

**Buffeting by the Unholy Trinity and
the 2006 Military Coup**
*Adjustments to external and internal
shocks*

Bhanupong

Lecture 7

Asian Economic Papers 5(2), 2006

outline

- The Avian Influenza
- The 2005 Asian tsunami
- The oil price shock in 2005
- The 2006 military coup

Buffeting of Thailand

Table 1. Estimates of the economic costs of the three shocks

	Crisis year	GDP growth (percent)	Financial loss (billion baht)	Loss of life
Avian influenza	2004	-0.1	20	14
Tsunami	2005	-0.3	65	5,400
Oil shock	2005	-2.0	90	

Sources: Estimates are from the Ministry of Finance, the Bank of Thailand, and the Tourism Authority of Thailand.

Bird flu

- Avian influenza (AI) broke out in Thailand in December 2003 and killed 14 people in the following 12 months.
- The Thai poultry industry had just recovered from the loss of generalized system of preferences (GSP) status in Europe in 1999 and the import ban on Thai chicken in 2002 resulting from the detection of antibiotic residues.

The damage

The spread of AI caused heavy damage to the industry because of massive culling and a temporary decline in domestic consumption.

The fear subsided by October 2004, and domestic chicken consumption returned to its rising trend.

The Ministry of Finance estimated that AI reduced GDP growth by 0.1 percentage points in 2004

