

Chapter 8

Fiscal Policy for Growth and Stability: Lessons from Thailand

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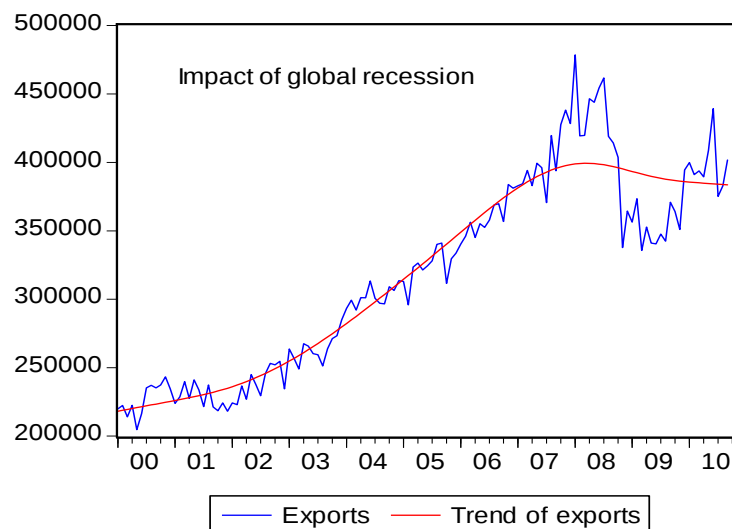
Fiscal policy be used to promote growth and stability. To stimulate growth in the aftermath of global recession, sufficient fiscal space is needed to carry out effective stimulus packages. The fiscal burden must be considered in addition to the impact on price stability. The role of tax automatic stabilizers and the ability to restore the budget balance must be taken into account when formulating fiscal stimuli. Although expansionary fiscal policy can be used during recessions, it is more effective when conducted under the condition that the government can maintain public confidence. The rules of fiscal sustainability must be strictly observed always ensure price stability and long-term growth.

I. Introduction

Between 2007 and 2009, most countries that suffered from the global financial crisis used expansionary fiscal policy to counteract the export shortfall. In developing countries where monetary policy instruments have limitations, fiscal stimulus is the only policy measure available to compensate declining export demand from advanced countries. In 2008, Thailand's exports continued increasing despite the impact of global economic slowdown that began in 2007. A temporary commodity boom and food price crisis gave rise to the impressive performance of Thai exports in 2008. From 2000 to 2008, the increasing trend of exports can be seen in Figure 8.1. In 2009, when the global financial crisis finally hit the Thai economy, exports declined sharply. At the time, domestic investment and consumer spending were also subdued. In 2009, the contraction of both external and internal demand caused real GDP to decrease by 2.3 %. It was the first time that the Thai economy experienced recession since the massive output contraction of 10 % in the aftermath of the 1998 currency and financial crises. The recession was short-lived, although massive financial asset value was destroyed during the meltdown of financial institutions. A rapid growth of exports restored growth. Since the Asian financial crisis did not spread to the rest of the world, Thailand was able to export its way out of recession through currency devaluation.

It was different in 2009, when advanced economies could not import from Asia, since they were trying to maintain wealth by raising savings and subsequently reducing imports. Baht appreciation made it difficult for Thai exporters to reap benefits they had gained during the 1997 Asian financial crisis. During this time, many Asian economists started questioning the traditional Asian model of growth, arguing that Asian countries should depend less on exports and pay more attention to domestic demand.

Figure 8.1: Booms and busts in exports



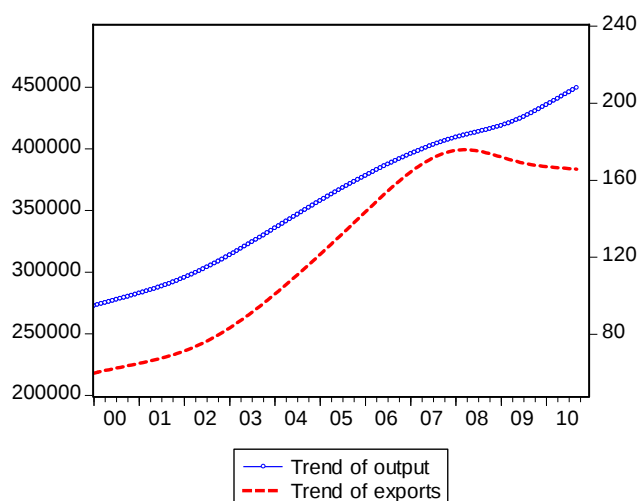
Source: The Bank of Thailand

By the first half of 2010, it became clear that manufactured exports had rebounded sharply. It is reckoned that the global financial crisis's impact had previously been overestimated. The

robust growth of India and China generated strong export demand for goods from Thailand. Whether the export recovery can be sustained depends to a large extent on economic recovery in advanced countries. If developed economies experience double-dip recession in the near future, developing countries must brace for another round of export contraction and must increase the volume of trade among them. The possibility is limited for market substitution from advanced economies to emerging countries in Asia, because a majority of final demand for manufactured goods originates from developed areas.

Even if remote possibility exists of a double-dip recession in developed economies, the important 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 act and stimulate the economy appropriately and efficiently. When the world economy recovers, public spending must return to the normal pattern observed before the global financial crisis. The 2009 collapse of exports may be seen as a temporary shock, and long-term output level should not be affected after exports return to normal. As Figure 8.2 shows, the export trend has not yet returned to its trend growth path. Nevertheless, long-term output growth remained unaffected by a trend of reduced exports.

