

Military Business Cycle, Coups, and Economics of Corruption

Bhanupong
Lecture 26

Our great quotation

- **“If we want peace for our nation, we must be readily prepared for wars.”**

Quotations from the 34th US president

“National security does not mean militarism or any approach to it. Security cannot be measured by the size of munitions stockpiles or the number of men under arms or the monopoly of an invincible weapon.

That was the German and Japanese idea of power which, in the test of war, was proved false.

Even in time of peace, the index of material strength is unreliable, for arms become obsolete and worthless; vast armies decay while sapping the strength of the nations supporting them; monopoly of a weapon is soon broken.”

Main themes

- Determinant of military spending
- Peace dividends
- Political vs. military business cycles
- Institution inefficiency and growth
- Corruption and marginal return on capital

Global Defense Spending

- Global military spending increased to \$1.7 trillion in 2015, with the U.S. being the biggest spender by a wide margin.
- A recent report from the Stockholm International Peace Research Institute shows that military expenditures across the globe climbed by 1 percent from the previous year, the first such increase since 2011.
- Overall, military expenditures were equal to **2.3** percent of the global gross domestic product.

The world's top three military spenders

- **The United States.** With **\$596** billion for defense in 2015, the U.S. was the largest spender by far. However, the huge price tag was actually a drop of 2.4 percent from 2014, though that's a slower rate of decline than past years. Still, ***the U.S. spent nearly as much on its military as the next eight biggest militaries combined.***
- **China.** Beijing came in second, as it did in 2014, with an estimated **\$215** billion in spending. That figure represents an increase of 7.4 percent from the previous year, although the rate of increase is beginning to slow in line with the country's weakening economic growth.
- **Saudi Arabia.** Coming in at third with spending of **\$87.2** billion, Saudi Arabia overtook Russia, mainly due to the fall in the value of the ruble. Additionally, Riyadh's military campaign against Yemen's Shiite rebels and their allies has led to billions of dollars more in purchases.

Top five military spenders

- **Russia.** The fourth-largest spender at **\$66** billion, the fall in oil prices meant that the country's increase of 7.5 percent in 2015 was considerably lower than projected in its budget, according to SPRI.
- "***The economic crisis*** related to falling oil and gas prices, coupled with economic sanctions, dramatically reduced Russian Government revenues," Actual military expenditure was 3 per cent lower in 2015 than originally planned.
- **United Kingdom.** The drop in the value of the euro was a major factor in ***France falling into seventh*** place and the United Kingdom climbing to fifth, with **\$55.5** billion in spending.

Australia is buying 12 new submarines from France for \$39 billion

- Australia has ordered 12 new submarines at a cost of \$39 billion, becoming the latest nation to upgrade its fleet in a region where the seas are getting crowded.
- The arms race has been underpinned in part by the region's growing economic power.
- While defense spending in Europe is basically flat, ***Asian countries are increasing their military budgets by 5% each year.***

Determinants of military spending

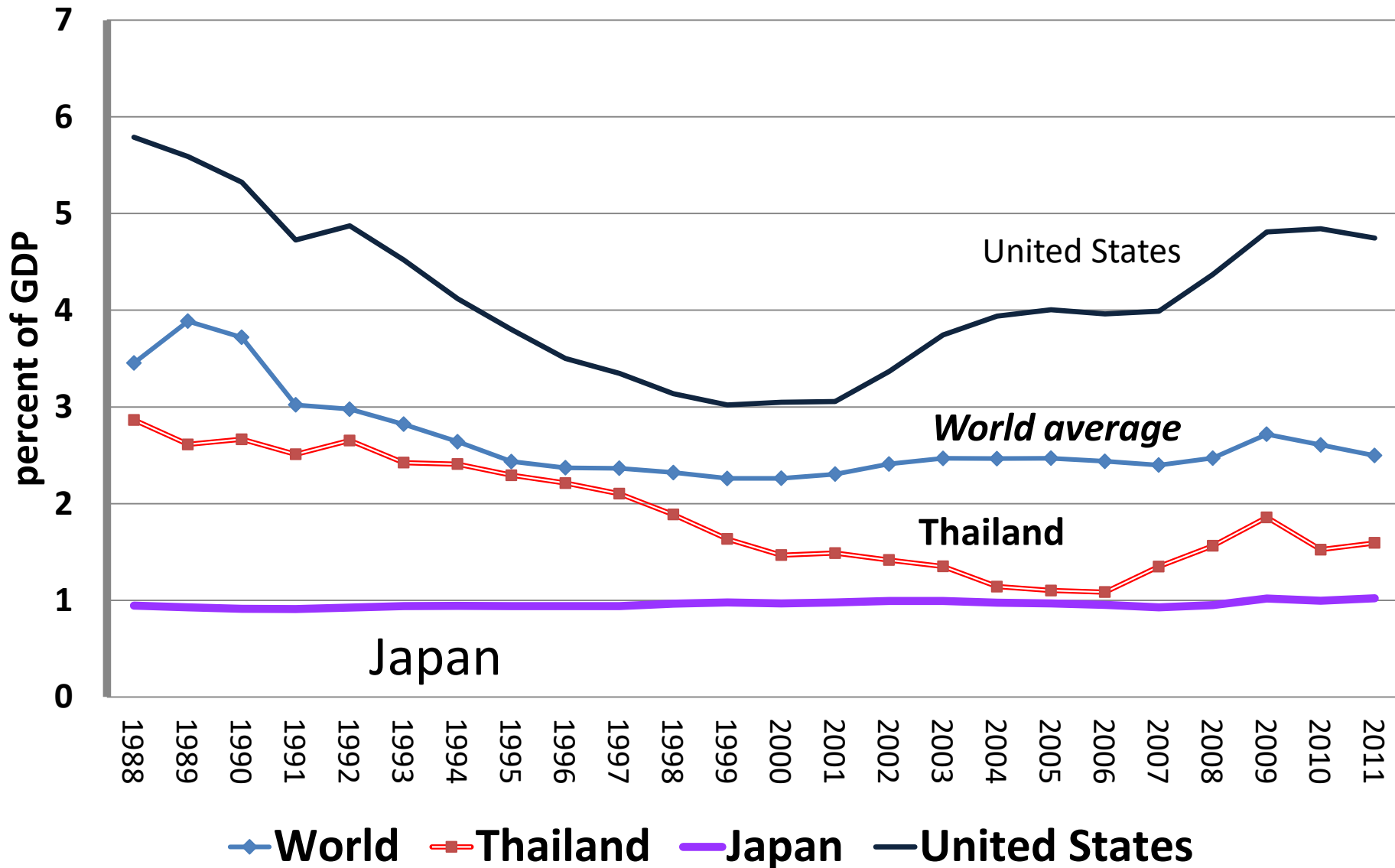
- External and civil wars, military spending by potential enemies, population, and democracy.
- While democracy is negatively related to military burden, other factors contribute to higher defense spending.

