation rate is positively related to the size of fiscal surplus. In the period 2000–12, the correlation coefficient between fiscal surplus and inflation rate was 0.65, because higher price levels led to higher tax revenues through bracket creep as well as higher corporate income tax revenues.

From 1990 to 2012, fiscal surplus was negatively related to current account surplus (Table 1). A current account deficit brings in more customs duties as imports increase thereby implying that deteriorating external balance does not exacerbate fiscal position.

Table 1. Correlation coefficients of fiscal surplus (% GDP)

Period	Growth	Inflation	Current account surplus
1990–2012	0.66	0.55	–0.83
1990–99	0.81	0.21	–0.87
2000–12	0.44	0.65	–0.53

Source: Calculation is based on data from the Bank of Thailand.

Figure 2. Confidence and economic activity

Source: Bank of Thailand.

Strong GDP growth leads to higher imports and a current account deficit. As a result, high GDP growth is associated with a strengthening fiscal position, with coefficients of correlation of 0.81 in the period 1990–99 and 0.44 in the period 2000–12 (Table 1). The decline in the correlation coefficient reflects continued trade liberalization.

A coincident index is constructed by the Bank of Thailand to measure ongoing economic activities. The index includes the following variables: manufacturing production index, value added tax (which reflects consumption), imports, and sales of automobiles. These variables are mainly determined by permanent income or expected income partially formulated by the level of consumer confidence and business sentiments. Figure 2 illustrates the lead–lag relationship between changes in the coincident index, representing economic activity, and changes in business sentiment index, which indicates changes in confidence levels. When consumer confidence started deteriorating in March 2002 and September 2009, economic activity slowed considerably afterwards. Utilizing data from 1999 to 2013, we find strong statistical evidence that the confidence change variable Granger-causes changes in coincident index. In other words, economic activity is affected by changes in investment sentiment. Therefore, it is critical to enhance business confidence and avoid shocks that incur premium risks for the private sector.

It is argued here that fiscal policy is more effective when consumer and investor confidence is strong. On the other hand, when business sentiment is low, the expansionary impact of fiscal deficit will have a minimal impact on the economy. The fiscal multiplier effect will be reduced if investors and consumers decide to postpone their investment during periods of uncertainties and risks. Fiscal stimulus utilized at the time when the level of confidence was lowest in 2005 and 2013 could not have been effective, compared with its use during a normal period. One might argue that a budget deficit can help to improve business confidence and therefore should be used during recessions. On the other hand, running a large budget deficit could lead to loss of confidence as the enlarging budget deficit would further lead to a huge public debt and the inevitability of a tax hike in the future. Whether running a budget deficit can reduce or raise business confidence depends on the public perception of public debt sustainability and the size of budget deficit. The non-Keynesian effect of fiscal stimulus will not be the case in Thailand because of the low level of public debt and fiscal deficit.¹

3. Automatic fiscal stabilizers

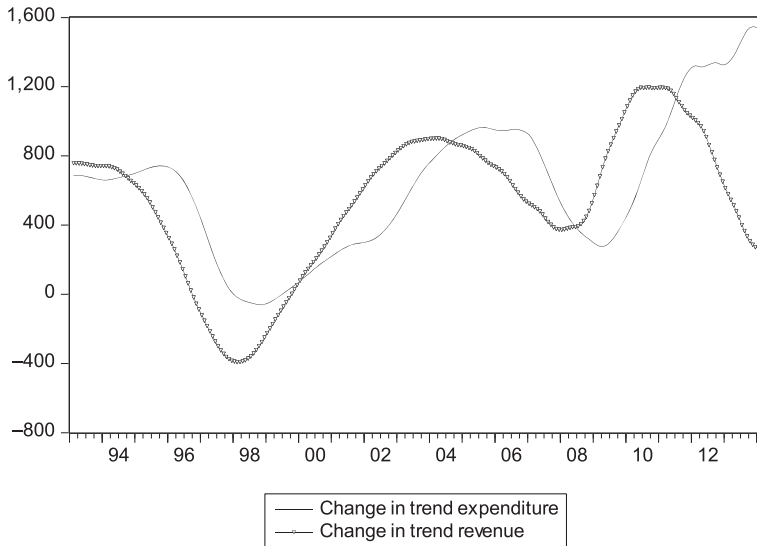
By removing cyclical components from the levels of actual public expenditure and revenue and utilizing monthly data from January 1993 to December 2013, we can obtain the long-term trends of public expenditure and revenue. Using the first difference of these trend variables, we can approximate patterns of fiscal stance, which reflects the outcome of discretionary fiscal policy and automatic fiscal stabilizers (Figure 3).