Figure 8.2: Long-term trend of output and exports



Source: Bank of Thailand

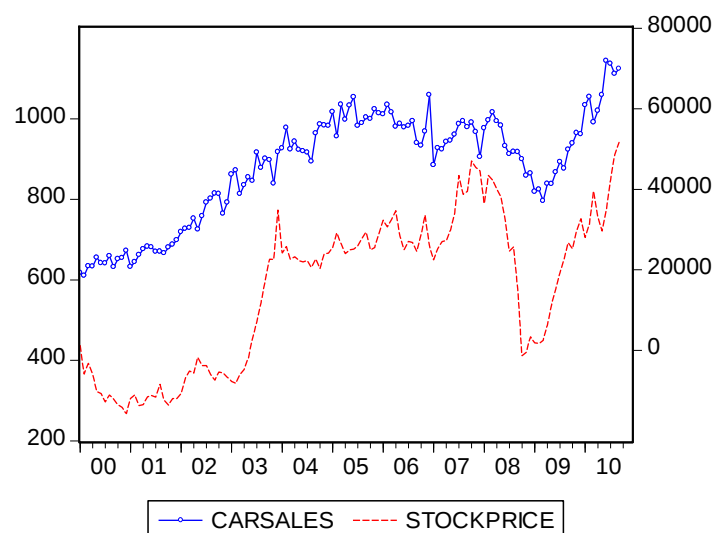
It should be noted that in the long run exports and imports move together. Increased exports generate income, which in turn leads to higher demand for imports. Additionally, manufactured exports require imported components. The emerging pattern of intra-industry trade causes imports and exports of manufactured goods to move together. A reduction in exports results in a fall in import of raw materials. Thus, the impact of export collapse on the current account is not severe. Even if exports collapse, any adverse impact on GDP will not be as harmful as the fall in exports, because imports also decline. This implies that governments should not take drastic fiscal measures in reaction to temporary export shortfalls, because the impact on GDP must be measured by a falling level of net exports rather than gross exports.

This chapter asks whether fiscal policy can be used to stabilize short-term fluctuations of output. It focuses on the relationship between fiscal and macroeconomic variables. Section 2 discusses the roles of domestic demand and fiscal policy. Section 3 highlights the importance of fiscal automatic stabilizers. Section 4 examines rules for fiscal sustainability. Section 5 analyzes the impact of fiscal expansion on growth and price stability. Concluding remarks are provided in the last section.

II. Domestic demand and fiscal measures

The movement of stock prices is a good indicator of investor confidence. Obviously, the global financial crisis from 2007 to 2009 depressed market sentiment considerably. Yet by the fourth quarter of 2010, the SET index regained the ground lost since its peak in 2007. Confidence has returned and other regional stock markets experienced similar sharp rebounds. Automobiles sales reflect consumer confidence since the decision to buy durable goods is determined by factors similar to those which dictate demand for physical investment. Expected or permanent income, the cost of capital, and fiscal incentives determine the desired level of capital stock. We can use the number of cars sold domestically as a proxy for consumer confidence. Both proxies for investor and consumer confidence, shown in Figure 8.3, move together during the downturn and upturn. Sluggish movement of the SET index in the early 2000s reflected poor sentiment during the mild U.S. recession, when the dot.com bubble burst on Wall Street and after the 9/11 incidence. In Thailand, these factors affected domestic consumer demand less than stock markets. The number of cars sold in Thailand continued increasing from 2000 to 2005, reflecting rising consumer confidence. After the 2006 military coup, subsequent political turmoil led to an erosion of consumer and investor confidence. In 2008, the global financial crisis had a harsh impact on business and consumer confidence.

Figure 8.3: Consumer durable goods and asset prices

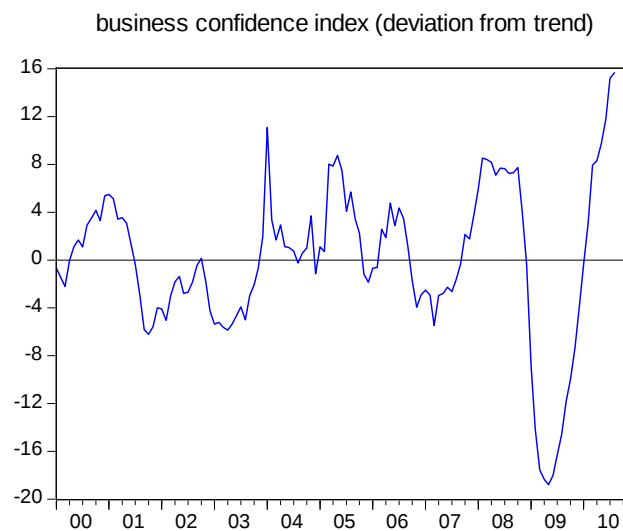


Source: Bank of Thailand

Because of excess liquidity in the banking system, low interest rates and ample bank credit were available to consumers and investors. Fiscal expansionary measures that give rise to public deficit would not create a crowding-out effect. Fiscal stimulus undertaken during this time would be effective without having to depend on the coordination of expansionary monetary policy.

It is argued here that fiscal policy will be more effective when consumer and investor confidence are strong. When business sentiment is low, the expansionary impact of fiscal deficit will have minimal impact on the economy. Any multiplier impact will be reduced if investors and consumers decide to postpone investment until the period of uncertainty and risk has passed.

Figure 8.4: Confidence regained after the shock



Source: Bank of Thailand

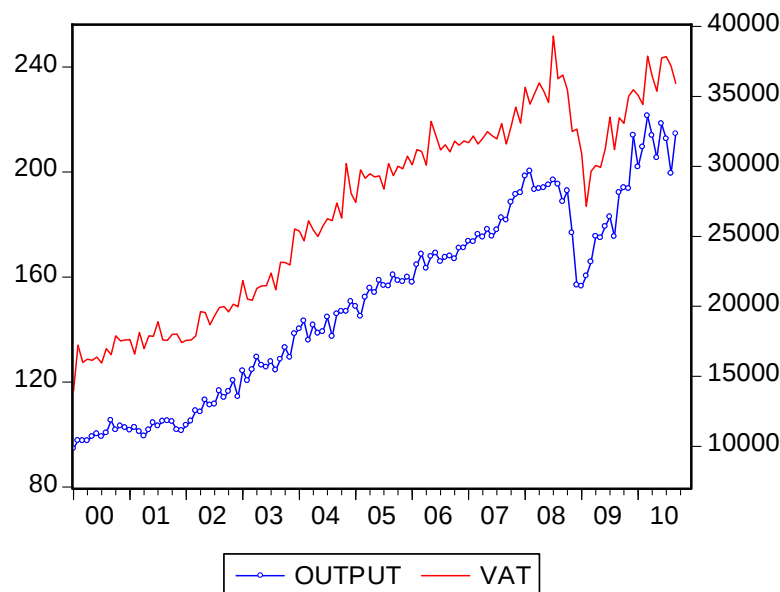
Akerlof and Shiller (2009) extend Keynes' concept of investors' animal spirits to include confidence or self-fulfilling phenomena, fairness, money illusions, criminal behavior, and stories from the media. With this extended definitions of animal spirits, the success of policy stimulus also depends on its psychological impact.