Rank		Country	Spending, 2015 (\$ b.)	Change, 2006–15 (%)	World share 2015 (%)	Spending as a share of GDP (%) ^b	
2015	2014 ^a					2015	2006
1	1	USA	596	-3.9	36	3.3	3.8
2	2	China	[215]	132	[13]	[1.9]	[2.0]
3	4	Saudi Arabia	87.2	97	5.2	13.7	7.8
4	3	Russia	66.4	91	4.0	5.4	3.5
5	6	UK	55.5	-7.2	3.3	2.0	2.2
6	7	India	51.3	43	3.1	2.3	2.5
7	5	France	50.9	-5.9	3.0	2.1	2.3
8	9	Japan	40.9	-0.5	2.4	1.0	1.0
9	8	Germany	39.4	2.8	2.4	1.2	1.3
10	10	South Korea	36.4	37	2.2	2.6	2.5
11	11	Brazil	24.6	38	1.5	1.4	1.5
12	12	Italy	23.8	-30	1.4	1.3	1.7
13	13	Australia	23.6	32	1.4	1.9	1.8
14	14	UAE ^c	[22.8]	136	[1.4]	[5.7]	[3.2]
15	15	Israel	16.1	2.6	1.0	5.4	7.5
Total top 15			1 350		81		
World total			1 676	19	100	2.3	2.3

[] = SIPRI estimate; GDP = gross domestic product; UAE = United Arab Emirates.

(Courtesy Fiscal Times)

Military Expenditures



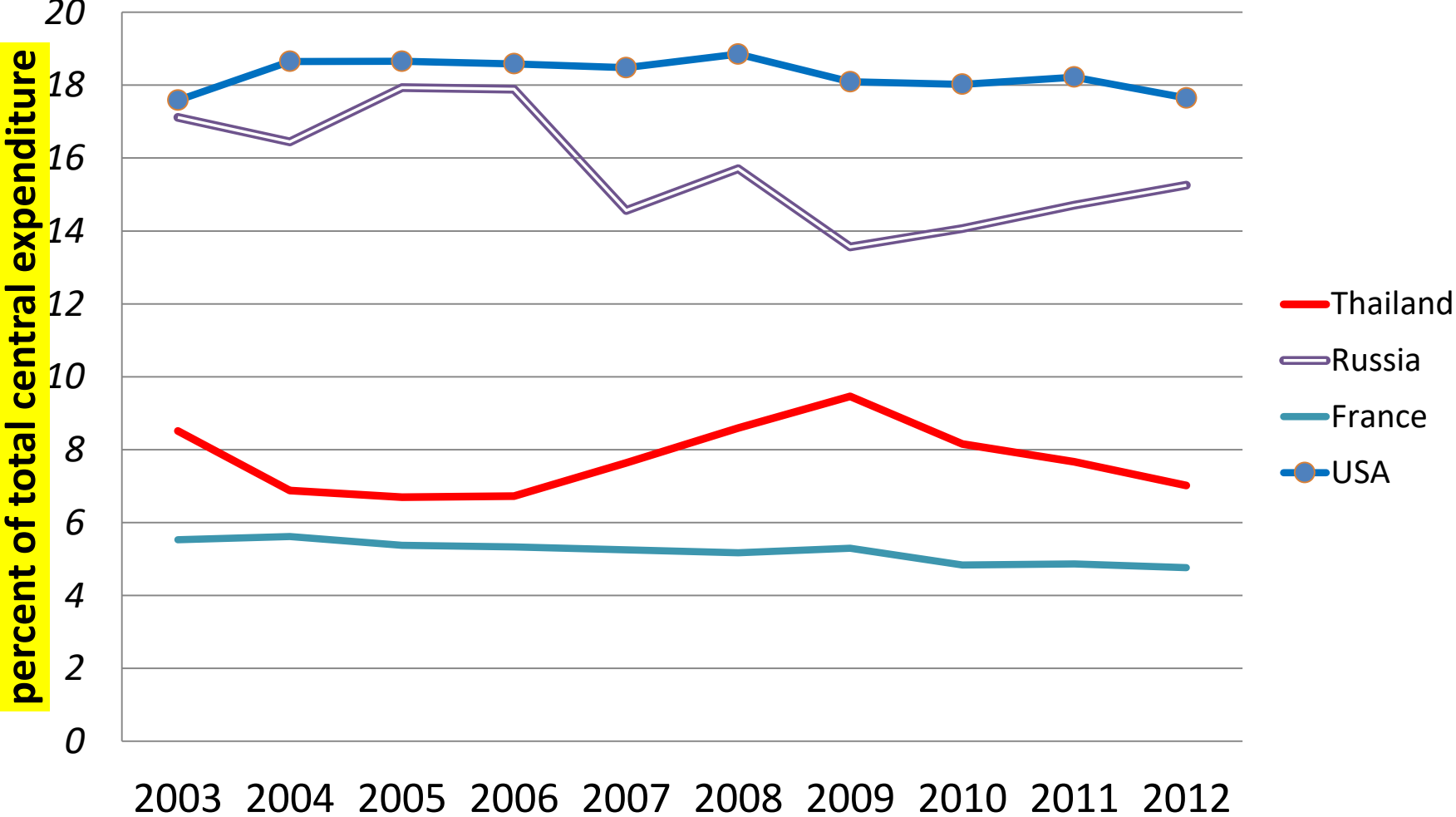
Peace Dividend

- Military spending can be considered as a wasteful spending in time of peace.
- The term “peace dividend” refers to a potential long-term benefit as budgets for defense spending are assumed to be at least partially redirected to social programs and/or a decrease in taxation rates.
- **Guns versus butter** theory used at the end of the Cold War, when many Western nations significantly cut military spending.

Political business cycle

- Governments tend to stimulate their economies with expansionary fiscal and monetary policies *before* elections, resulting in employment gains or wealth transfers, thus increasing government popularity.
- Restrictive policies *after* the election lead to a full circle in economic activity (Nordhaus, 1975)