It is possible that increased revenue leads to higher public spending and vice versa. On the one hand, if public goods are normal goods, rising GDP per capita would imply an increase in the demand for public goods. On the other hand, governments may want to spend first by issuing bonds or printing money, but eventually they have to raise taxes. Thus, the causation can run both ways between tax revenue and public spending.

Using monthly data from January 1993 to December 2013 to examine whether taxation leads to public spending, we find that government spending Granger-causes taxation and vice versa. The finding indicates that Thailand's fiscal policy was conservative because spending was constrained by tax capacity. The reason behind this fiscal prudence is related to conservative fiscal policy and budgetary laws.

Fiscal stimulus can also be carried out through tax reduction together with increased spending. In this case, the impact on fiscal burden and public debt will be larger. In

¹ From 2000–14, the budget deficit averaged 1.6 percent of GDP. If taxpayers are ultra-rational and forward-looking, a fiscal stimulus can lead to a non-Keynesian result of fiscal policy: output contraction (expansion) because of fiscal deficit (surplus). See, for example, Giavazzi and Pagano (1990).

Figure 3. Fiscal stance: Structural changes in trend fiscal variables

Source: Calculation is based on data from the Bank of Thailand.

theory, tax financing is less expansionary than bond-financing a budget deficit. If bonds are net wealth and wealth has a significant impact on private consumption, a bond-financed budget deficit can lead to a more expansionary impact because of enhanced spending due to holdings of more government bonds.

The military-led government is attempting to sell government bonds in 2015 to finance the budget deficit. Because some of the proceeds from selling government bonds will be used to finance increases in current expenditures, instead of capital expenditures, there will be a question of the burden of public debt for future generations.

Discretionary fiscal policy can be delayed because of information and decision lags as well as implementation lags caused by the lengthy parliamentary process of budget approval. If a country has established fiscal automatic stabilizers, fiscal policy can be stabilizing as it does not have to depend on a long-delayed budgetary process. Let's examine the role of automatic stabilizers in both revenue and expenditure when they change in response to changes in output and prices. Cointegration analysis indicates the existence of long-run relationships between fiscal variables, output, and the price level.

Public spending responded to output and price levels. On the revenue side, inflation did not significantly lower the tax revenue, while output growth raised it. The revenue output

**Table 2. Revenue and expenditure elasticities
(Jan 1993–Dec 2013)**

	Price elasticity	Output elasticity
Revenue	0.65	0.72
Expenditure	1.51	0.33

Source: Estimated coefficients obtained from running a double-log regression of revenue and expenditure on manufacturing production and consumer price indexes.

elasticity is 0.72, which is greater than the estimated expenditure output elasticity of 0.33, implying that tax revenue rises faster than expenditure when output expands (Table 2). This is a feature of automatic tax stabilizing during the course of economic expansion. During the economic downturn, revenue falls faster than expenditure; therefore budget deficit is rising when output contracts.

The revenue price elasticity is 0.65, and the price elasticity is 1.51. This finding has an important policy implication: Running a fiscal deficit tends to be destabilizing during high inflation. It is imperative that public spending be controlled during high inflation to avoid giving more inflationary pressure to the economy. Inflation can be spiraling if the government wants to maintain the level of spending in real terms. The fiscal sustainability is threatened if inflation is triggered by rising prices of energy and food. This precarious situation produces output contraction and further raises the price level.