Fiscal stimulus during the lowest level of confidence in 2008 would have been relatively ineffective (Figure 8.4) compared to a normal period. One might argue that a budget deficit can improve business confidence and therefore should be welcome during recession. Yet running a large budget deficit could lead to loss of confidence as the enlarging budget further lead to huge public debt and the inevitability of future tax hikes. Whether running the budget deficit can raise and lower business confidence depends on public debt sustainability.

Value Added Tax (VAT) is a type of consumption tax, based on consumption rather than income. Unlike income taxation, it has no adverse impact on saving incentives. Additionally,

it has an automatic stabilizer feature. VAT excludes food consumption, therefore it reflects activity in the manufacturing sector.

Figure 8.5: Output and Value Added Tax



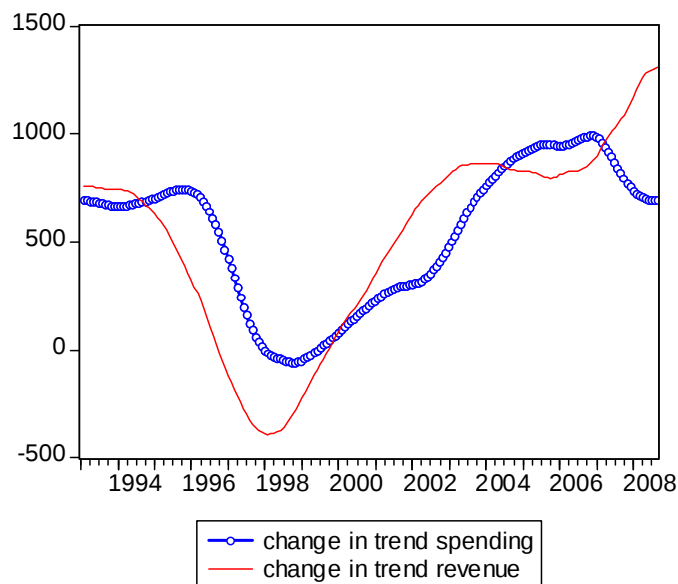
Source: Bank of Thailand

III. Automatic fiscal stabilizers

The primary budget (a budget excluding interest payment) is prone to surplus during times when the economy is growing above its natural rate and tends to deficit when it declines below its natural level. Figure 8.5 illustrates the co-movement between amount of value added tax and the manufacturing output index. Thus, budget deficit is a natural consequence of recession, just as budget is surplus during a boom. The expenditure side of budgets must be counter-cyclical to make a fiscal automatic stabilizer work.

By removing cyclical components from actual public spending and revenue, and utilizing monthly data from January 1993 to December 2008, we can obtain long-term trends of public expenditure and revenue. Using the first difference of these trend variables, we find a pattern of fiscal stance which reflects the outcome of discretionary fiscal policy and automatic fiscal stabilizers (Figure 8.6).

Figure 8.6: Fiscal stance shown by the structural budget



Source: Bank of Thailand

A positive difference between changes in trend spending and trend revenue suggests fiscal expansionary policy stance. A large budget deficit in the late 1990s turned into a surplus in the 2000s. The deficit was sustainable because of rapid increase in tax revenues during recovery and an ability to trim public spending. Investment in infrastructure was postponed while tax capacity was enhanced. In 2009, a sharp deterioration in fiscal position occurred, but in 2010 tax collection was above the expected level. The automatic tax stabilizer was at work. In some countries, it is difficult to cut the budget deficit because of an inability to curtail public spending.

The structure of spending matters for long-term growth. If a large part of government spending is for current rather than capital spending, it would be difficult for a government to curtail total spending as it would affect the social welfare of those receive government benefits. Yet if the budget contains a large portion of capital spending, it would be relatively easier for a government to cut the deficit. Political economy is involved here, since current consumption includes military spending, health, education, and social welfare.

It is possible that high revenue leads to higher public spending and vice versa. If public goods are normal, rising GDP per capita would imply an increase in demand for public goods. Some governments may wash to spend first by issuing bonds or printing money, but they will have to raise taxes later. Causation can run both ways, between tax revenue and public spending.

Employing monthly data from 2000 to 2010 to examine whether taxation leads to public spending or vice versa, we find that government spending does not Granger-cause taxation, but higher tax revenue leads to higher spending (Table 8.1). This 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 budgetary laws of and fiscal policy.

Table 8.1: Spending-led taxation?

Null hypothesis	F-Statistic	Probability
$\Delta(G)$ does not Granger-cause $\Delta(TAX)$	2.23	0.11
$\Delta(TAX)$ does not Granger-cause $\Delta(G)$	3.97	0.02

Source: Calculation is based on 125 observations of monthly data from January 2000 to August 2010. The test employed two lags.

The budgetary law states that the proposed amount of expenditure cannot exceed 20 % of anticipated revenue. One can argue that this rule would limit the size of fiscal stimulus during a period of economic depression, when large fiscal stimulus is required. If all engines of growth are shut down, there is an urgent need to apply a large fiscal deficit. However, relaxation of this rule would enable politicians to be fiscally profligate and use populist policies for their own benefit. We have seen that the global economic recession is a temporary shock. Therefore, we should not amend fiscal rules for the benefit of incumbent governments.