Military Expenditure

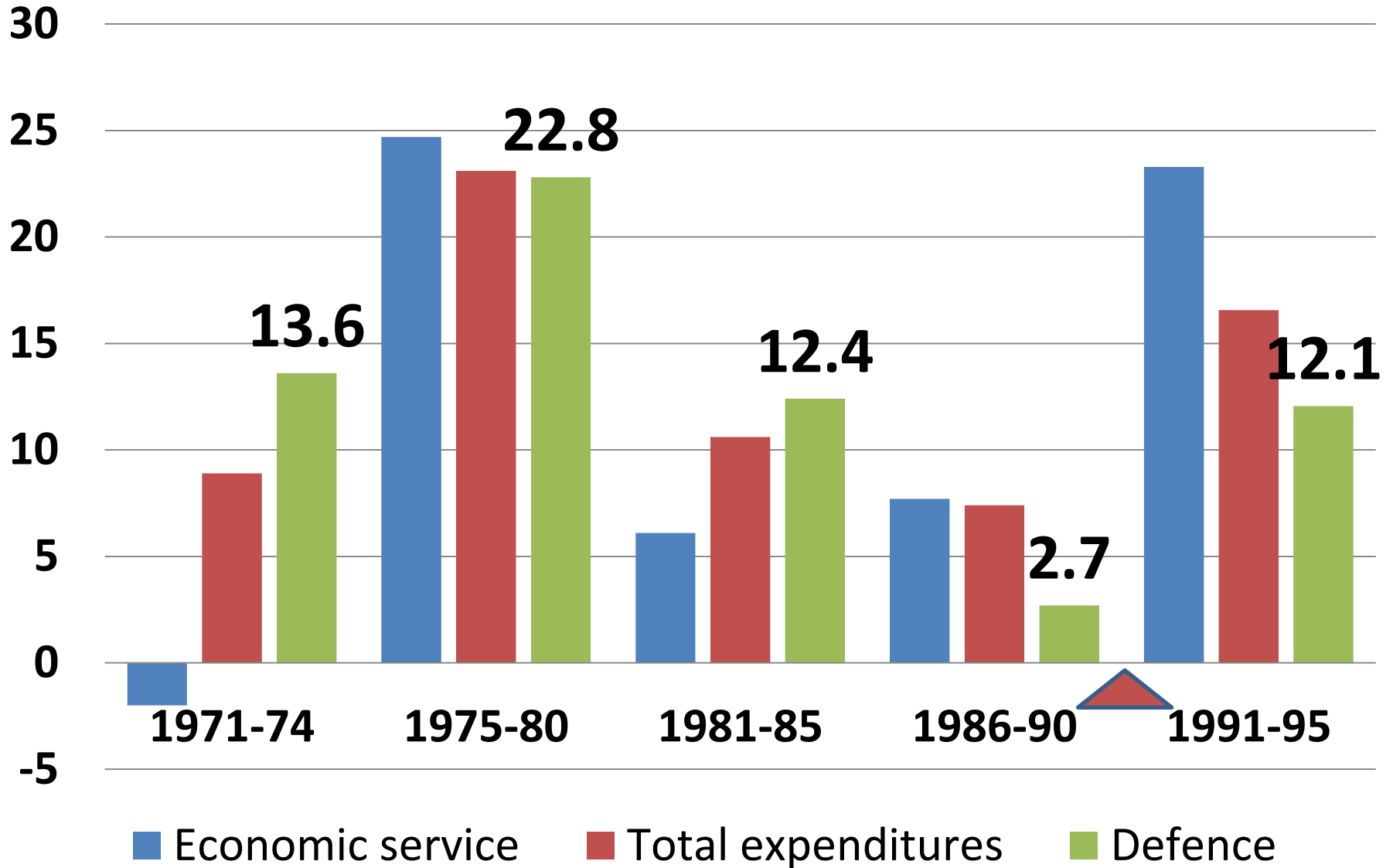


Land of the coups (PM name)

- 1971 (General Thanom)
- 1976 (Seni)
- 1977 (Thanin)
- 1981, 1985 (General Prem, coup attempts)
- 1991 (Chartichai overthrown by General Suthorn, Feb 1991)
- 2006 (Thaksin overthrown by General Sonthi, Sep 19, 2006)
- 2014 (Yingluck overthrown by General PCOC, May 22, 2014)

Military Business Cycle

(period average growth rate)



Hypothesis of military business cycle

- ***Military spending slump is a leading indicator of a military coup in Thailand***
- Military spending rises rapidly after a military coup and slowly dies off as a democratic government is elected under a new constitution.

Compare and contrast

- Too low military spending may be dangerous to democracy because the military need to be pacified.
- Are the justifications for the 2006 coup the same as those in the 2014 coup?
- Indiscipline and defiance to the rule of law have a long lasting impact, causing addiction to military coup.
- Political dynamics would make it difficult to cut current (consumption) spending in the future.
- Fiscal discipline has been neglected in the pursuit of short-run political gain at the expense of the long-term economic growth and stability (dynamic inconsistency problem).
- Ultra-populism policy can be a legal means of vote buying or returning “happiness” to pacify the masses.

Seemingly transparent procedures

- Strategic use of multi-year budgeting whereby really tough policies are systematically postponed to year 2,3, or 4 of the plan and seldom implemented since multi-year plans can be revised every year (Alesena & Perotti (AER, 1996)

Fiscal illusion

- Politicians generally choose to be ambiguous.
- Buchanan and Wagner (1977): Uninformed and naïve voters **underestimate the costs** of current and future public programs.
- Even with rational voters, ***strategic ambiguity*** may create advantage for policy makers in pursuing their goals (Rogoff, 1990).

Creative fiscal policy

- Creative and strategic use of what is kept in and off the budget.
- Optimistic prediction on key macroeconomic variables (confirmed by the next slide).
- ***Optimistic forecasts of the effects on the budget of various new policies.***
- *“The Thai government estimated that economic growth would rise to 2% to 3% in 2010 as the result of the 2009 fiscal stimulus, and 5 % annually with in the next few years.”*

Fiscal Policy Office: Stimulus can boost the 2014 GDP to 2%

- “Economic growth is likely to reach 2% this year (2014) if stimulus measure that will come to force in the fourth quarter are taken into account”
- “Growth is expected to rise to 4.5% next year (2015) on the back of the planned economic stimulus” Finance Minister Sommai Phasee
- Bangkok Post, Sep 30, 2014

Fiscal indiscipline

- Rule of fiscal prudence cannot be ignored.
- Multi-year budget is detrimental to fiscal flexibility and efficiency.
- Non-transparent budgetary procedure conceals corruption.

Growth and institutional efficiency

- Revolutions and coups, political assassinations **tend to lower long-term growth** (Barro, QJE 1991)
- This is true for the most recent coups in Thailand.
- Institutional inefficiency causes low growth.

Indicators of institutional inefficiency

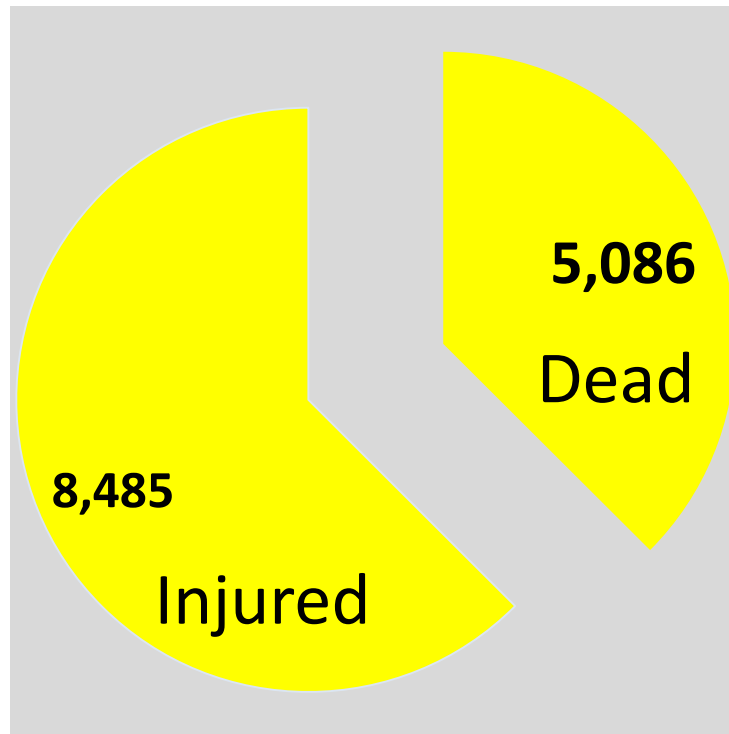
Mauro (QJE, 1995)

- Political changes: Possibility that institutional framework will be changed within the forecast period by elections or other means (e.g. military or/and juristic coup).
- Political instability: Conduct of political activity and the degree to which the orderly political process tends to disintegrate or become violent.

