

BIG FAT GREEK SPENDING: LESSONS FOR A WELFARE STATE

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THE EMERGENCE of the sovereign risk crisis in Greece, driven by the unprecedented high level of public debt, is an important warning call for welfare state economies. While a welfare state serves to promote well-being and more equal income distribution, recent experiences in some European countries demonstrate that this policy direction can be susceptible to crisis if prudence does not take precedence.

Many European countries have witnessed deteriorating fiscal positions due to large-scale fiscal stimulus packages in response to the global financial crisis.

For Greece, the US subprime crisis was not the main factor behind the public debt problem, as the economy was less severely affected by that crisis compared to other Euro zone countries in the early crisis stage. Indeed, Greek public debt has been rising largely as a result of prolonged high fiscal deficits owing to the following reasons:

First, Greece launched a large scale welfare upgrading, including an expansion of social insurance coverage and an increased access to health care in the 1980s.

While government revenue is approximately 37 per cent of GDP, the over-committed social welfare benefits have pushed up public current expenditure to nearly 90 per cent of its total revenue, leaving only a small remaining portion for interest payments and investment.

Second, unlike other successful welfare states with comparable welfare expenditure, such as Norway and Sweden, the Greek government's revenue base has been much smaller due to lower income.

Moreover, Greece's tax collection system has been inefficient with significant tax evasion. Government revenue growth has therefore lagged behind that of expenditure.

The problem has been compounded by a lack of fiscal discipline - as joining the Euro zone allowed Greece to borrow to finance deficits at low interest rates.

Third, Greece's competitiveness has continually declined due to insufficient policy emphasis on promoting economic efficiency in the past. This problem worsened when the adopted Euro currency appreciated and adversely affected Greece's export competitiveness.

As a result, Greece has been running large current account deficits in parallel with high fiscal deficits.

Declining competitiveness has also resulted in lower economic growth and negatively affected the government's tax revenues.

Spain is also under the spotlight with its sovereign credit downgrading. Its problems stem not only from a large employment of civil servants but also an inflexible labour market and generous labour welfare benefits particularly unemployment benefits which reduce labour's incentives to improve productivity, search for jobs, and move across industries.

As lessons learned for emerging economies, particularly those thinking more in favour of a welfare state system, this European experience should highlight the importance of maintaining fiscal discipline.

In the case of Thailand, with the prospect of significantly rising expenditure from an ageing population and policies that aim to provide social safety nets, tax collection must be made more efficient and broad-based in order to maintain a prudent fiscal future.

Importantly, policymakers need to ensure that more generous welfare does not become a disincentive for the willingness to work and for labour quality improvement.

(The views expressed in this column are the writer's own.)

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