It should be emphasized that fiscal stimulus can also occur through tax reduction, in addition to increased spending. The impact on fiscal burden will be the same. In theory, a tax-financed budget deficit is less expansionary than a bond-financed budget deficit. If bonds are net wealth and wealth has a significant impact on private consumption, a bond-financed budget deficit can lead to more expansionary impact when bonds holders start spending, because they feel wealthier because they hold more government bonds.

Discretionary policy can be delayed because of implementation lags caused by the lengthy parliamentary process of budget approval. It is argued here that if a country has established fiscal automatic stabilizers, fiscal policy can be stabilizing and need not depend on a long-delayed budgetary process. Let's examine the role of automatic stabilizers in both taxation and expenditure when they change in response to changes in output and prices.

Table 8.2: Estimated fiscal elasticities: Jan 2000-Dec 2005

	expenditure	Tax revenue
Output	0.22	0.55
Price level	1.27*	-1.1*

Source: Author's calculation

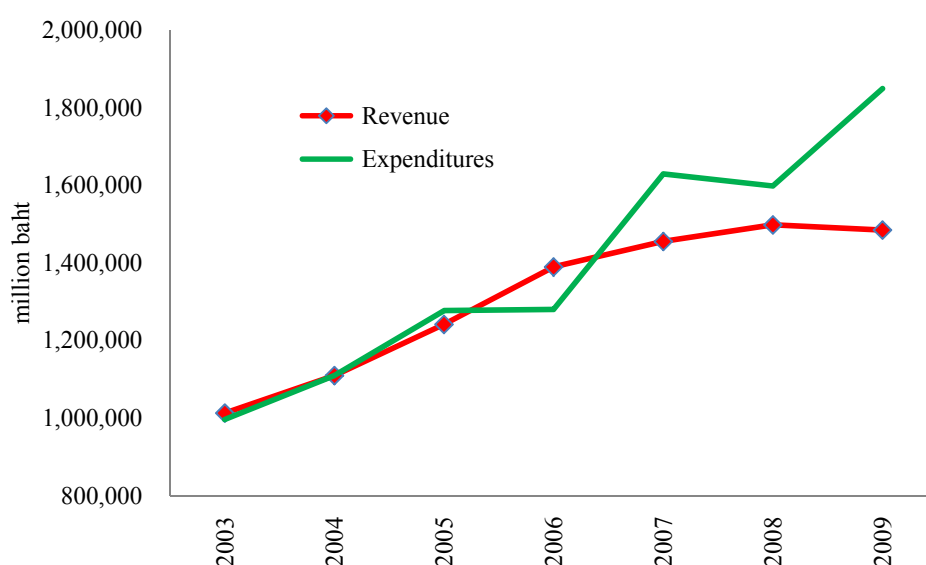
Table 8.3: Estimated fiscal elasticities: Jan 2006-Aug 2010

	expenditure	Tax revenue
Output	-0.35	1.19*
Price	1.82	-1.89*

Source: Author's calculation

If fiscal policy can be employed for growth and price stability, we must recognize feedback effects from growth and inflation on tax revenue and spending. Elasticities of expenditure and revenue can be calculated for output and price levels. As reported in Table 8.2, between 2000 and 2005, there was no significant impact of change in output on public spending and revenue. But the price level caused a reduction in tax revenue and increase in expenditure. Inflation caused an increase in budget deficit in real terms. Note the estimated value for two elasticities in Table 8.2. They were greater than unity. Fortunately, the inflation rate was subdued at this time. In 2006, a small budget surplus was observed (Figure 8.7). This was mainly due to political upheavals relating to regime change that slowed budget utilization. That turned out to be a blessing in disguise, since it provided ample fiscal space before the subsequent global recession was experienced.

Figure 8.7: Thailand's fiscal stimulus



Source: Bank of Thailand

Similar to the estimated coefficients in Table 8.2, a double-log regression functional form is employed for monthly data from January 2006 to August 2010. Public spending did not respond to output or price levels (Table 8.3). On the revenue side, inflation led to lower tax revenue, while growth raised it. The output elasticity is greater than one, implying that revenue rose faster than output¹. This is a positive feature of the automatic tax stabilizer during economic expansion. However, inflation decreases tax revenue. The estimated coefficient is greater than unity. It suggests that real tax revenue would decline almost 3 % because of inflation. As a policy implication, automatic tax is destabilizing during high inflation. Public spending must be controlled during high inflation to avoid adding more

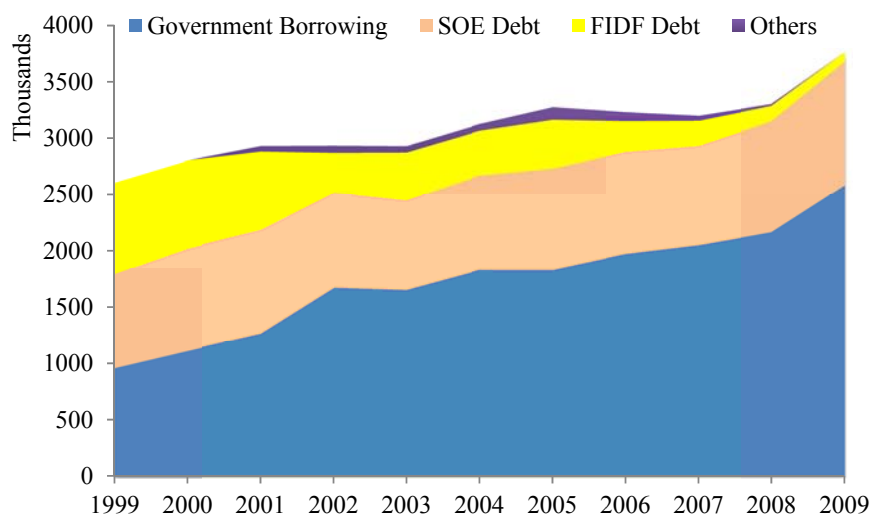
¹ Mourmouras and Rangazas (2009) states that the relative size of government spending and taxation increases as an economy develops because of structural transformation from traditional to modern production, rising public infrastructure investment, and less democratic governments in many of today's developing economies.

inflationary pressure to the economy. Inflation can spiral if the government tries to maintain the level of real spending during a time of high inflation.