Indicators of institutional inefficiency

- Probability of opposition group takeover (a snap election or dissolve the parliament)
- Stability of labor: Degree to which labor represents possible disruption for manufacturing or business activity.
- Conflicts with neighboring countries
- Terrorism

Southern Violence: Number of dead and injured 2004-2012



Further Indicators of inefficient institutions

- Legal system, judiciary: Efficiency and integrity of the legal environment as it affect business.
- Bureaucracy and *red tape*

*The World Justice Project
Rule of Law Index 2014
www.worldjusticeproject.org*

	Thailand	Sweden	USA	Myanmar	Japan
Laws are stable	0.39	0.87	0.75	0.23	0.77
Freedom of opinion and expression	0.59	0.95	0.79	0.30	0.79
Effectively Enforced civil justice	0.12	0.89	0.53	0.45	0.76
Overall score	0.52	0.85	0.71	0.41	0.78

Further Indicator of ineffective institution: Corruption

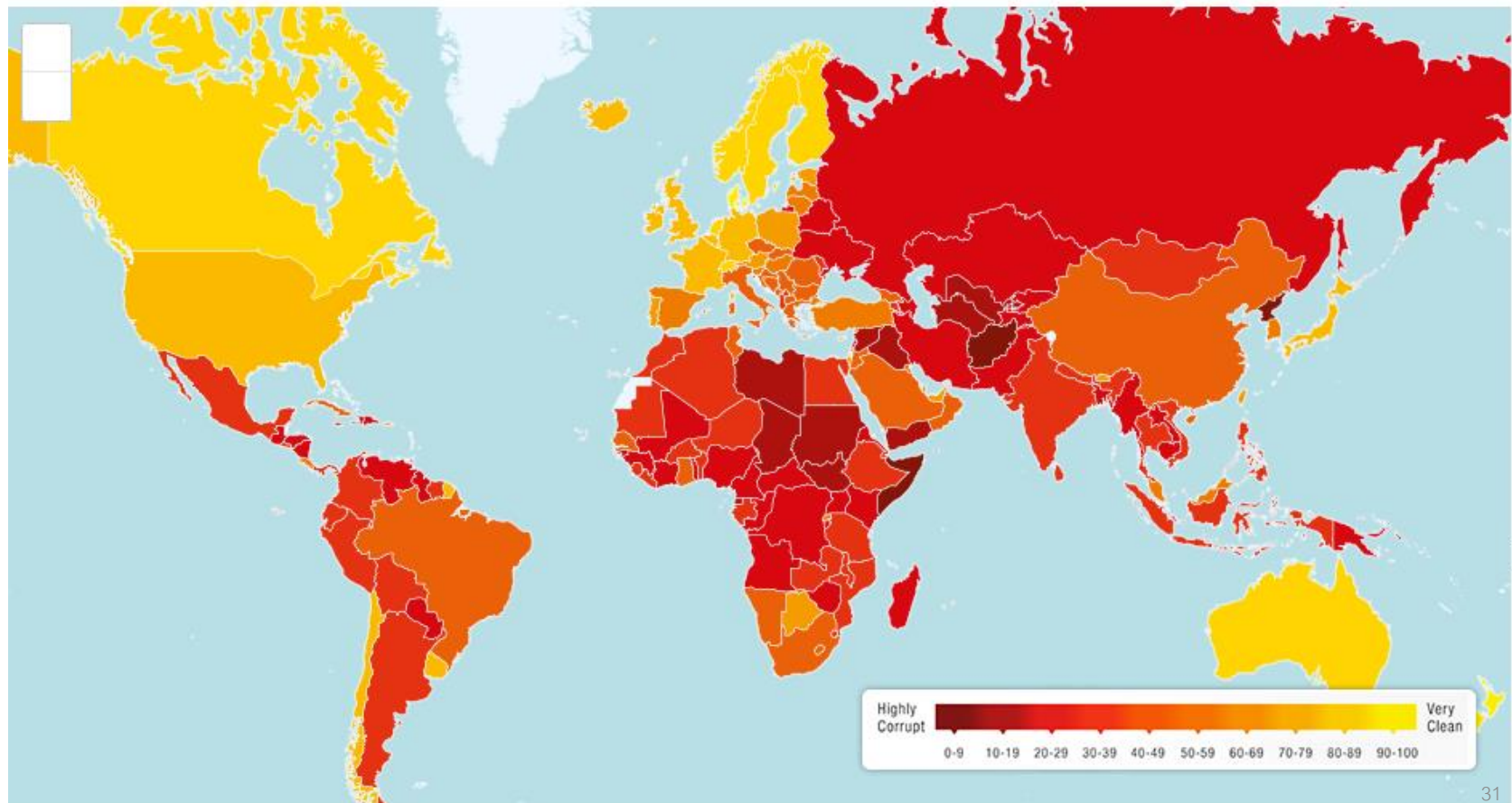
The degree to which business transactions involve corruption or questionable payments
Corruption Perception Index (CPI)

The Index scores 177 countries on a scale from 0 (highly corrupt) to 100 (very clean). No country has a perfect score, and two-thirds of countries score below 50. This indicates a serious, worldwide corruption problem

CORRUPTION PERCEPTIONS INDEX 2013

[VIEW BROCHURE](#)

[VIEW RESULTS TABLE](#)



