

# [Budget surplus and deficit economics essay](https://assignbuster.com/budget-surplus-and-deficit-economics-essay/)

Fiscal Policy is the action done by government in order to influence the economy of their country by adjusting government spending and taxation. There are few variables in economy which will be influenced by the actions which are the aggregate demand and the level of economy, the distribution of income, and the pattern of resource allocation. Basically, it separate into three categories which are policy concerning government purchases good and services, policy concerning taxes and policy concerning transfer payment (David N. Weil, 2008). When the government budget is in surplus which means that the revenue is higher than spending, fiscal policy is said to be contractionary. However if the government budget is in deficit which means that the spending is higher than revenue, fiscal policy is said to be expansionary.

This assignment focus on how fiscal policy play a role in stabilize the economy of the country in order to keep the gross domestic product close to its potential level and inflation at acceptable level. Actually, this should be done by both monetary policy and fiscal policy, however in recent years, monetary policy focus on controlling the inflation rate rather than the output level. In this way, the management of the output level could be done by fiscal policy (Budnevich, 2002). Besides, it could be a problem for government to find a balance when exercising this policy. For example, when government is trying to boost up the economy, it appeared to have risk of leading to inflation. This is because when government tries to decrease the taxation, consumer will have more money to spend, thus increase the consumer demand and result in the decrease of value of money which mean that consumer have to use more money to buy the same thing which do not have changes in their value.

In this assignment, we will review about the theoretical background and issue of fiscal policy and use the ideas developed to discuss and argue about the fiscal policy of Thailand. At last, we will make recommendations regarding the weaknesses of the fiscal policy developed by Thailand.

Fiscal policy is discuss how government can influence macroeconomic or nation productivity level by changing in government spending and taxation. In many Asian countries, fiscal system of Thailand is highly centralized. In Thailand, government have implemented stimulus packages and increased budget expenditure to reduce the impact of high inflation in year 2008 and recession in year 2009. Government forecasted the expenditure which will increase by 100 billion baht to increase the fiscal deficit to 3. 5% of GDP in year 2009.

Due to the serious economic recession, the public debt, budget deficit and government borrowing rose more than their expectation because they were overconfident about 2009 tax revenue. They look forward to another year of strong revenue growth in year 2010 as the economy recovers.

The Thai government concerned more about the Fitch Ratings’ assessment of the country’s rating which monitors Thailand’s fiscal policy. It noted that targeted renovation spending in the floods by government and private sector, could improve the economic growth and strengthens the Thai economy’s supply potential.  Fiscal stimulus also helps to reduce the weakness in the global market.

Prime Minister Yingluck Shinawatra has affirmed that the 2013 fiscal policy budget will mainly go to infrastructure development for preparing the nation for the ASEAN Economic Community (AEC) in year 2015 because Thailand is still lacks in terms of infrastructure by comparing with other countries.

## 2. Theoretical background and Issues

First, we will take a look at how the price of a good is determined. Adam Smith, the early classical economists described the role of market in the resources allocation using the concept of “ invisible hand” (Eltis, W., 2000). He indicated how the changes in supply and demand influence the price of good which is when the supply of good increased and the demand decreased, the price for good will decreased, vice versa. Classical economists have several implications based on the theory free of outside intervention and emphasize on the role of production in influencing economic output. They think that government should only play a minor role in determined the economy because they believed that the extensive intervention of government will avoid the efficient operation of market in determine the price of goods and the allocation of resources to production line. Based on their theory, the natural economic will always at full employment even economic recession or depression is only temporary in nature. Classical economists believed that the economy will still return to a normal level with normal output.

This thought remained strong until the Great Depression during 1930s where for many industrialized countries, outputs were plummeted and unemployment rates reached the peak. The classical argument which mentioned that interest rates and falling prices would restore the economy never occurred. The economy remained stuck until John Keynes point out the last sector of aggregate demand which could have the potential to restore the economy to normal condition: government spending. Keynes is able to find out several problems about the classical theory. One of the important issues is that the wages would not fall as much as prices because it is sticky in nature during economic downturns. This cause the demand for labor decreased as the cost of labor increased. Another idea is that when the economic is weak, investments tend to no respond towards the changes in the interest rates. In this case, a decrease in interest rate will have little or no effect in the investment component of aggregate demand (Brent Radcliffe, 2009).

