

Intricate Issues behind Public Debt Management

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1. INTRODUCTION

In recent years (2011-12) economic stresses and strains as experienced by many industrial countries clearly demonstrate the importance and widespread repercussions of public debt management. The United States of America, for example, encountered its limit on government debt of U.S.\$ 16.4 trillion by the end of 2012, so whether the legal amendment or “fiscal cliff” will occur will certainly have strong impact on global economy. Japan and some countries in the Euro zone could hardly restrict their governments’ borrowings, so Japan’s short- and long-term debt surged to 229 percent of GDP in 2011, while those of Greece and Italy reached 160 percent and 120 percent respectively (see Table 1). Another surprise was that even though the European Union (EU) has regulations controlling member countries’ annual fiscal deficits to stay within 3 percent of GDP and public debt outstanding within 60 percent of GDP, actually both member countries and Japan continually undertook fiscal policies in several formats so as to support income of the general public as well as the status of their economies. Governments provided various kinds of welfare which gave rise to enormous amounts of long-term obligated fiscal expenditures. Besides, those welfare programs became the channels which stimulated the general public to request for continual or even more assistance from the governments. In other words, the role of fiscal measures has been converted from being temporary rescuing instruments during economic recession or excessive boom to the permanent ones as demanded by the public. And when the governments could not collect adequate revenue, growing expenditures pressured them to commit more debts on a continual basis until public debt predicaments not only emerged but also persisted or even worsened.

Thailand is not any exceptional case. Even though its ratios of public debt outstanding and fiscal deficit to GDP (41% and 4% respectively) are well below those of EU countries, most political parties tried to utilize fiscal measures in various fashions so as to

attain popularity. Examples of these policy actions were rice pledging, first-time car purchase, free bus service, financial credits extended to small businesses, debt refinancing for low-income farmers, and many other populist measures. Before trying to derive some useful guidelines to achieve optimal public debt management, it is worth reviewing the fundamental roles of public debts in most economies. Primarily, those borrowings are meant to complement tax revenue in financing public spendings and basic infrastructure projects. Secondly, those borrowings enable the government to implement some fiscal policies in order to stabilize the country’s economic growth path. Thirdly, government securities normally play some important roles in the recycling of domestic savings to fund investment and consumption. For example, rates of return on treasury bills and government bonds typically serve as benchmarks for financial instruments issued by private entities, because the government is ordinarily given the best ranking by most credit rating agencies. Moreover, government securities serve as a means of financial intervention in the secondary markets by the central bank for the purpose of tightening or loosening liquidity in domestic financial markets. Such intervention enables the government to flexibly adjust local liquidity in order to properly cope with global trends and/or pressures on the domestic front.

2. THAILAND’S REGULATIONS AND THEIR SHORTCOMINGS

Given the prominent roles of public debts in most economies as stated above, the two questions that several parties may have in mind are (1) whether the Thai government has regulations controlling public (domestic and foreign) debts, and (2) whether those rules are adequately prudent ensuring that Thailand will certainly not encounter public debt crises such as the ones in EU and Japan. Details of those rules are the following.

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Table 1 Public Debt Outstanding as a Percentage of GDP in 2011

Greece	160.81	Singapore	100.79
Italy	120.11	Malaysia	52.56
Portugal	106.79	Thailand	41.69
Ireland	104.95	Philippines	40.47
Spain	68.47	Indonesia	25.03
Japan	229.77	Laos	57.36
U.S.	102.94	Myanmar	44.32
France	86.26	Vietnam	37.97
Canada	84.95	Cambodia	28.60
U.K.	82.50		
Germany	81.51	Singapore	100.79
New Zealand	37.04	Taiwan	40.80
China	25.84	South Korea	34.14
Australia	22.86	Hong Kong	33.86

Source: Eurostat

(1) In each fiscal year the government's total borrowings cannot exceed 20 percent of annual budgetary appropriations plus 80 percent of repayment expenditures. In other words, the government can borrow funds to refinance maturing debts.

(2) In each fiscal year the government's commitments of external debts have to stay within 10 percent of annual budgetary appropriations. And the ratio of foreign debt service to export earnings must not exceed 9 percent.

(3) Total government's debt service (principal plus interest) remitted to domestic and foreign creditors must not exceed 15 percent of fiscal revenues.

The above-mentioned regulations may indicate that Thailand is careful about preventing its public sector from borrowing to an excessive extent. However, a closer scrutiny reveals that these rules contain several loopholes as illustrated below.

(1) Financial commitments by state enterprises are only restrained in the aspect of government guarantee. For instance, if the public agencies are limited companies (e.g., Thai Airways Co., Ltd., Bangkok Dock Co., Ltd.) or financial institutions (e.g., Krung Thai Bank, Government Savings Bank, Government Housing Bank), the total amount of government guarantee in each fiscal year cannot exceed 10 percent of the budgetary appropriations. In each case, if the borrower is a limited company, the amount guaranteed by the government cannot exceed six times of the capital fund of that company. If the borrower is a financial institution, the amount guaranteed cannot exceed four times of the capital fund of that financial institution. However, if the public agencies are organizations or authorities (e.g., Electricity Generating Authority of Thailand, TOT Public Company Limited, State Railway of Thailand, Bangkok Mass Transit Authority, Metropolitan Waterworks Authority, Provincial Electricity Authority), there is no limit on the amount of government guarantee. Special preference is given to the agencies providing public utilities such as water works or electricity generation and distribution.

