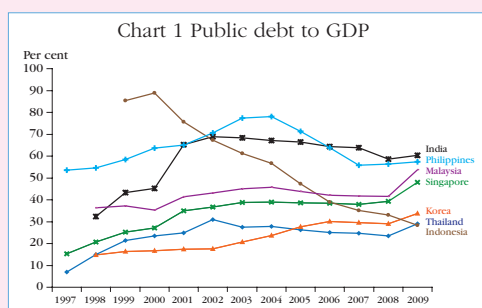


Resolving the sovereign debt problem

The sovereign debt crisis in some European countries such as Greece reflects a structural problem which has persisted for many years, as current expenditure on public welfare programs have outpaced government revenues. The problem was intensified by the recent global economic crisis which saw increased spending by governments to ameliorate the impact of the global slump.

The European debt crisis has triggered stakeholders to pay more attention to the level of public debt in Thailand. At present, Thailand's public debt is at a satisfactory level of 42.2 per cent of GDP (as of end-April 2010), with direct government borrowing of only 28.5 per cent of GDP. Moreover, the ratio of foreign liability to total public debt has declined dramatically from 30.0 per cent at end-fiscal year 2000 to 8.7 per cent in the current fiscal year, while short-term liability to total public has fallen from 19.0 per cent to 6.1 percent over that same period.



Source: IMD World Competitiveness, May 2010

In comparison with OECD countries, Thailand maintains modest levels of public debt and budget deficit relative to GDP. Even though the ratios are somewhat above the pre-Asian crisis levels, Thailand has been able to reduce public debt from 90.0 per cent of GDP in 2000 to 28.3 per cent of GDP by the end of fiscal year 2009, in line with the performance of other crisis-hit Asian countries like Korea, Singapore, Malaysia and the Philippines, with Indonesia being the only exception. Thus, overall risks in managing public debt remain low in Thailand.

Nevertheless, public debt as a share of GDP is just one among many indicators of the Medium-term Fiscal Sustainability Framework. That many countries, including the EU and Thailand, try to keep their public debt below the international benchmark of 60 per cent of GDP is not necessarily sufficient

Table 1 Public debt and fiscal balance to GDP in 2009

	Public debt (% of GDP)	Fiscal balance (% of GDP)
U.S.A.	83.0	-11.0
Japan ^{1/}	192.9	-7.2
Euro area	86.3	-6.3
Germany ^{2/}	76.2	-3.3
France	86.3	-7.6
Greece	119.0	-13.5
Ireland	70.3	-14.3
Italy	128.8	-5.2
Portugal	87.0	-9.4
Spain	62.6	-11.2
Thailand	45.2	-3.9

Note : ^{1/} Including debt of the Japan Railway Settlement Corporation and the National Forest Special Account from 1998 onwards.

^{2/} Including debt of the Inherited Debt Fund from 1995 onwards.

Source: OECD Economic Outlook, Public Debt Management Office and Bank of Thailand

for fiscal sustainability in the longer term. Governments need to lower their fiscal deficits in order to bring the ratio of public debt to GDP down in the future.

For Thailand, although there are no signs of an emerging public debt crisis at this time, issues regarding fiscal sustainability still warrant attention, especially in light of a number of limitations in the fiscal structure. In particular, average revenue growth of 8.0 per cent per year is well below the average growth rate of 15.0 per cent per year for committed expenditure and social welfare outlays. As it becomes increasingly difficult for the government to attain a balanced budget, public debt as a percentage of GDP will eventually increase, risks to fiscal sustainability in the medium term.

In addition, the present expenditure structure lacks flexibility as current expenditure and transfers make up as much as 80 per cent of total expenditure with the ratio deteriorating in accordance with the aging demographic structure. Meanwhile, interest payments may also trend upwards given a larger amount of total borrowing and higher risk premiums associated with higher debt. Eventually, funds for investment in infrastructure projects and the maintenance of national competitiveness may be crowded out. That in turn will weigh on Thailand's potential growth and add even more limitations to the expansion of government revenue.

On the financing side, the present structure of long-term domestic saving and a thin capital market also limit the government's ability to find alternative funding sources. Japan, in contrast, has a very high saving rate; therefore, domestic savings can be used as an important financing source for the government despite Japan's public debt approximately doubling the size of its GDP.

To rein in risks to fiscal sustainability down the road, the government should plan to achieve balanced budgets within the next 5-10 years. In order to do so, concrete guidelines for fiscal consolidation must be in place, including a reform of the tax system and the revenue structure, as tax collection now stands at only 17 per cent of GDP— just half of that in developed countries— with only a sixth of the workforce in the tax base. In addition, the government should avoid measures relating to populist policies, such as cost-of-living subsidy measures which have already been terminated by many countries, including the G-20. On the contrary, more attention should be given to capital expenditure, especially investment in basic infrastructure. Some projects, however, may require a change in funding schemes towards greater participation of users with the ability to pay. Public-private partnerships (PPPs) should also be promoted to relieve the burden of the government as well as to enhance the effectiveness of investment.