Next, we will explain about the basics of fiscal policy. Fiscal policy covers both government spending and taxation and it is approved by the legislative and executive branches of government. Let us begin by using the basic equation for GDP:

GDP = C + I +G + NX, where:

C = Consumption

I = Investment

G = Government Spending

NX = Net Export

Since AD = GDP,

It can be modify into:

AD = GDP = C(Y-T) + I(r) + G + NX, where:

Y = income

T = taxes paid

Y – T = disposable (after-tax) income

r = the rate of interest

Using this GDP equation, fiscal policy can be broken into two parts which are change in tax or tax rate, T which will affect the total consumption, C or influence the aggregate demand and growth rate of GDP by changing the government spending, G.

During economy recession, government will implement expansionary fiscal policy. They will increase the aggregate demand through two ways which are by increases its purchases but keep tax constant or the government can cut tax or increase transfer payments. In this case, household disposable income will increase and they tend to spend more and this increase the consumption, C. The increase in consumption leads to the increase in aggregate demand which in turn help to boost up the economy.

http://www. colorado. edu/Economics/courses/econ2020/section9/gifs/fig92. gif

Figure 9-2 shows that the economy is in recession as the intersection point of original aggregate demand curve, AD1 and aggregate supply curve, AS2 is to the left of the full employment point, YF. In this case, government will imply expansionary fiscal policy such as income tax cut or increase government spending to boost the aggregate demand and GDP growth.

When the economy growth rate is too high which have the risk that lead to inflation, government will implement contractionary fiscal policy. This involves the raise of tax or decreases in government spending in order to slow down GDP growth and reduces inflation. With less money and more tax to pay, household demand for goods and services decrease and this decrease the consumption, C which leads to lower economy growth.

http://www. colorado. edu/Economics/courses/econ2020/section9/gifs/fig91. gif

Figure 9-1 shows that the economy growth is high. The contraction of aggregate demand, AD due to reduction in government spending and increase in taxes happened. As the result of contractionary fiscal policy, the aggregate demand curve, AD0 shift from full employment, Y1 to a point with higher unemployment rate, Y0.

The Thai government’s short term fiscal policy includes tax reduction and expenditure increase. Government reduces the tax on the first-time home and car buyers and cuts the corporate income tax (CIT) rate over the two years to help private companies to settle the higher labor costs. Also that, the temporary reduction of the fuel excise tax has been extended repeatedly. Government introduces reduction of fee in real estate business too.

However, government increases the salary of civil servants and decides a debt moratorium for some low-income households to reduce their burden of life. The flood-prevention investment has to be implemented over the three years. They spend on infrastructure development to settle the annually flood problem. Thai government increases the higher tax rate on cigarette and liquors to increase government revenue and also reduce the consumption of these products.

Besides that, fiscal policy is one of the issues by which public action can have impact on poverty. To decrease the poverty in Thailand, a range of free utilities which are free water, electricity, train and bus is provided to low- income individuals or families.

In theory, when government deserves a large amount of deficit money market which are usually affected from public borrowing. The increase the interest rate will lead to the appreciation of the exchange rate. The government bond’s return rose progressively since the beginning of year 2009. This reflected that the government had to finance its deficit.

To improve the income of Thailand, government promotes investment and business transaction within ASEAN region. Yet, the income will come from exports and tourism. Their foreign exchange earned from export allows importing intermediates and capital goods that enlarges production potential.

## Issues

In year 2013, Thailand government is expected to set their fiscal budget at 2. 4 trillion baht which emphasize on maintaining the fiscal and monetary discipline. Their Prime Minister Yingluck Shinawatra gave a explanation on the 2013 fiscal budget after approved by the mobile cabinet in Udon Thani on 23 February 2012 to all the heads of government agencies. The 2013 budget had an increase of 20 billion baht as compared to previous year which is 2012 budget. It is expected to have a budget deficit for the year 2013. From the national budget, 2. 4 trillion baht, 1. 8 trillion baht will be used for regular spending. It is about 78. 5 percent from the total fiscal budget. Whereas for investment purpose, it is about 467 billion baht will allocated, which is an increase of 19. 5 percent from last year. For the debt repayment, 182 billion baht has been set aside. Thailand government assumed that the country’s GDP would grow about 4-5 percent.