Corruption Perception Index: 2016

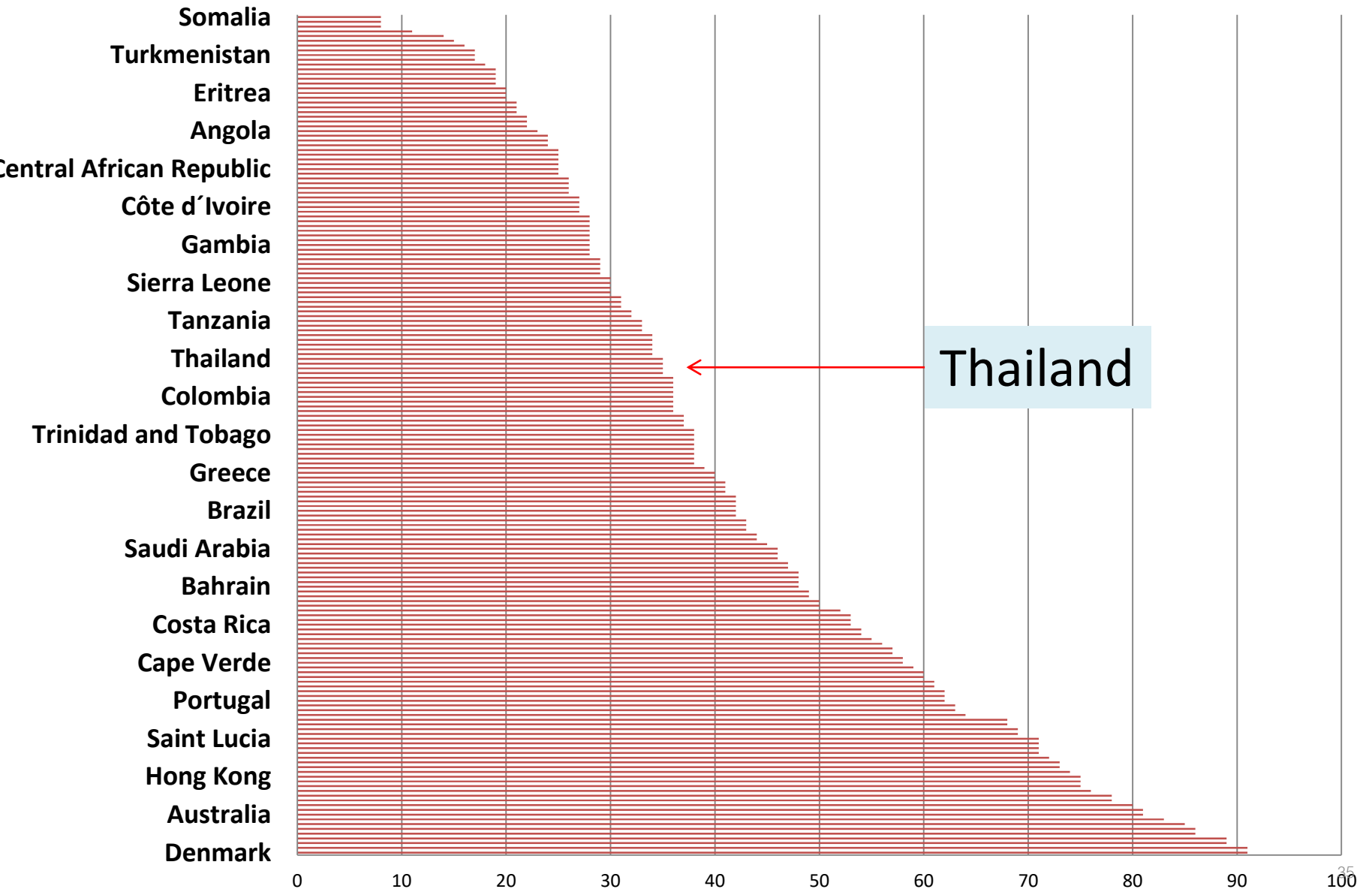
	score	Rank (177)
Somalia, N. Korea	8	175
Thailand	35 38(in 2014)	101
China	40	80
USA	73	19
Japan	74	18
Netherlands	83	7
Singapore	86	5
Denmark	91	1

The linkages between corruption, inequality and populism: Transparency International

- The interplay of corruption and inequality also feeds populism. When traditional politicians fail to tackle corruption, people grow cynical.
- Increasingly, people are turning to populist leaders who promise to break the cycle of corruption and privilege. Yet this is likely to exacerbate – rather than resolve – the tensions that fed the populist surge in the first place..

Corruption can lower investments by reducing the private **marginal product of capital**; thereby lowering economic growth rate.

Corruption Perception Index: 2013



Bay tong, Yala, 2014



**The UK GT200 distributor was found guilty of fraud
But Thailand purchased GT 2000 bomb detectors employed in the Deep South**



A Thai soldier using the fraudulent bomb detector GT200 at an army checkpoint. The UK-based manufacturer was sentenced to jail last Friday. (Pic: AP)

The Army's GT200

Detecting *golf balls or bombs?*

- A bomb-dowsing rod: The GT200 devices have proved worthless at finding explosives. (**500** million baht)
- Even more seriously, they have actually resulted in casualties, and inhuman rights violations against civilians, particularly in the South.

GT200: Testing
“You need to have steady hands
and enough sleep last night
to make it work properly”



“We shall continue using GT 200”

Director of the forensic Institution.

Feb 16, 2010

“..สถาบันนิติวิทยาศาสตร์
จะใช้เครื่องจีที 200
ต่อไป..”

พรทิมย์ โรจนสุนันท์

16 ก.พ.53



<http://www.manager.co.th/Politics/ViewNews.aspx?NewsID=252522&Page=1>

It was a fraudulent bomb detector.
The UK manufactures were sent to
jail for deceiving the public.

A multi-billion-baht boondoggle

- The list of boondoggle is long but includes the country's greatest white elephant ever, the multi-billion-baht aircraft carrier purchased from Spain during the height of the country's economic growth in the late 20th century.
- Design and constructed by Spanish shipbuilder [Bazán](#), *Chakri Naruebet* was ordered in 1992, launched in 1996, and commissioned into the Royal Thai Navy in 1997.

China's first aircraft carrier: Laioning



Thailand's first aircraft carrier

- The flagship of the Royal Thai Navy and Thailand's first and only aircraft carrier.
- The aircraft carrier HTMS Chakri Naruebet was sent out to rescue people stranded on islands like Koh Tao.
- Requires a vertical takeoff aircraft

HTMS Chakri Naruebet: A sky jump platform



USS Carl Vinson



The Nimitz-class aircraft carrier USS Carl Vinson and its task force, seen here in the Philippine Sea recently, are headed towards Korea. (Photo via US Navy)

List of aircraft carriers by country

Country ↕	In service ↕
 Argentina	0
 Australia	0
 Brazil	1
 Canada	0
 China	1
 France	1
 Germany	0
 India	2
 Italy	2
 Japan	0
 Netherlands	0
 Russia	1
 Spain	1
 Thailand	1
 United Kingdom	0
 United States	10

The Air force and the Gripen

- Adding to the equally ground-bound Alpha jets purchased against massive public opposition, the Gripen fighters were purchased from Sweden.
- Vertical takeoff jets bought together with the aircraft carrier.
- The Gripen have never effectively flown in combat.

The Gripen



Threat by neighbors

- The decision to buy the Chinese-made tanks was prompted by the fact that Thailand then faced a serious security threat on its eastern border from a hostile Vietnam, which had occupied Cambodia and fought a war with Cambodian resistance forces secretly backed by Thailand and the United States.
- The Thai army also ***could not afford*** the more expensive armored vehicle from the US or the other western countries.
- The 25 tanks were bought at a "friendship price" of about one billion baht from China in 1987 when Gen Chavalit Yongchaiyudh was army commander-in-chief.

T69-II

During the 1980s, China was reported to have sold hundreds of Type 59 and Type 69 main battle tanks to Iraq



Size of this preview: 800 × 546 pixels. Other resolutions: 320 × 219 pixels | 640 × 437 pixels | 1,024 × 699 pixels | 1,280 × 874 pixels.

T69 is too heavy for Eastern muddy terrain

- The Chinese-made tanks were found to be too heavy and became stuck in the muddy terrain on the eastern border of Thailand, especially during the rainy season.
- The tanks were never positioned near the border, particularly at the Aranyaprathet-Poipet border, where it was feared that Vietnamese armour would make its move if there was an invasion.