IV. Rules for fiscal sustainability

After the 1998 financial meltdown, the budget deficit experienced caused public debt on a rising trend (Figure 8.8). Economic contraction reduced tax revenue during the downturn. Since 2007, the continued budget deficit raised the level of public debt. Additionally, the government bailed out troubled financial institutions through the Financial Institutions Development Fund (FIDF), but this type of public debt has continued declining as financial institutions underwent structural changes and emerged stronger. They were not affected much by the global financial crisis from 2007 to 2009.

Figure 8.8: Public debt by type (million baht)

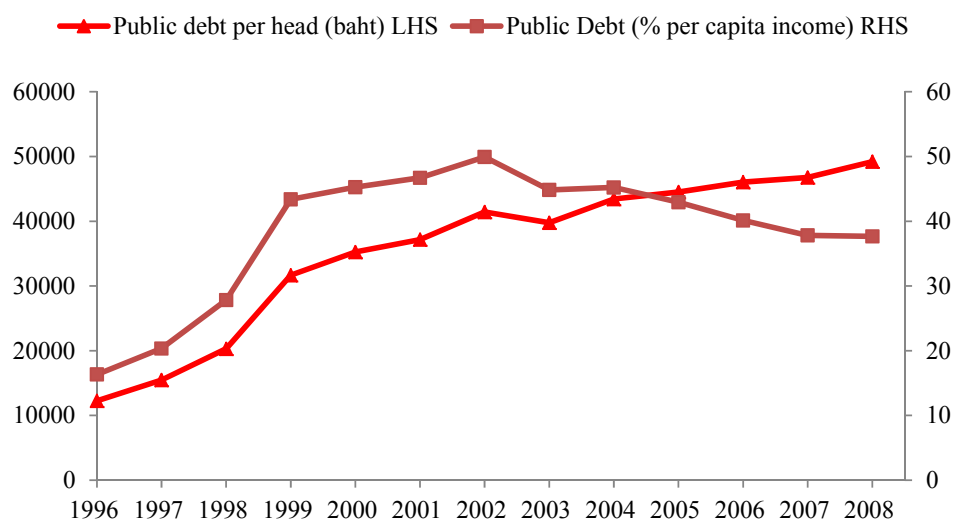


Source: Fiscal Policy Office

If the primary deficit cannot be contained, public debt will keep rising and threaten the fiscal system's sustainability. To stabilize debt-to-GDP ratio, the primary deficit must be cut and GDP growth rate must exceed the real rate of interest. During economic recovery, the government must ensure that fiscal stimulus can bring about an economic growth rate higher than the real interest rate.

Figure 8.9 illustrates that in 2008 public debt per head of Thai people rose to 50,000 Baht, a fivefold increase from 1996. Since per capita income increased faster than the amount of debt, the level of debt per head as a percentage of per capita income peaked in 2002 and has declined steadily.

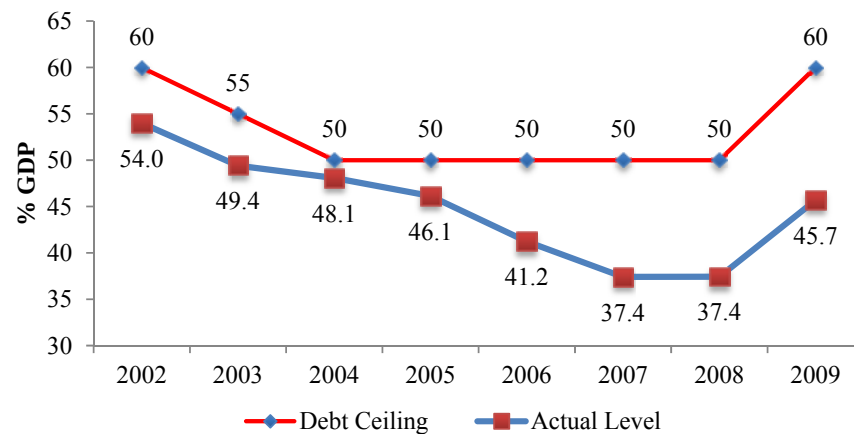
Figure 8.9: Public debt burden



Source: Fiscal Policy Office

Because the level of per capita debt has been declining, the Thai government still has room to employ fiscal stimulus to counteract any future impact of global recession. This ample fiscal space is basically the result of fiscal discipline. There are at least three rules of fiscal sustainability observed by past governments. Some rules have been changed to make room for fiscal expansion. For example, the rule that regulates the level of public debt to GDP level was altered. It was made less stringent from a maximum level of 60% in 2002 to 50 % in 2004 and was maintained at that level until 2008. In 2009, to accommodate fiscal expansionary policy, the maximum debt was raised to 60%. The actual debt-to-GDP ratio increased substantially to 45.7 % in 2009, still below the original 50% ceiling. With a rapid recovery, the government has no need to make the rule less stringent. This rule has never been breached. This conservative policy had historical reasons. Aversion to hyperinflation and fear of foreign invasion were behind conservative fiscal policy.