(2) At various times the Thai government issued particular legal decrees enabling the government

to borrow additional funds for extra spendings. Even though some of these borrowings which are allocated to serve emergency incidents (such as the Decree on Soft Loan for Flood-Affected People, B.E. 2555, the Emergency Decree on Water Resource Management, B.E. 2555, the Decree on Insurance Pool Fund, B.E. 2555) may seem justifiable, these special legal decrees effectively nullify the above-mentioned 20 percent limit of government borrowings, so they could lead the country to face public debt predicaments.

(3) Worse yet, recent Thai governments favor the adoption of various populist measures in order to capture public attention. Examples of these populist projects are tax reduction on first-car and first-house purchases, debt suspension for low-income farmers, overall health insurance or the 30-baht scheme, free bus service, and rice pledging program. These fiscal policy actions can easily induce the public sector to be trapped in a vicious deficit cycle such as the ones in Euro zone countries.

(4) Certain ceilings of public debt outstanding to GDP ratio, such as 50 percent or 60 percent, are often announced by the Thai government as a policy guideline in managing public debt. However, this limit has never been legalized. So it does not have any steadfast and favorable impact on public debt management.

3. SUGGESTED AMENDMENTS AND THEIR RATIONALES

(1) A very crucial issue in managing public debt is fiscal sustainability. This should be well-preserved at all times for the purpose of supporting stable economic growth path. To achieve this, the Maastricht criteria to limit budget deficits should be put into a law, such as the one by the Indonesian government. This law prescribes that the *consolidated* national and local government's deficit on the *overall cash balance* be limited to 3 percent of GDP in any given year, and that the total central and local government debt not exceed 60 percent of GDP. This

law will certainly help in ensuring fiscal sustainability. In this context, what also deserves strong attention is that the above-mentioned “consolidated and overall cash balance” is defined to cover those on- and off-budget expenditures of all government agencies and state enterprises so as to avoid loopholes.

(2) In complying with the limit of debt commitments, the government should thoroughly examine the public sector’s debt servicing capacity in the macro context, not just current expenditures. Examples of items which determine the debt servicing capacity are expected revenue and net project earnings. The government does not have unlimited debt servicing capacity since it cannot always resort to the central bank as a certain source of funds, because doing so may conflict with the prevailing restrictive monetary policy. Neither may it raise particular taxes at any time due to political reasons. Worse yet, it may have difficulties in issuing bonds to the general public or investors overseas if its credibility has deteriorated to some extent. To be on the safe side, the government should disperse its future debt service over the long run and continually abide by its obligations on time. Otherwise, it may get caught in a debt trap or evil cycle such as the ones experienced by some Latin American countries in the past and some Euro zone countries now.

(3) Debt servicing capacity largely depends on the efficiency of fund usage. Therefore, the government should give strong preference to productive investment projects when it comes to the allocations of public borrowings. Special emphasis should be placed upon the investment projects which yield high returns plus low risks within a short time frame.

(4) To achieve efficiency of resource usage essentially requires good coordination and cooperation among relevant parties, including public and private ones. Such coordination and cooperation will also help yield benefits from economy of scale. Route planning or logistics of transport is one clear-cut example of projects that need comprehensive cooperation among several concerned authorities holding responsibilities in designing and constructing roads, railways, subways, expressways, and skytrains. Thus, strong attention

should be given to the timing of cooperative efforts to undertake the targeted projects.

(5) The time profile is a very important element of public debt management in many respects. Other than the timing of cooperative efforts among various agencies involved, the government should investigate the overall profile of its existing debt service before committing new debts. This consideration will help select proper maturities of new debts so that the country’s future debt services do not cluster in any particular period. Avoiding such bunching-up will help the government reduce the risk of encountering debt tension. Close and continual monitoring of the overall debt service profile together with global financial atmosphere will give opportunities for adjusting or improving the prevailing debt obligations by prepaying or refinancing some parts of the debts already committed. Examples of such improvements are to reduce foreign exchange risks, lessen debt burden, and smoothen debt service structure in the future.

(6) Another crucial facet of public debt management is its consistency with the prevailing and upcoming monetary and exchange rate policies. Otherwise, conflicts may arise and generate adverse effects to all concerned parties. Strong attention should also be given to global economic atmosphere and domestic income distribution. These elements are suggested because domestic policy actions are ordinarily subject to the prevailing external constraints. Meanwhile, those actions certainly have impact upon income distribution.

The above-mentioned six aspects of measures recommended to deal with public debts may seem complicated and difficult to implement, but they should assist the country in averting sovereign debt difficulties. They deserve continual efforts, because once the degree of investor confidence is shaken or declines due to the high chance or actual occurrence of sovereign debt crises, the recuperation tends to take a very long period of time as widely experienced by several member countries in the Euro zone (e.g., Portugal, Ireland, Italy, Greece, and Spain) between 2008 and 2013.