4. Rules for fiscal sustainability

If the primary deficit cannot be contained, public debt will continue to rise and threaten the sustainability of the fiscal system. To stabilize the debt-to-GDP ratio, the primary deficit must be cut and the GDP growth rate must exceed the real rate of interest. Thus, during economic recessions, the government must ensure that fiscal stimulus can bring about an economic growth rate that is higher than the real interest rate. The ceiling on the debt-to-GDP ratio was reduced from 60 percent to 50 percent in 2004, reflecting the conservative fiscal ideology. But the fear of the GFC prompted the government to raise the ceiling back to 60 percent in 2009. Nevertheless, Thailand's actual debt-to-GDP ratio has never hit the debt ceiling. The gap between the ceiling and actual level of debt-to-GDP ratio indicates fiscal space, which allows the government to pursue debt-financing the budget deficit to spur growth.

Because high debt causes a rapid rise in interest payments, another rule of fiscal sustainability was institutionalized by imposing a ceiling on debt service as a percentage of total budget. In 2003, the ceiling was made more stringent by lowering the maximum debt service from 16 percent to 15 percent. The Thai government was able to control the debt

service within this ceiling. The high liquidity in the money market during economic downturn enabled the government to borrow at a low rate of interest. As far as foreign debt is concerned, the debt-service to exports ratio declined while exports grew rapidly in the last decade. The total debt-service ratio declined from 8.2 percent in 2008 to 4.9 percent in 2014, while the public sector's debt service ratio averaged 0.7 percent during the corresponding period.

The structure of government spending matters for long-term growth. If a large part of government spending is on current rather than capital spending, it would be very difficult for the government to curtail total spending as it would affect the social welfare of those who are used to receiving such benefits.² On the other hand, if a large portion of expenditures falls into capital goods, it would be relatively easier to reduce the budget deficit in the future. Fiscal flexibility will be impaired with a higher proportion of current expenditure in the total budget. The political economy of fiscal spending involves when the government has to choose between capital goods and consumption goods, which include military hardware.

Public investment in infrastructure projects can increase productivity in the private sector and enhance the economy's long-term growth. In particular, public investment in transportation and communication has a natural high rate of return to the economy. Such investment is complementary to private investment. Therefore, increased public investment has a crowding-in effect. In contrast, high public consumption relative to public investment can retard growth. Empirical evidence from cross-country investigations indicates that growth can be jeopardized if public consumption increases faster than public investment. Butkiewicz and Yanikkaya (2011) found that total expenditures have negative growth effects for some developed countries. In developing countries with ineffective governments, consumption expenditures produced a detrimental growth effect, but there would be growth impact provided by capital expenditures. Yoshino and Mizoguchi (2010) argued that Japan's strong growth period (1950–85) can be attributed to public investment, which had positive impacts on output and tax revenue. After the asset bubble burst in the 1990s, however, fiscal stimulus through bond financing was not able to revive growth to previous levels while large public debt has become unsustainable.

Thailand's rule of fiscal sustainability also focuses on the long-term growth. It imposes a minimum level of public investment, requiring that it must not fall below 25 percent of the total budget. Since 2008, however, the budget allocated to public investment has fallen below the required level. The share of capital spending was 35 percent in 1997, declining steadily to 9 percent in 2013. With depreciation of existing public capital stock, the net

2 Claus, Martinez-Vazquez, and Vulovic (2013) found evidence from 150 countries that tax systems tend to be progressive, but government expenditures are a more effective tool for redistributing income.

public investment would not be sufficient to raise public capital stock. Consequently, the long-term growth of the Thai economy has been adversely affected by the declining share of public investment. In the short-run, we will not see the impact of a slowdown in public investment as the tradeoff between output and future consumption will become apparent in the forms of sluggish growth, low productivity, and deteriorating international competitiveness in the longer term.