Figure 8.10: Regulation on Public Debt

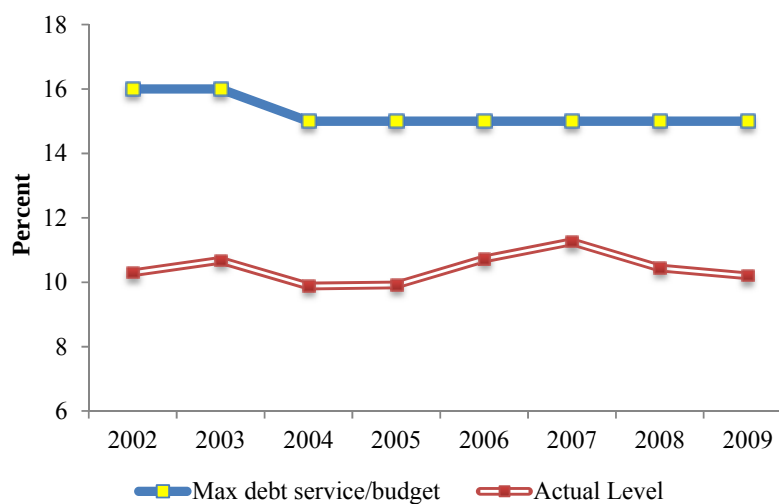


Source: Fiscal Policy Office

Since 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 planned expenditure. After 2003, the ceiling was made more stringent by lowering the maximum debt service from 16 % to 15% of the total budget. Again the Thai government was able to control debt service within the ceiling. Plentiful liquidity in the money market enabled the government to borrow at low interest rates.

Another rule on foreign borrowing is noteworthy: the debt-service ratio applies to foreign borrowing. In recent years, foreign borrowing declined while exports grew rapidly. There is no problem in keeping the foreign debt-service to exports ratio within the permissible range.

Figure 8.11: Debt service to total proposed spending

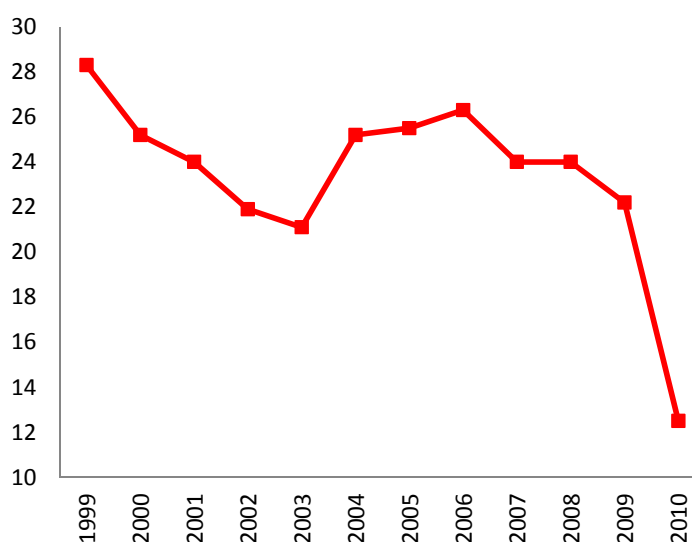


Source: Fiscal Policy Office

As mentioned earlier, fiscal spending structure matters for long-term growth. Public infrastructure can increase productivity in the private sector and enhance long-term growth. Public investment in transportation and communication has a super normal high rate of return to the economy. If public investment complements private investment, increased public investment can lead to a crowding-in-effect. By contrast, high public consumption compared to public investment can retard growth. Empirical evidence of cross-country investigation indicates that growth can be jeopardized if public consumption increases faster than public investment.

The rule of fiscal sustainability deals with this issue. It imposes a minimum level of public investment, which must not fall below 25 % of the total budget. Since 2008, the budget allocated to public investment has fallen below the required level (Figure 8.12). If we take into account depreciation of public capital stock, net public investment would not be much higher than the break-even level of public investment. Consequently, long-term output growth in Thailand can be adversely affected².

Figure 8.12: Public Capital Expenditure (% total budget)



Source: Fiscal Policy Office

² Akitoby and Stratmann (2008) examine the effect of fiscal policy on sovereign risk spreads in emerging markets. Financial markets also react to the composition of spending. Cuts in current spending lower spreads more than cuts in investment.

In the short run, we will not see any impact from a slowdown in public investment. In the longer term, the tradeoff between present and future consumption will become apparent for growth, efficiency, and international competitiveness. Fiscal sustainability is ensured if rules and regulations are strictly observed. Rules also give importance to long-term growth. The time inconsistency of fiscal policy is similar to the problem of monetary policy. In this case, both the government and those who benefit from present consumption through populist programs of fiscal stimulus are happy, but in the long run, fiscal policy departing from the rule of adequate capital spending will retard growth³. Yakovlev (2007) provides empirical evidence that an increased defense budget at the expense of other development goals can be detrimental to economic growth.

V. Evaluation of the short-run impact of fiscal policy

By nature, shocks by nature are random and temporary. In time, the economy can gravitate back to its natural output level. The speed of adjustment back to long-term growth path depends on labor market efficiency as well as flexibility of wage and price levels. In the short-run where rigidities exist, the economy achieves equilibrium but remain at the output which corresponds to less than full employment of labor. Usually monetary policy is employed for short-term stabilization, while fiscal policy is a tool for long-term growth. When the policy interest rate is close to zero, there is no room for further cuts in the cost of borrowing. In addition, if the economy is subjected to pessimism, the low cost of funds would not encourage firms to expand plant sizes.

During the global recession, fiscal policy was called upon to stimulate domestic demand in a period of ineffective monetary policy measures. Expansionary fiscal policy used to counteract short-term fluctuations must be withdrawn after the economy is on its path to recovery. If not, it can be a burden to the government and adversely impact the economy. The risk and adverse consequences of withdrawing fiscal spending must be considered before implementing fiscal expansion in response to insufficient aggregate demand.

If the short-term expansionary impact of fiscal policy is large, then it would be appropriate to stimulate the economy with tax or public spending measures. We must also consider other alternative means of enhancing aggregate demand to ensure that fiscal policy is the most efficient stabilization tool.

A vector autoregression model is used to evaluate the short-term impact of Thailand's fiscal stimulus. The VAR model utilizes monthly data from January 2000 to August 2010; it consists of seven variables: public spending (G); tax revenue (Tax); private investment (Invest); private consumption (Cons); real effective exchange rate (REER); business sentiment index (BSI); and core price index (CORE). All data are obtained from the Bank of Thailand. The BSI variable captures expectations of investors and consumers. As argued earlier, the effectiveness of fiscal and monetary policy depends on business and consumer confidence. The real exchange rate is included, since it is affected by the domestic price

³ 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.

level. The core consumer price index is used, since it excludes exogenous factors such as price of fresh food and energy. Private consumption is an index constructed by the Bank of Thailand. It includes spending activities involving imported consumer goods, household electricity usage, value added tax revenue, car sales and fuel consumption. The private investment index constructed by the Bank of Thailand includes activities in construction and capital formation, such as construction areas permitted in municipal zones, imported capital goods, and domestic sales of machinery, cement, and commercial cars. Private and consumption indexes represent domestic demand which would be directly and indirectly affected by increased government spending.

