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Estimating Fiscal Reaction Functions in Malaysia, Thailand and the Philippines

(Anggaran Fungsi Reaksi Fiskal di Malaysia, Thailand dan Filipina)

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ABSTRACT

As with most of the world economy, the 2008/09 global financial crisis has brought massive impacts on Southeast Asian economies. The debt/GDP ratios in most economies rose significantly, thus putting the spotlight again on fiscal sustainability. This article aims to distinguish the reaction of the primary balance/GDP to changes in the debt/GDP to assess the fiscal sustainability of Malaysia, Thailand, and the Philippines. In investigating how the respective governments react to the accumulation of debt, the article estimates the fiscal reaction function, initiated by Bohn (1998), using Ordinary Least Square (OLS) and Vector Autoregression (VAR). The empirical analysis reveals that, based on past behaviour, fiscal policy in Malaysia, Thailand, and the Philippines remains sustainable.

Keywords: Fiscal reaction functions; fiscal sustainability; Malaysia; Thailand; Philippines

ABSTRAK

Seperti kebanyakan ekonomi dunia, krisis kewangan global 2008/09 telah membawa kesan besar ke atas ekonomi Asia Tenggara. Nisbah hutang/KDNK di kebanyakan ekonomi meningkat dengan ketara, dengan itu meletakkan perhatian semula terhadap kemapanan fiskal. Artikel ini bertujuan untuk membezakan tindak balas keseimbangan primer/KDNK kepada perubahan hutang/KDNK untuk menilai kemapanan fiskal Malaysia, Thailand, dan Filipina. Dalam menyiasat bagaimana kerajaan masing-masing bertindak balas kepada pengumpulan hutang, artikel menganggarkan fungsi reaksi fiskal, yang dimulakan oleh Bohn (1998), dengan menggunakan dengan menggunakan Kuasa Kedua Terkecil Biasa (OLS) dan Vektor Autoregresi (VAR). Analisis empirikal menunjukkan bahawa, berdasarkan tingkah laku yang lepas, dasar fiskal di Malaysia, Thailand, dan Filipina kekal mampan.

Kata kunci: Fungsi reaksi fiskal; kemapanan fiskal; Malaysia; Thailand; Filipina.

INTRODUCTION

Public debt accumulation has become a topic of major concern in the broader international community since the outbreak of the sovereign debt crisis in 2009. This has raised the discussion on the issue of debt sustainability particularly after the Global Financial Crisis in 2008, which has given rise to growing concern on the fiscal stance in the world economy. The aftermath of the 2008/09 crisis caused a sharp increase in government debt in most of the advanced countries, involving the United States, Japan, Portugal, Ireland, Italy, Greece, and Spain. This is mainly caused by high exposure particularly in the domestic banking sectors to sovereign risk and inflexibility of monetary policy, which contributed to the sovereign and banking crises in the European countries mentioned above (Kawai & Morgan 2013).

Most of the emerging and developing economies weathered the global financial crisis well relative to the advanced economies, as many have implemented fiscal stimulus packages to decrease the deficits and debt and alleviate the impact of the crisis. However, it is crucial to emphasise that, despite the remarkable resilience to the financial crisis, many developing as well as emerging economies seem to have had primary (non-interest) fiscal deficits, deteriorating primary surpluses, and rising public debt levels in the years immediately prior to the crisis (Rajan, et al. 2015; Sangsubhan & Basri 2012). The subsequent deterioration of fiscal balances is rather critical for some countries. Recurrent budget deficits increase debt level, which builds up expectations of future government expenditure pattern and therefore increase future net deficits because of the need to service higher interest payments on the debt. Higher interest rates will result a rise in debt-servicing costs which increases the budgetary outlays. This leads to a wider deficit and forms a potentially vicious circle which the fiscal policy is deemed to be unsustainable. This leads to a more challenging debt management strategy. There are numerous reasons to explain this situation. When an economy reaches higher level of income, the real growth rates will slow down and raises government expenditure as a result of rapid aging. This will lead to economic dynamism and diminishing financial repression contribute to a narrowing gap between bond