Using data on 42 developing countries from 1975 to 2001, Vergne (2009) finds evidence that election-year public spending shifts towards more visible current expenditures, in particular wages and subsidies, and away from capital expenditures. Ehrhart (2013) investigated panel data from 56 developing countries over the 1980–2006 period and concluded that indirect tax revenue in election years is estimated to be lower by 0.3 percent of GDP than in other years. His result supports the opportunistic political budget model. Viewed in this light, fiscal variables are affected by political and economic factors. Fiscal sustainability is ensured if rules and regulations are strictly observed but a time inconsistency problem can occur in conducting monetary and fiscal policy. Governments and people who are receiving the benefit of present consumption through populism programs are happy in the short-run, but in the long-run, fiscal policy that departs from the rule of adequate capital spending will retard growth.

For Thailand, there was no specific election year, which varies according to the years of military coups and the length of time spent on drafting a new constitution. But it can be observed that current expenditures, in particular defense spending, increase after the military coups. Too low of a military budget may lead to overthrowing a democratic government.

Yakovlev (2007) provides empirical evidence that an increased defense budget at the expense of budget for other development goals can be detrimental to economic growth. Similarly, Hou and Chen (2013) applied the Augmented Solow Growth Model to examine the influence of military expenditure on economic growth for 35 developing countries over the period 1975–2009. The empirical results from the system of Generalized Method of Moments estimators indicate that defense expenditure has a negative and significant effect on economic growth.

In 2014, Thailand's military-run government proposed a purchase of submarines for protecting natural resources and preventing human trafficking in the Gulf of Thailand. The detrimental impact of increased defense spending on long-term growth is imminent when the share of public expenditure on economic services declines, as happened after the 2006 military coup (Nidhiprabha 2009a). While Thailand's fiscal budget for the fiscal year 2016 increases by 5.6 percent, the government allocated US\$ 6.3 billion to defense expenditures, an increase of 7 percent from the previous fiscal year, representing

1.5 percent of GDP. The rise and fall of the share in defense spending is akin to a military business cycle. It increases after the coup, and declines after a democratic government is elected.

5. Short-run impact of fiscal policy

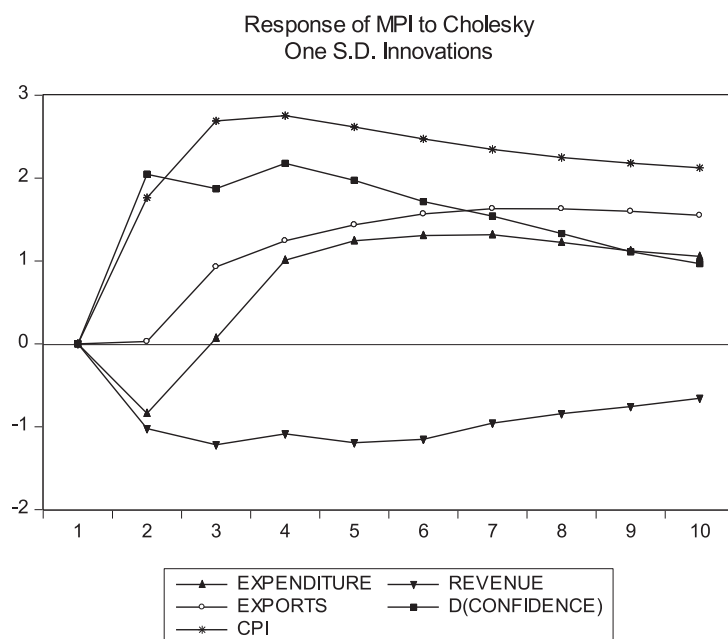
During the 2008–09 GFC, fiscal policy was called upon to stimulate domestic demand during the period of ineffective monetary policy measures, which were caused by zero lower-bound interest rates. If the short-term expansionary impact of fiscal policy is large, then it would be appropriate to stimulate the economy using tax or public spending measures. But we also need to consider conditions for enhancing aggregate demand to maximize the efficacy of fiscal policy.

A vector autoregression model is used to evaluate the short-term impact of Thailand's fiscal stimulus. The vector autoregression model utilizes monthly data from May 1999 to February 2014. The model uses six variables: output (represented by the manufacturing production index), exports, public expenditure, public revenue, consumer price index, and change in Business Sentiment Index. All data are obtained from the Bank of Thailand and the Thai Ministry of Commerce.