This national budget is begin to implement on 1 October 2012 and end on 30 September 2013. The budget planning for this year have to take into account risk factors since the economy is volatile, said by the prime minister of Thailand. She also mentioned that depend more on the domestic economy can help to reduce risks.

During a seminar in Chon Buri talking about the strategies to promote new investments for intensive growth of Thailand industries, Udom Wongviwatchai said that there are many business operators worried about the Bol’s revised 5 years (2013-2018) investment privilege policy. But, this new policy is only applicable to those new applicants.

This new policy stated that the corporate tax exemptions will not exceed 8 years. However, it is suggested that it should be amended to allow more flexibility. Besides, the Thailand government has approved a tax cut for personal income tax rates during year 2013. They also allowed the husband and wife to have separate tax returns. This is to help to increase the net disposable income especially for those with lower income in order to encourage them to increase their consumption and help to boost up the Thailand economy.

## 3. Discussion and Argument

## 3. 1 Budget Surplus and Deficit

The 2013 national budget of Thailand shows an increase of 20 billion baht, or 19. 5 percent, compare to 2012 budget. Therefore, it is stated that in year 2013 will be another year of deficit budget. It is predicted to collect revenues of 2. 1 trillion baht, but the Government has set a deficit of 300 billion baht. In this case, government spending of 300 billion baht is more than tax collected of 2. 1 trillion baht only. This will leads to a budget deficit. Budget deficit is when government spending is more than tax collection. On the other hand, budget surplus occurs when government spending is less than tax collection. If the Government expenditures are more than government receives, Budget Deficit occurs while if the government expenditures are less than the government revenue, it is budget surplus.

When a budget deficit continues for a long time, structural deficit happen, and thus it create a problem. When there is a deficit, government will start to borrow money, and if this continued borrowing carry on in long run, this will becomes a huge debt. When the debt get too high, it will leads to high inflation. ( Financial Times Lexicon, 2013)

In order to focus on maintaining monetary and fiscal discipline, the national budget for the fiscal year 2013 has been set at 2. 4 trillion baht. One of the policy changes includes reducing corporate income tax from 30 percent to 23 percent changes under the controversial spending plan. According to Finance Minister Kittiratt Na-Ranong, he promised to ensure transparency in budget spending.

According to the briefing concerning the 2013 national budget made by Prime Minister of Thailand, Yingluck Shinawatra, out of the national budget of 2. 4 trillion baht, 1. 88 trillion baht will be used for regular spending, which is 78. 5 percent of the total budget. For investment, around 467 billion baht will be distributed, while for debt repayment, 182 billion baht has been allocated. (Thailand’s National Budget for the 2013 Fiscal Year, 2012 ) The pie chart represents the Thailand budget in details in 2013.

http://cdn. asiancorrespondent. com/wp-content/uploads/2012/08/basegraph-eng-621×448. png

( Saksith Saiyasombut & Siam Voices, 2012 )

During budget deficit, government will announce stimulus package. Stimulus package is when government combines a package of economic measure to boost up the economy and avoid or reverse a recession by enhancing employment and spending. With the increased in government spending will leads to a lesser impact of a recession.

In 2010, Thailand economic stimulus package of $3. 33 billion is mostly on social-welfare segment. Other segments that are allocated are for consumption, real-estate, tourism, and medium and small enterprises. In order to boost the economic growth, Thai central bank, Bank of Thailand, has eased monetary policies as part of an economic stimulus package. ( EconomyWatch, 2010)

## 3. 2 Federal Budget under Different Leadership or Government

Fiscal policy refers to the setting of the overall level of government spending and taxation by government policymakers. Its goals are to achieve full employment and overcome inflation. Thailand did apply this policy to achieve such goals and it has brought out some issues which are related to their federal budget, tax policy and whether they are surplus or deficit.

The federal budget issues that we are going to discuss will be distributed into 3 parts which are the Federal budget set by former prime minister of Thailand, Thaksin Shinawatra (From 2001-2006), Abhisit Vejjajiva (From 2008-2011) and the current prime minister of Thailand, Yingluck Shinawatra (From 2011- now).