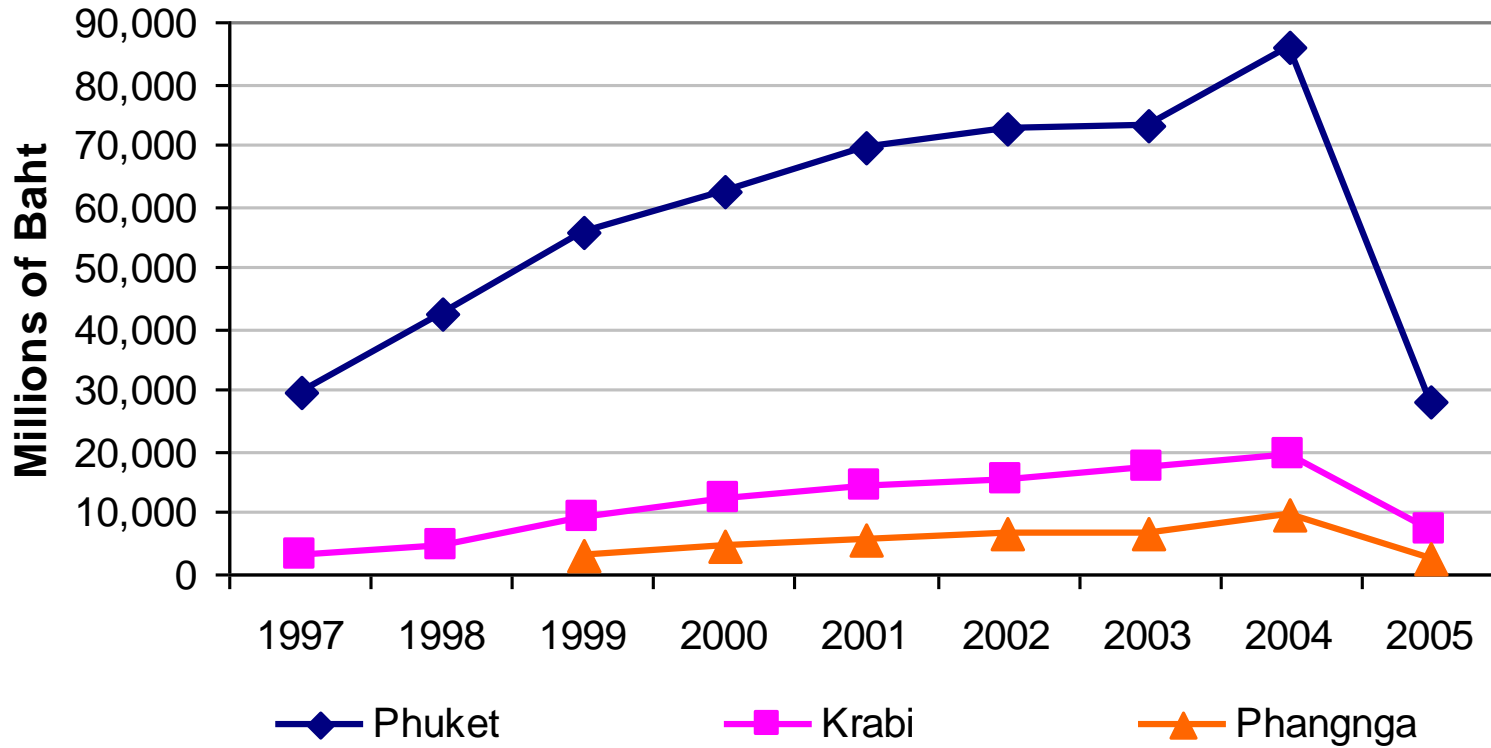
The Asian Tsunami

- AI has caused less damage in Thailand than the tsunami that hit six southern provinces of Thailand on December 26, 2004, killing 5,394 people—half of them foreign visitors.
- The tourism industry was badly affected, in particular, the hotel business on the Andaman Coast. Fisheries were also affected by the tsunami, as a result of the destruction of fishing boats and shrimp farms.
- Estimates show that the tsunami reduced GDP growth in 2005 by 0.3 percentage points

December 26, 2004



Tourism Revenue from Visitors in Three Provinces



Source: Tourism Authority of Thailand

Shocks after shocks

- World recession 1991
- Asian financial crisis 1997
- SARS and Iraq war in 2003
- Avian flu (H5N1) 2004
- Tsunami (Dec 26, 2004)
- Coup d'état (Sep 19, 2006)

TSUNAMI RECORD



Source: Disaster Prevention and Mitigation Department

PDSTgraphics

More Shocks (still counting)

- Bangkok bombing (Jan 2007)
- PAD uprising and airport shutdowns (2008)
- Global (Great) recession (2009)
- Type-A(H1N1) (2009)
- Red shirts (UDD) uprising (April 2009, March 2010, April and May 2010)
- Japan quake (March 2011)

The oil price shock

- The oil price shock of 2005 did not lead to loss of life, but its impact on economic growth in Thailand was the greatest among the three recent shocks.
- It caused a decline of 2 percentage points in the GDP growth of 2005.
- The oil fund deficit caused by an existing oil price subsidy carried a fiscal cost of more than 90 billion baht.
- The oil price shock had an adverse direct impact on the tourism industry by raising the cost of traveling. The slowdown in world output growth aggravated the slump in the industry