Decommissioned tanks and care for environment: Army's wasteful defense spending

- *Bangkok Post, published: 27/07/2010*
- The army's dumped a fleet of **25** decommissioned Chinese-made T69-2 medium tanks into the sea off Narathiwat and Pattani provinces
- The good news is that the army demonstrated that it is not just a heartless fighting machine, but has a soft side too, for the environment.
- The unusable tanks (there are no parts for repairs) will form an ***artificial coral reef***, a shelter for fish and other marine life in the sea off the two southernmost provinces.

Ukraine BTR-3E1 armored personnel carrier(APC).

- The purchase of the Ukrainian armored cars was another expensive exercise in poor military judgment.
- Altogether 535 units were bought at an average price of one million baht apiece;

Ukraine BTR-3E1

The **BTR-3** is an 8×8-wheeled [armored personnel carrier](#) was designed by Adcom Manufacturing from [UAE](#) in 2000/2001 and manufactured in [Ukraine](#)



ns/c9/BTR3.jpg

Ukraine BTR-3E1

- 96 BTR-3E1s delivered with the price tag of 4 billion baht, 120 more on order from Ukraine.
- The first 2 of 96 BTR-3E1 have been delivered at U Tapao Airport on 17 September 2010.
- The second batch of 121 BTR-3E1s with a price tag of 5 billion baht have been ordered by [Royal Thai Army](#) and 14 BTR-3E1s have been ordered by [Royal Thai Navy](#)

28 more Chinese tanks: VT-4

The army had signed an agreement to purchase 28 VT-4 tanks from China and in the second phase would procure more such tanks until it has a full fleet of 49 tanks in fiscal year 2017.

After problems with the delivery of 49 Oplot tanks ordered from Ukraine, the army committee which decides on military hardware procurements has opted to cut the number of tanks to be bought from Ukraine and buy more from China instead, he said.

The problem facing the Ukrainian supplier was due mainly to Ukraine's internal situation, he said.

However, the Ukrainian tank maker should be able to deliver all 49 tanks to the Thai army by October, 2017, according to Gen Chalermchai.

That is why the army turns to the east: VT-4 Tanks from China



Why Chinese made weapons?

Legal restriction by the US government

An army source said the army also has drawn up a plan to procure several more fleets of 49 VT-4 tanks to replace US-made ones that need to be decommissioned.

Military hardware produced in the US and other Western countries is high quality but also expensive.

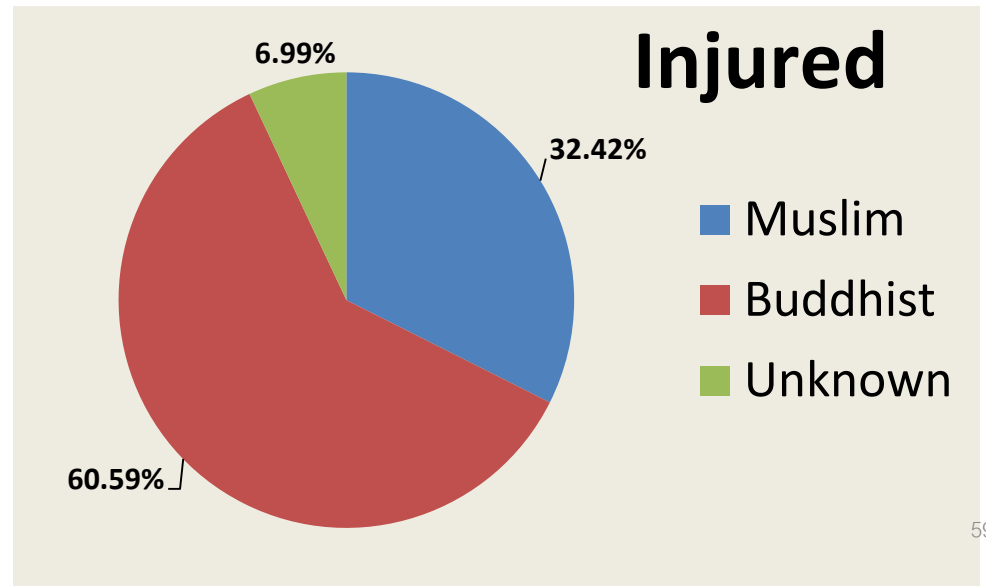
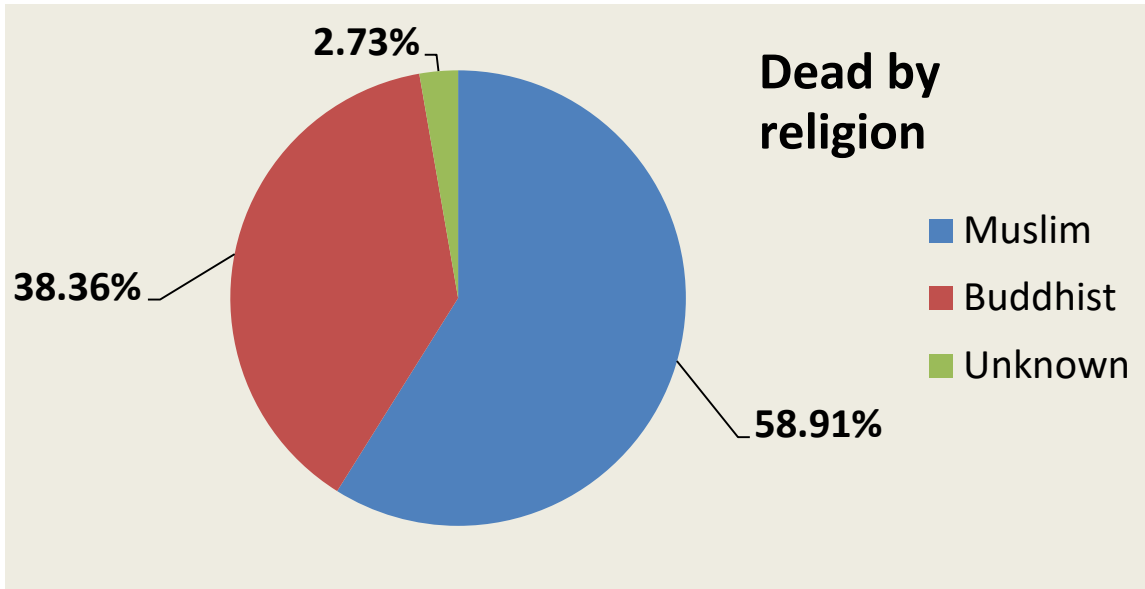
"In any procurement, the budget is also a key factor to put into account."

Still, the US had previously not offered to sell weapons to Thailand due to the US's own legal restrictions on selling weapons to Thailand since the coup, he said.