When the Thaksin Shinawatra was the prime minister of Thailand, Thailand was enjoying a stable economic which their GDP growth are increase from 5. 3% in 2002 to 7. 1% in 2003, however, there has a significance decrease from 6. 3% in 2004 to 4. 5% in 2005. But, overall the performance of Thailand is good at that period as it was recovery from the ASIAN Financial Crisis 1997. Part of the reasons that Thailand can enjoy a stable economics that time is because the government which led by Thaksin Shinawatra has applied a policy which so called “ Thaksinomics”.

People said that Thaksinomics had greatly helped Thailand paid back the debt owe to the International Monetary Fund (IMF) within 2 years which owed when the economic crisis and reduced the poverty in rural area of Thailand. He was using the techniques by make the underground lottery system turn into a legal business by running a Government Lottery Office or we can called as legalize the lottery. And the tax and revenue get from the legalization of lottery which estimated 70 billion baht (US$2 billion) are spent in development of education sectors like “ One District, One Scholarship” program which enable the poor students to further study. This help the poor people from working into gambling sector.

Not only that, Thaksin also adopted the massive program of infrastructure investment in 2007 which invested US$50 in construct the roads, public transit and a new international airport. And because of this intensively implemented balanced budget was carried out, the foreign exchange reserve rate of Thailand has been doubled up from US$30 billion in 2001 to US$63 billion in 2006.

Thailand was just same as other countries, facing the global economic crisis when the Abhisit Vejjajiva was appointed as prime minister of Thailand in 2008. Under his leading, Thailand GDP growth drop 2. 3% in 2009 as the crisis was greatly affect the export sector of Thailand (export-dependent); but it rebound back to a positive amount of 7. 8% in 2010. Although the GDP growth rate has been rebounded back in 2010, but the ranking of Thailand in World Competitiveness was drop from 26th in 2009 to 27th in 2010.

Thus, Abhisit Vejjajiva has launched a policy called Creative Economy in 2010 by which together with Creative Thailand Commitments to overcome such situation. Creative Economy is an important alternative for Thai government to boost their economic growth by being creative and innovative to nurture more skilled and multitask workforce which can directly promote Thai’s wealth creation. In order to do so, Thai’s government hopes that ranking in World Competitiveness can be raised back. They had distributed a budget of 20 billion baht (US$6million) to 20 major creative economy projects under this sector and estimates it can help to boost the Thai industrial value from 12% in 2010 to 20% in 2012. Besides, they also formed public and private partnership in different creative sectors to achieve the goal of creative economy.

Under administration of Abhisit Vejjajiva by implementing this Creative Economy, the GDP growth has a sharply increases, which are 7. 8% in year end of 2011.

Yingluck Shinawatra started enter the office from 5th August 2011, unfortunately when she started play as the prime minister of Thailand, Thailand was facing the most serious flooding over the 70 years. The flooding not only harm the Thai’s live from 65 out of 70 provinces and also affect the whole Thailand economic which the GDP growth even rise only 1% in 2011 and bare US$ 46 billion losses (Seah, B. L., &Neo, Edwin. 2012 ). Therefore, Yingluck has proposed a series of policies to revitalize the economics of Thailand. First of all, the Thai government has planned to invest heavily in long term water management plan which cost US$ 10 billion to avoid any flood cases happen again. They will spend most of the budget to improve the dams and water drainage systems.

Moreover, the Thai government which leaded by Yingluck also applied a new federal budget and starts enforced from 1st April 2012 which is the minimum wage policy. This new policy requires the Thailand’s employer must pay their employees at least 300baht (US$10) per day to the local employees and around 60 bath (US$2. 03) per day to the Cambodian workers. If the employers do not follow this policy, they will be fined. Actually this is one of the promises of election campaign of Pheu Thai Party which led by Yingluck, through this policy, they are expecting it can spur the economic growth rate of Thailand and achieve the low unemployment. Besides, they do hope that can increase the general income level of employees which directly will boost the consumption of them and improve the overall economics if Thailand by applying this policy.

In fact, it did function well to boost the economic growth of Thailand as we can seen from the permanent secretary of Thailand’s Ministry of Labor said that the workers’ productivity increased by 12% compare with the previous year but it also brings lot of adverse effect to the employers especially to the small- and medium-sized enterprises (SMEs) who are more reliably on labour. They argued that the related policy is coming too fast and they are not able to afford the cost. And this had lead to over 7000 jobs were lost from April to December in 2012 because the companies which forced to shut down due the higher input cost (Sarah, A., 2013). Thai government still trying to overcome this issue after by implemented some policies which can ease the burden of SMEs like reduce the employers’ contributions to the Social Security Fund from 5% to 4%.