The impulse response function reveals that the impact of fiscal policy stimulus has an expected outcome: Increased government spending leads to higher output, and increased tax revenues lead to output contraction (Figure 4). Thus, countercyclical policy can be carried out effectively by fiscal stimulus during recession and fiscal consolidation can be used to cool down an overheating economy. Output expands more in response to increasing exports than to increasing public spending. A simultaneous tax cut and expenditure hike can be very powerful when the economy is experiencing a decline in exports caused by a global recession. Because of its expansionary impact on output, running a budget deficit during an economic slowdown is not as dangerous as it seems.

The finding from the impulse response of output to fiscal spending is consistent with the results reported by Agnello, Furceri, and Sousa (2013). Using panel data of 132 countries from 1960 to 2008, they found that discretionary public consumption leads to crowding-in effects in the short-run, while crowding-out effects take over in the medium-run.

Improved business sentiments and increasing consumer confidence indirectly lead to output expansion through encouraging private spending in the first six months after experiencing a positive fiscal stimulus. The initial expansionary impact of improved sentiments is stronger than fiscal stimulus or increased exports. Fiscal policy is more powerful when applied during a time when the government can reduce business uncertainties and enhance consumer confidence. On the other hand, the impact of expansionary fiscal policy

Figure 4. Expansionary impact in output through fiscal stimulus

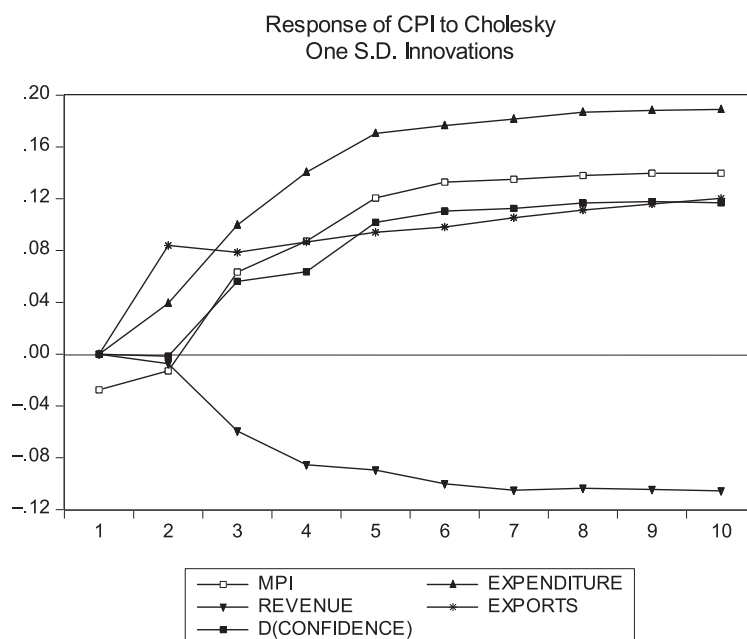
Source: Results from the vector autoregression model. CPI = consumer price index; D(CONFIDENCE) = Change in Business Sentiment Index.

will be limited during a period of deteriorating business sentiments and declining consumer confidence.

Good governance and the effective legal infrastructure are requirements for maintaining favorable business sentiments. If the outcomes of legal disputes are seen as fair and just, outcomes of the judiciary process would not be unexpected. Thus, the risks of unexpected decisions such as a judicial coup can be minimized. When consumers and investors postpone spending, output would contract and magnify the adverse impact of declining exports.³ Similarly, a rebound in export demand can lead to a V-shaped recovery provided that consumer confidence is sufficiently strong.

In addition, output is mostly responsive to an increase in the price level. It indicates a positive supply response to price changes, which are related to profitability of the industrial sector. A moderate inflation rate caused by output demand expansion should be favorable

³ Exports declined by 4 percent (year-on-year) in the first quarter of 2015.