The impulse response function of the impact on price stability is shown in Figure 8.13. Price level is positively related to output level, as can be expected from the dynamic aggregate supply function. Price level increases in response to increased consumption more than increase in public spending. A rise in investment does not cause inflationary pressure as much as other components of aggregate demand. Investment involves imported capital goods which is a leakage from the domestic economy. Traded goods prices are exogenously determined by the world price level, which explains why an increase in domestic investment does not create inflationary pressure as much as domestic consumption and public spending. Furthermore, enlarged plants and equipment means higher output capacity which would by itself lower upward pressure on price levels.

A tax hike initially raises the core inflation rate but the impact dissipates within two months when the contractionary impact takes effect. Clearly taxation can lead to a slowdown in private consumption, thereby reducing inflationary pressure. Therefore, fiscal policy can be used to stabilize price levels and should be used to lesson inflationary pressure during booms. An increase in public spending financed by a tax increase has lower inflationary pressure than other methods of deficit financing. We now turn to analyze the impact of fiscal policy measures on output level.

The impulse response function reveals that the impact of fiscal policy stimulus has an expected outcome. Increased government spending leads to higher output, while increased tax revenues lead to output contraction (Figure 8.14). Fiscal stimulus through either reducing tax or increasing public spending can spur growth during a slowdown⁴. This expansionary impact dies off slowly within a year.

⁴ Libanio (2009) believes that it is misleading to treat growth as entirely determined by supply-side variables, since aggregate demand and output growth influences the trajectory of labor supply and productivity in the long run.

Figure 8.13: Impacts on price stability of various shocks

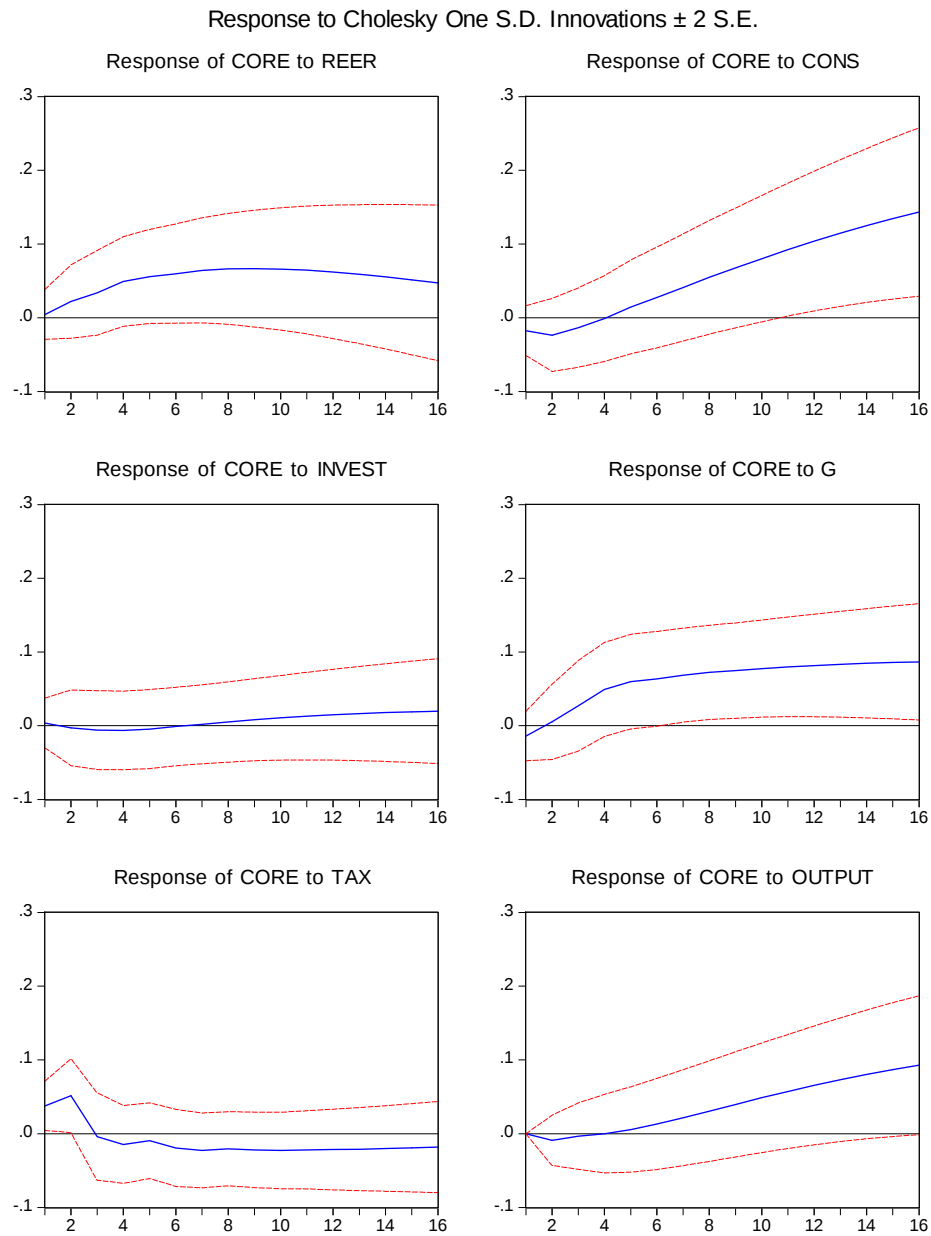
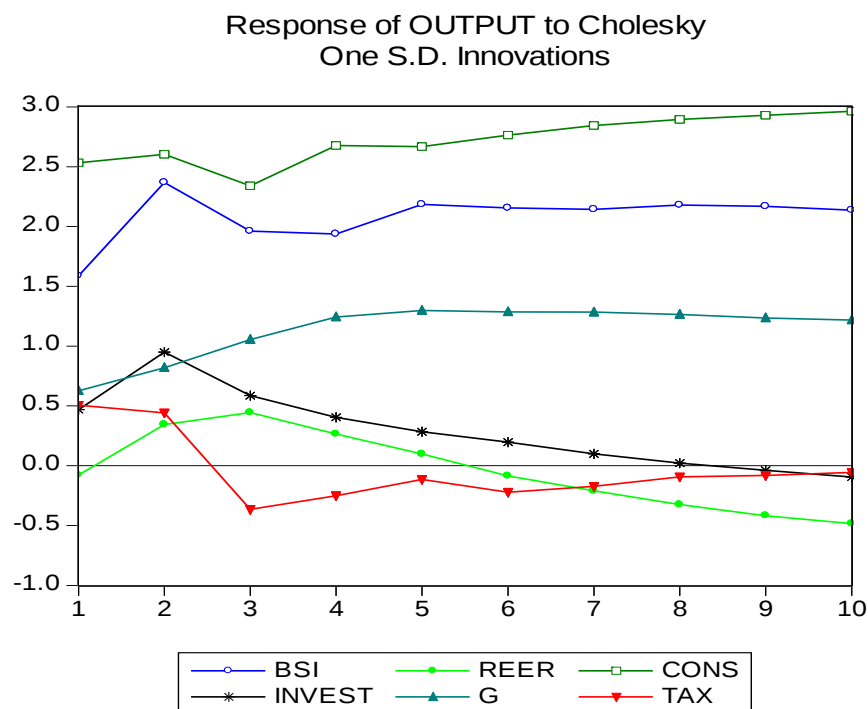