## 3. 3 Tax Issues

A government can only control tax rates, but not tax revenue. Increase in tax rates will indirectly affect spending and consumption, causing GDP to decrease, as disposable income is calculated by income deducting tax. The main aspects in a tax system are labour, capital, individuals and corporation taxes. These taxes affect employment rate, labour force participation rate, and tax revenue (Claus, Gemmell, Harding & White, 2010). Tax is one of government’s major revenue.

## Tax Collection Fiscal Year 2007-2012

## Types of Taxes

## 2008

## 2009

## 2010

## 2011

## 2012

## Total

## 1, 276, 270. 378

## 1, 138, 645. 329

## 1, 264, 314. 097

## 1, 516, 571. 685

## 1, 617, 293. 278

Personal Income Tax

204, 935. 836

198, 156. 623

208, 384. 380

236, 492. 982

266, 203. 226

Corporate Income Tax

460, 724. 677

392, 189. 307

454, 623. 429

574, 598. 447

544, 590. 662

Business Tax

10. 038

5. 793

4. 197

17. 237

5. 815

Value Added Tax

503, 483. 963

431, 775. 345

502, 258. 241

577, 728. 662

659, 803. 625

Specific Business Tax

25, 105. 124

18, 100. 077

22, 998. 904

35, 715. 890

41, 056. 551

Petroleum Income Tax

74, 033. 423

90, 712. 404

67, 598. 999

81, 444. 349

94, 096. 753

Stamp Duties

7, 733. 140

7, 488. 621

8, 209. 409

10, 312. 661

11, 180. 073

Others

244. 178

217. 159

236. 537

261. 457

356. 573

(The Revenue Department, 2013)

According to Thailand’s Revenue Department, tax collected for fiscal year 2012 was 1. 62 trillion baht, an increase of 6. 64% from previous year. The biggest contributors are value-added tax (660 billion baht), corporate income tax (544 billion baht), and personal income tax (266 billion baht). Value-added tax is an indirect consumption tax charged on producers and importers of goods and services. It was introduced in Thailand since 1992 (Son, 2006). Currently this tax has been lowered to 7% from the standard 10% since 1999, and exporters are given a zero rate. Non-profit organisations such as education institutions, government and private hospitals and clinics, are exempted from the tax (PricewaterhouseCoopers, 2012).

Corporate income tax has been decreased from maximum 30% to 23% in 2012 and 20% in 2013. This action reduced government’s tax revenue, but it may bring in foreign investments and decrease tax avoidance (Ernst & Young, 2012). It also helps in reducing company’s burden caused by the increased national minimum wage rate (Swire, 2011). Small and Medium Enterprise (SME) in Thailand is eligible for tax reduction as stated in Stimulus Package 1(SP1). SP1, a short term expenditure policy and tax measures are implemented to reduce impact of financial crisis. This policy depends on marginal propensity to consume (MPC), as poor people generally have higher MPC compared to rich people. MPC increases when net disposable income increases (Sangsubhan and Wangcharoenrung, 2011).

Residents and non-residents who stay in Thailand for more than 180 days are required to pay personal income tax based on net income. The table below shows the current tax rates, with new tax rates applicable from 1 January 2013 onwards, in bold and italics. The new rates result in tax savings for tax payers in every income groups. By doing so, the government wants to increase net disposable income and lower living costs for low and middle income groups, to encourage consumption. Tax deduction is given to first-time car or home purchase. Personal income tax is also a tool to reduce poverty and improve financial equity among citizens (Son, 2006).