Figure 5. Inflationary impact of aggregate demand stimulus

Source: Results from the vector autoregression model. CPI = consumer price index; D(CONFIDENCE) = Change in Business Sentiment Index.

to economic growth, whereas price deflation or very low inflation could signify a slow-down in economic activity.⁴

Examining the impulse response function of the price level from various shocks, we can observe that, similar to the pattern observed in Figure 4, an increase in output causes an increase in the price level (Figure 5). An increase in public spending raises the price level higher than an increase in exports or improved business sentiments. An increase in tax collection can curb inflationary pressure through its impact on the aggregate demand and a reduction in tax revenue can stimulate recovery during a global financial crisis. This finding is consistent with the result of investigation of ten emerging Asian countries by Jha et al. (2014). They found that tax cuts have a greater countercyclical impact on output than government spending, implying that there is some scope for countercyclical tax adjustments as long as fiscal sustainability is not compromised.

⁴ The inflation rate has declined consecutively from 2.6 percent in May 2014, to 0.6 percent in December 2014, and to -1.04 percent in April 2015.

Expansionary fiscal policy through tax cuts and increases in spending can effectively increase output, but its impact on inflationary pressure cannot be ignored. Therefore, the timing of policy implementation is important. If fiscal stimulus is carried out during the period of oil price decline and exchange rate appreciation, the inflationary impact of running a budget deficit can be mitigated.

Carrere and de Melo (2012) analyzed data from 140 countries over 1972–2005 and concluded that the probability of occurrence of growth in the years following a fiscal stimulus is greater, the lower the level of fiscal deficit. Hence, the success of a growth-oriented fiscal expenditure reform is associated with a stabilized macroeconomic environment. Vera (2009) points out that the conventional arguments against fiscal activism are based on simple monetarism assumptions, ignoring developing countries' economic structure and causation mechanisms.

The expansionary impact on output of fiscal stimulus suggests that the Thai economy could have returned to the pre-shock growth path had fiscal stimulus been earnestly implemented. The fear of excessive budget deficit inhibits output stabilization and incurs opportunity cost of high growth in the long run. As discussed in Nidhiprabha (2009b), short-term fiscal stimulus would not be able to shorten the duration of a recession because the recovery hinges on the ability of the government to restore public confidence.

6. Concluding remarks

This paper provides evidence that Thailand's fiscal policy can be used to stabilize short-term fluctuations of output and maintain price stability. There are several lessons from Thailand's fiscal experience. To stimulate growth in the aftermath of the GFC, sufficient fiscal space is needed to carry out fiscal expansionary policy. If rules of fiscal sustainability are observed, available fiscal space permits effective fiscal stimulus. Specific types of economic stimulus matter for long-term growth. Stimulus fiscal packages should focus on capital spending rather than current spending so as to maintain fiscal flexibility of spending and to promote long-term growth.

Fiscal stimulus must not be applied too late and too little after the collapse of exports and domestic demand. The empirical evidence from this paper points out that fiscal policy instruments are effective tools to stimulate growth when experiencing external and internal shocks. With ample fiscal space, discretionary fiscal policy can be undertaken to achieve long-term growth. Unwarranted fears of unsustainable public debt and ultra-conservative fiscal policy has cost Thailand a lost opportunity for achieving high growth.

After the military coups in 2006 and 2014, the Thai economy experienced the lowest economic growth in the ASEAN region. To make matters worse, budget spent on economic

services were diverted into current spending such as defense and income transfer payments. The opportunistic political budget model predicts increases in fiscal spending before an election to gain votes by incumbent governments. In the case of Thailand, such spending comes after military coups. Unlike the political business cycle mode of a democratic government, the cycle of military spending depends on the period of coups rather than the time of elections.

Expansionary fiscal policy used to counteract short-term fluctuations must be withdrawn after the economy is on its recovery path. If not, it can be a burden to the government and result in an adverse impact on the economy as people gradually become addicted to populism policy, such as providing cash handouts to farmers and rubber tree growers when world commodity prices are declining. The political risk and adverse consequences of withdrawal of fiscal spending must be considered before implementing fiscal expansion in response to insufficient aggregate demand.