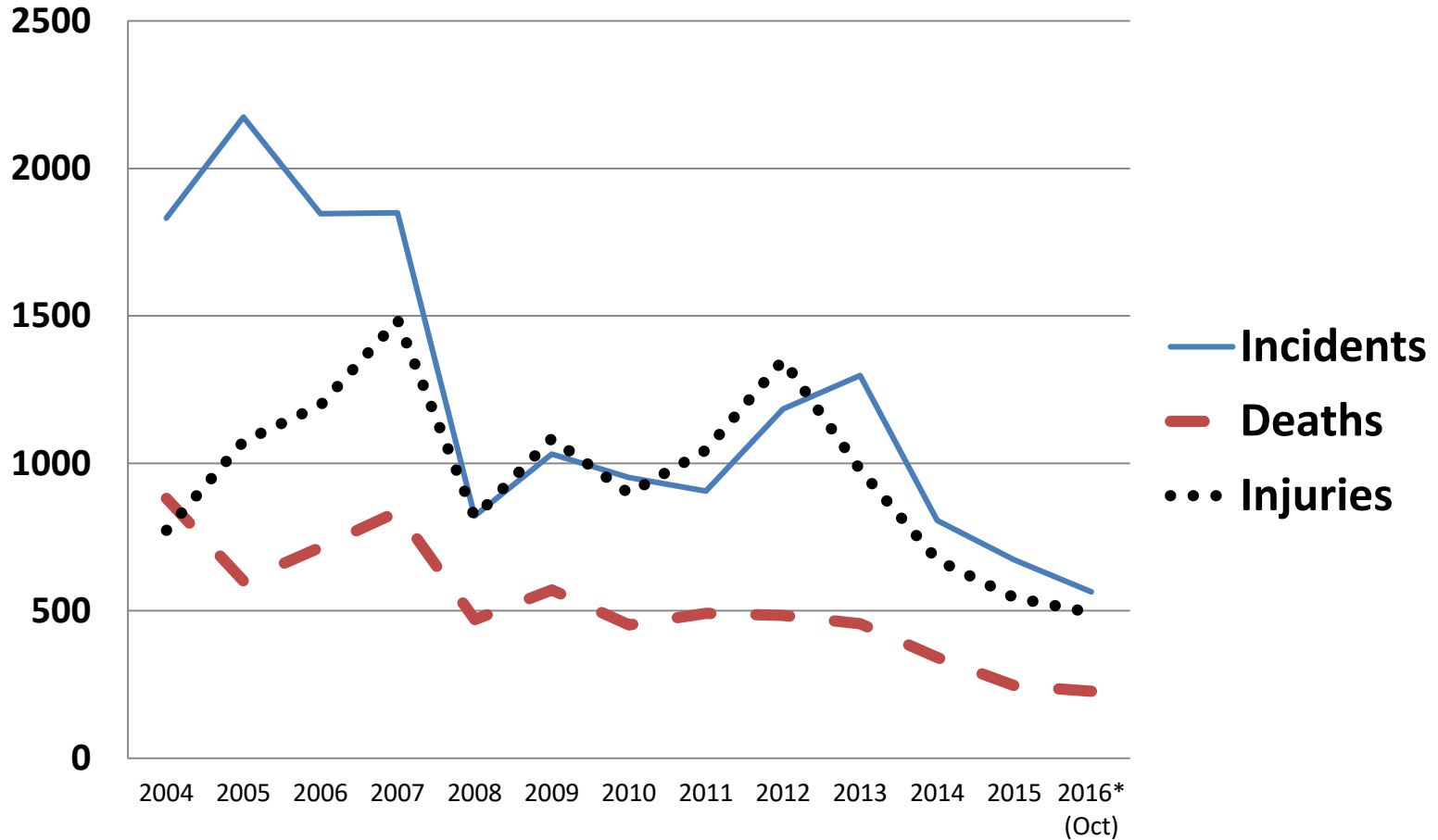
What's more, several other countries in this region had also turned to Chinese-made military hardware, he said.

Identify foreign enemies first, but
We do have enemy from within

Violence in the South (2004-2012)

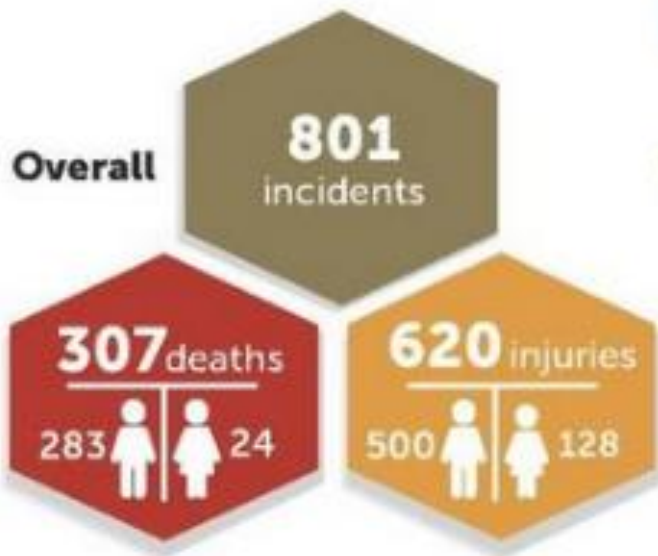


Number of deaths and injuries stemming from attacks in the deep South

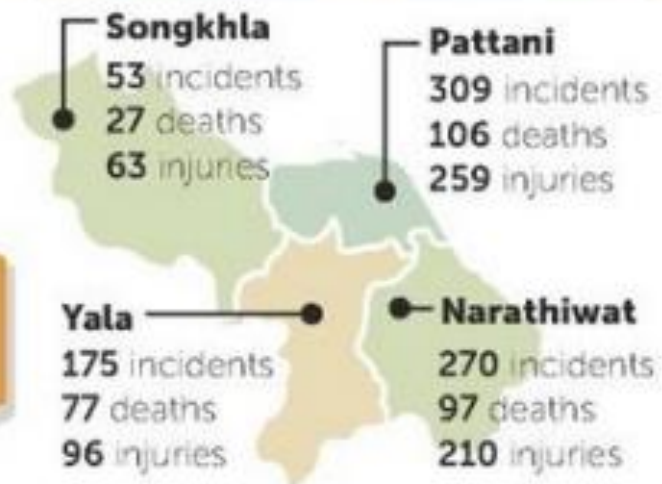


SOUTHERN VIOLENCE

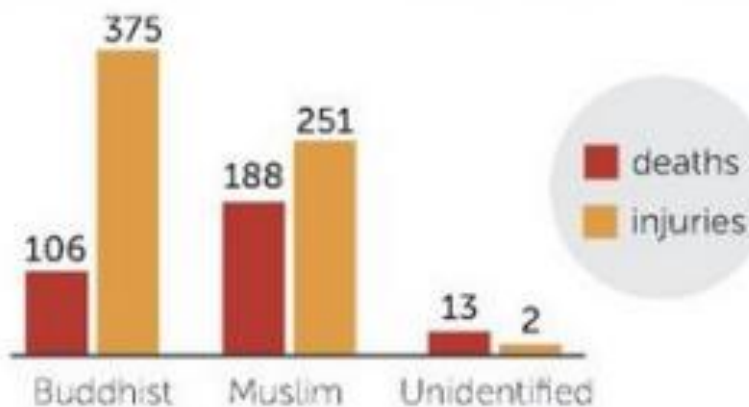
2016 statistics of violence in four southern border provinces - Narathiwat, Pattani, Yala and Songkhla.