## Net Income (Baht)

## Rate (%)

0-150, 000

0

## 150, 001 – 300, 000

## 5

300, 001 – 500, 000

10

## 500, 001 – 750, 000

## 15

750, 001 – 1, 000, 000

20

## 1, 000, 001 – 2, 000, 000

## 25

2, 000, 001 – 4, 000, 000

30

4, 000, 001 and above

35 (previously was 37%)

(KPMG, 2013)

## 4. Recommendations

## 4. 1 Budget Surplus and Deficit

In general, it is not necessary for government to ensure that the country is always in a budget surplus condition. A budget deficit indirectly shows that the country is still under-developing, just that government may have spent more on projects than estimated. In addition, the government may have reduce taxes and lost some income. Budget deficit also may happen during recession as fewer people are employed and are paying tax. However, that does not mean that budget deficit is favorable. Instead, government has to be careful on budget deficit, by ensuring that the means of financing the deficit do not leads to a heavy burden of interest. This is because interest will affect the Gross Domestic Product of a country. An increase of interest payments will leads to a rise on the proportion of Gross Domestic Product. Therefore, the government must be able to reduce the average interest rate paid on the debt. The revenues that actually can be used for more productive project, but because of the increasing interest burden, the government revenues are divided to pay for other financing costs.

In short, the government only need to always bear in mind of interest costs as a proportion of their income, and they do not need to worry much whether their budgets are in surplus or deficit. Somehow, to stimulate or to slow down the economic growth of a country is through budget surplus. It acts as an indicator concerning the economic growth. On the other hand, some economist says that actual production change in an economy will only be affected by the factors which are changes in the labor force, the state technology used, and productivity of the workforce and so on. Thus, manipulating the budget deficit will only result in a change in the price level in the economy.

According to Prime Minister Yingluck said that budget planning for the 2013 fiscal year must take into account risk factors from the volatility of the global economy. One way to reduce the risks is to depend more on the domestic economy. The Prime Minister cited 2012 as the year for flood restoration and rehabilitation. She believed that Thailand’s GDP growth in 2012 would be 5. 5 to 6. 5 percent. The Government would emphasize monetary and fiscal disciplines, as it expected a balanced budget in the future. Prime Minister Yingluck urged all government agencies to tighten their belt, since a large amount of the national budget would be spent on infrastructure development. She also stressed that budget preparation must respond to the needs of the people and be spent with efficiency and transparency. (Thailand’s National Budget for the 2013 Fiscal Year, 2012)

Besides, it is important for central bank and the Ministry of Finance to coordinate closely on fiscal policies. The country’s major economic institutions meet every year to discuss on the government budget framework for each fiscal year in Thailand. The discussion is mainly on the different views for economic and monetary conditions, collection of income, government bonds and the maintainable level of public debt. However, there are still many rooms for improvement and they are still in the process of finding ways to strengthen this coordination for the implementation of effective policies. (Suchada Kirakul, Fiscal policy and its implication for central banks, p. 329 )

## 4. 2 Federal Budget under Different Leadership or Government

In a nutshell, the federal budgets of Thailand toward their economic are quite well, but there still have some improvements need to be considered. Just take the example of implementing the minimum wages policy, most of the Thais entrepreneur complaint that this policy was being implemented too fast and had increased their burden. This led them cannot afford the higher input cost and forced to shut down their business, not only that, some of them even voice out besides the wages, other operating expenses like logistic, gasoline and others also make them hard to earn profit. Therefore, in such case, Thailand government should do a survey and understand what the needs of their citizen then just discuss with other parliaments and set the policies which are best suited to the citizens and the ways to carry out the policies. Therefore, Thai government should implement any policy step by step and give enough time to the citizens to get to used it and the effect just will efficient.

## 4. 3 Tax Issues

Thailand government should implement a larger scale tax reform. Many economists have suggested this as the country has evolved into developing country, from agriculture-based to industrial-based. People have higher income, improving from 2, 456 Baht per capita in 1961 to 49, 480 Baht per capita in 1992 (Sujjapongse, 2005). Therefore, tax structure should be updated, and it may refer to ‘ broad base, low rate’ approach to improve tax efficiency. It means to tax all types of income at a low rate. Thailand government has been decreasing tax rates, for example, personal income tax decreased from maximum 55% to maximum 35%. Tax reform will also help in distributing wealth equally. Researches show that developed countries’ tax revenue depends heavily on direct taxes (personal income tax), while developing countries rely heavily on indirect taxes (value-added tax). More direct tax will promote equity as tax is charged based on net income, and indirect tax has to be paid regardless of a person’s income.

Next, Thailand’s Revenue Department should review their tax rates to prevent unqualified people to benefit from tax exemptions. In order to recover their revenue loss from reducing corporate income tax, they could implement new taxes, or collec