When formulating countercyclical fiscal policy measures, the role of automatic stabilizers must be taken into account. Tax revenue increases faster than expenditure during economic upturns, mitigating the inflationary pressure from expanding budget surplus. During economic downturns, tax revenue declines faster than expenditure, leading to a budget deficit to reduce the deflationary gap. When the economy experiences rising price levels, government spending tends to increase faster than revenue. If public spending goes to infrastructure rather than wage increases in the public sector, the economy's output capacity can be raised. Thus, raising the share of capital expenditure in the total budget is important to promote long-term growth with price stability. It is imperative that current spending be curtailed once the economy regains its pre-shock growth path. Since 1997, the share of capital spending has declined so much that it reduces long-term growth rate. The expansionary impact of increased public spending and tax cuts would not be effective during a period of political turmoil and uncertainty. Countercyclical policy can lead to output expansion, provided that the government is able to maintain consumer confidence and improve business sentiments.

References

- Afonso, Antonio, Luca Agnello, and Davide Furceri. 2010. Fiscal Policy Responsiveness, Persistence, and Discretion. *Public Choice* 145(3–4):503–530.
- Agnello, Luca, Davide Furceri, and Ricardo M. Sousa. 2013. Discretionary Government Consumption, Private Domestic Demand, and Crisis Episodes. *Open Economies Review* 24(1):79–100.
- Butkiewicz, James L., and Halit Yanikkaya. 2011. Institutions and the Impact of Government Spending on Growth. *Journal of Applied Economics* 14(2):319–341.
- Carrere, Celina, and Jaime de Melo. 2012. Fiscal Spending and Economic Growth: Some Stylized Facts. *World Development* 40(9):1750–1761.

- Claus, Iris, Jorge Martinez-Vazquez, and Violeta Vulovid. 2013. Coping with Rising Inequality in Asia. *Asian Economic Papers* 12(3):1–33.
- Ehrhart, Helene. 2013. Elections and the Structure of Taxation in Developing Countries. *Public Choice* 156(1–2):195–211.
- Giavazzi, Francesco, and Marco Pagano. 1990. Can Severe Fiscal Contractions Be Expansionary? Tales of Two Small European Countries. In: *NBER Macroeconomics Annual*, edited by Oliver Blanchard and Stanley Fisher, pp. 75–111. Cambridge, MA: MIT Press.
- Hernandez de Cos, Pablo, and Enrique Moral-Benito. 2013. What Drives a Successful Fiscal Consolidation? *Applied Economics Letters* 20(7–9):748–753.
- Hou, Na, and Bo Chen. 2013. Military Expenditure and Economic Growth in Developing Countries: Evidence from System GMM Estimates. *Defiance and Peace Economics* 24(3):183–193.
- Jha, Shikha, Sushanta K. Mallick, Donghyun Park, and Pilipinas F. Quising. 2014. Effectiveness of Countercyclical Fiscal Policy: Evidence from Developing Asia. *Journal of Macroeconomics* 40:82–98.
- Nidhiprabha, Bhanupong. 2009a. The Thai Economy After the Coup. In: *Divided Over Thaksin, Thailand's Coup and Problematic Transition*, edited by John Funston, pp. 172–188. Singapore: Institute of Southeast Asian Studies.
- Nidhiprabha, Bhanupong. 2009b. The Hard Road Ahead for Thailand's Economic Recovery. *Asian Economic Papers* 8(3):113–137.
- Vera, Leonardo. 2009. Reassessing Fiscal Policy: Perspectives from Developing Countries. *Development and Change* 40(4):611–643.
- Vergne, Clemence. 2009. Democracy, Elections and Allocation of Public Expenditures in Developing Countries. *European Journal of Political Economy* 25(1):63–77.
- Yakovlev, Pavel. 2007. Arms Trade, Military Spending and Economic Growth. *Defense and Peace Economics* 18(4):317–338.
- Yoshino, Naoyuki, and Tetsuro Mizoguchi. 2010. The Role of Public Works in the Political Business Cycle and the Instability of the Budget Deficits in Japan. *Asian Economic Papers* 9(1):94–112.