Figure 8.14: Expansionary impact of fiscal policy stimulus



Output is also affected by real exchange rate appreciation, but the contractionary impact becomes apparent only after six months. The government has time to compensate the output contraction which results from a loss in international competitiveness. In the real world where other factors also change, the contractionary impact of appreciated currency can be mitigated by other policy measures.

Fiscal and monetary policy instruments can be coordinated to achieve an optimal policy mix to address the problem of losing international competitiveness. Fiscal incentives, such as tax incentives for investment and temporary reduction in consumption tax can boost domestic demand. These measures are temporary by nature and should be withdrawn after export demand returns to its normal growth path.

Figure 8.14 shows that consumption has the highest expansionary impact on output, much larger than public spending. Thus any measure that enhances private consumption can ensure a fast recovery. The main factor attributed to the 2009 recession in Thailand is the loss of consumer confidence. Political turmoil and uncertainties gave rise to pessimism (Figure 8.4) and a sharp decline in private consumption. Figure 8.14 confirms this conjecture. An improvement in business confidence affects output trajectory. The expansionary impact of an optimistic view is even stronger than public spending. Therefore, it is important to nourish business sentiment through establishing order and laws.

Good governance and effective legal infrastructure are requirements for maintaining business sentiment. If outcomes of legal disputes are seen as fair and logically justified, judicial

decisions would not be unexpected. Thus the risks of unexpected results from legal institutions can be minimized. In times of crisis, if the government cannot maintain confidence in the private sector, a mild recession caused by a fall in export demand can lead to a severe depression. When consumers and investors postpone spending, output can contract and magnify a fall in exports. Similarly, a pickup in export demand can lead to a V-shaped recovery, provided that consumer confidence is strong.

The growth collapse episode in Thailand is consistent with the observation that good political institutions help prolong growth spells. Growth decelerations are found to be associated with macroeconomic instability, conflict, and export collapses (Hausmann, Rodriguez, and Wagner, 2006). The military coup in September 2006 derailed growth process in Thailand, confirming the hypothesis that growth is affected by democracy (Tavares and Wacziarg, 2001). Existing literature on the role of institutions on growth duration points to the relationship between sustained growth episodes and distributional conflict, and weak domestic institutions that cannot handle shocks (Berg and Sachs, 1998; Rodrik, Subramanian and Trebbi, 2004). Poor institutions create economic and political turmoil which make countries more crisis-prone and growth more volatile. The success of fiscal policy undertaken to stimulate growth in the short run and promote long-term growth depends largely on the quality of institutions.

VI. Concluding remarks

Fiscal policy can become an effective means to spur growth when consumer and investor confidence remains strong. When business sentiment is low, the expansionary impact of fiscal deficit will minimally impact the economy. The ability of legal institutions to maintain peace and the rule of law is crucial for political stability. Maintaining a favorable business environment is important for preventing the propagation of global recession and severe economic contraction.

Thailand's fiscal policy was conservative because spending was constrained by tax capacity. The reason behind this fiscal prudence is related to conservative budgetary laws. Debt-to-GDP is low, providing fiscal space for the government to counteract future external shocks. Thailand has established fiscal automatic stabilizers from the revenue side rather than from expenditure. Discretionary fiscal expansion has some limitation. Moreover, fiscal policy employed to counteract short-term fluctuations must be withdrawn after the economy is on a solid recovery path. Otherwise it can be a burden to the government and result in long-term growth. The risk and adverse consequences of withdrawal of fiscal spending must be considered before implementing fiscal expansion in response to insufficient aggregate demand.

Public spending must be controlled during high inflation to avoid fueling inflationary pressure. Inflation can spiral if the government insists on maintaining the level of real expenditure in a time of high inflation. Furthermore, the structure of public expenditure matters for long-term growth. A rising share of current spending is detrimental to growth in the long run.

Continued fiscal deficits enlarge the fiscal burden and raise public debt. This burden can be minimized if the government succeeds in restoring consumer confidence and improving business sentiment. Our findings indicate that a less costly means of fiscal stimulus can achieve the same impact on growth.

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