Classified by province



Classified by religion



Targets



Note: *soldier, police, local officers, defence volunteer

Bay Tong, Yala



A Sky Dragon: Air surveillance

The 350 million baht airship, which leaks and has yet to be fixed and which fails to rise to a safe altitude, above the reach of gunfire. The 350-million-baht "Sky Dragon" had problems with flying.



The ship cost 250 mb, Two cameras cost 70 mb, and ground support system 20 million baht

March 2015: Thai PBS News

After the accidents, we could not fix the sky dragons

- “The sky dragons worked well when examined them in Iraq, but not in the three southern provinces.”
- With 70 million baht spent on fitted cameras, Can you see terrorists hide under those trees in the rice field?
- After the accident which caused it to land on the rice field, 50 million baht was spent to fix it to fly again.
- Would another 20 million baht be spent to make it fly above reach of the terrorists’ gunfire?

Landed on the rice field



Submarines for the Navy

- After years of being turned down, it now appears the Royal Thai Navy is actually closer to getting permission to purchase submarines than ever.
- **The Navy pushed for (Abhisit) Cabinet endorsement of projects that require funding of more than Bt16 billion, to buy six used submarines and to upgrade two of its frigates.**
- The subs -being **decommissioned** by the German navy - are more than 30 years old but are expected to be good for another 10 years.

U-206



The German WWII submarines were employed to sink American cargo ships in the Atlantic Ocean (4,000 meter depth) to force the UK to surrender.

Gulf of Thailand: Not too shallow to submerge

- Rear Admiral Suriya Pornsuriya, the first commander of the submarine unit, said:
- "These submarines will travel at a depth of 30 metres,"
- "Don't believe rumors they can't run in the Gulf of Thailand because the sea is too shallow. They can work well there."

Khun Suthep's logical argument

- Deputy Prime Minister Suthep Thaugsuban defended the purchase, saying that the 7.7-billion-baht procurement for the submarines is "necessary for maritime territory protection," and that
- "Some countries in the region have submarines and could pose a threat to the national interest."
- Singapore has 6 submarines, Malaysia 2, Indonesia 2+3

Pivoting policy: Imported military hardware from China



Source: The Nation

NATION GRAPHICS

Thailand set to get first Chinese submarine

The Nation July 2, 2016

- **The Royal Thai Navy will buy its first submarine from China in the coming fiscal year, Defence Minister General Prawit Wongsuwan.**
- Prawit, who is also deputy prime minister overseeing security affairs, said the Navy planned to buy three submarines at Bt12 billion each.
- "The budget is not too high as payments can be made over a period of about 10 years,"
- *This is the multi-year budget appropriation (it sounds like buying a BMW with down payment and low interest rate).*

A Chinese submarine



A similar illogical argument

Prawit said China's submarine technology was good and modern, playing down criticism of the move. He said the Navy had studied all details. "It first presented its plan in 2008 or 2009."

Asked why the Navy would want submarines since it had abolished the submarine division, Prawit said the country needed them to protect its massive marine resources in the Andaman Sea.

"Neighboring countries all have submarines. Myanmar has 10," Prawit said. (Really?)

Cabinet approves purchase of Bt13.5-bn submarine from China

April 25, 2017

- THE CABINET has approved a Navy proposal to buy a Yuan-class submarine from China for Bt13.5 billion, a government source said yesterday.
- Deputy Prime Minister Prawit Wongsuwan quietly put the proposal to Cabinet for a decision last week and instructed the Navy Commander Admiral Na Arreenich to finalise the purchasing contract with the designated Chinese manufacturer soon.
- The military government had planned to purchase three Yuan-class S26T submarines at a total cost of Bt36 billion. Prime Minister Prayut Chan-o-cha said earlier that Thailand had been offered a “buy two, get three” deal with China, complete with various weapons systems and after-sales services.
- However, the Cabinet last week actually approved only the purchase of one
- submarine initially, with a budget of Bt13.5 billion, including weapons systems, spare parts and technology transfer.

The Cabinet had approved a Navy proposal to buy a Yuan-class submarine from China for Bt13.5 billion.

- “China attaches much importance to this project, so we have to be careful not to say anything about this matter,” he told reporters.
- The S26T will be the Thai Navy’s first submarine since the end of World War II. Thailand procured its first submarines from Japan in 1937, but they were decommissioned more than 50 years ago.
- The China Shipbuilding Industry Corporation (CSIC) will be the likely main contractor for the Thailand-bound submarine, which will take six years to build. If the contract is secured, Thailand will become the company’s second foreign customer after Pakistan.
- Earlier this month, the Cabinet approved the purchase of another 10 Chinese-made tanks at a cost of Bt2 billion.

Buy two get one free

- When asked why the Cabinet did not hold a press conference on the deal being approved, Prawit said it was not held because documents related to the project were confidential.
- “It’s not unusual. No Cabinet reveals confidential documents because they are related to national strategy,” he said.
- He said the purchase of the submarines was necessary for the country as it would help preserve Thailand’s marine natural resources and was part of the Navy’s development.
- The government planned to purchase three Yuan-class S26T submarines at a total cost of Bt36 billion.
- **Prime Minister Prayut Chan-o-cha said earlier that Thailand had been offered a “buy two, get three” submarine deal with China, complete with various weapons systems and after-sales services.**

UNDER THE PERISCOPE

Deputy Prime Minister and Defence Minister Prawit Wongsuwon has defended the Royal Thai Navy's proposal, approved in secret by the cabinet, to buy three Yuan-class S26T submarines from China, citing these main reasons.

- ▶ Submarines are needed to safeguard Thailand's maritime interests.
- ▶ They are necessary to protect shipping lanes in and close to the Gulf of Thailand that are used by 15,000 ships annually.
- ▶ Many countries in the region already have submarines
- ▶ China's Yuan-class S26Ts are reasonably priced compared with subs built in other countries; they are equipped with an Air Independent

Propulsion system and submarine-launched missiles.

▶ The subs suit Thailand's geography with an average 50-metre depth in the Gulf of Thailand.

▶ The money for the purchase comes from the Royal Thai Navy's own budget, not the government's central budget. While one submarine will be paid for at a time, all three will be purchased in installments over a period of 11 years.



Dwight D. Eisenhower
34th U.S. President

“Every gun that is made, every warship launched, every rocket fired signifies a theft from those who hunger and are not fed, those who are cold and are not clothed. This world... is spending the sweat of its laborers, the genius of its scientists, the hopes of its children. The cost of one modern heavy bomber is ... a modern brick school in more than 30 cities. It is two electric power plants, each serving a town of 60,000 populations. It is two fine, fully equipped hospitals. It is some 50 miles of concrete pavement. We pay for a single fighter plane with a half-million bushels of wheat. We pay for a single destroyer with new homes that could have housed more than 8,000 people ... This is not a way of life at all ... Under the cloud of threatening war, it is humanity hanging from a cross of iron.”