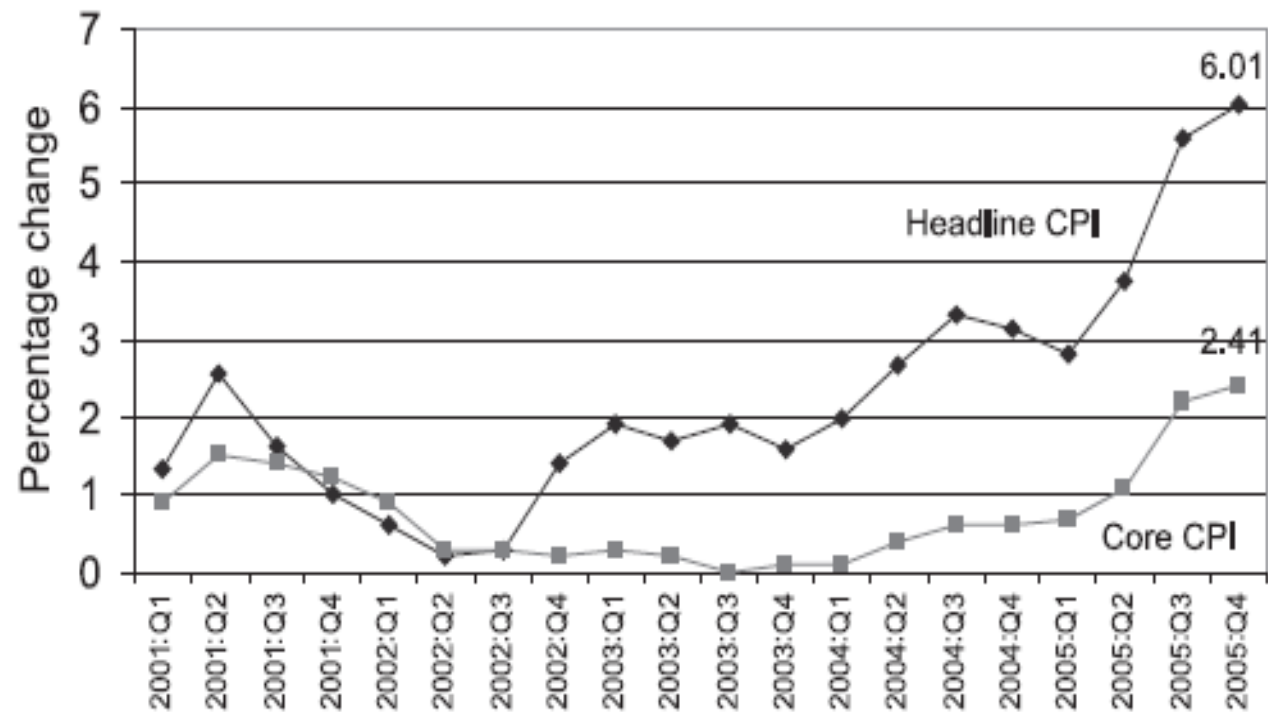
Buffeting of Thailand

Table 2. Macroeconomic impact of the three oil price shocks (percent)

	First oil shock		Second oil shock			Third oil shock	
	1973	1974	1978	1979	1980	2004	2005
GDP growth	9.9	4.4	10.4	5.3	4.8	6.1	4.5
Inflation	15.5	24.3	7.9	9.9	19.7	2.7	4.5
Current account/GDP	-0.5	-0.6	-2.8	-4.9	-6.4	4.5	-4.8
Trade balance/GDP	-1.7	-2.4	-3.1	-4.4	-6.1	2.3	-2.1
World oil price index	3.3	11.6	12.9	30.1	35.9	37.7	54.2

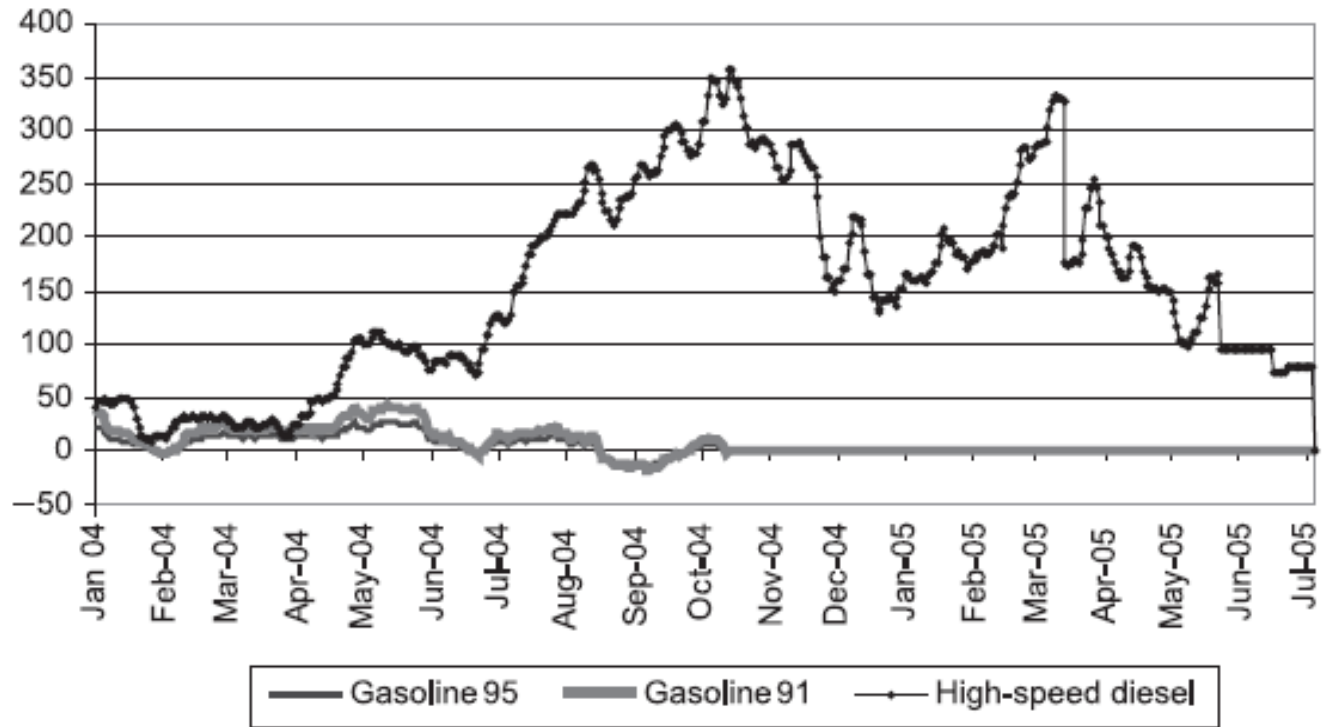
Sources: Bank of Thailand, International Monetary Fund.

Figure 4. Inflationary impact of the third oil price shock



Source: Bank of Thailand.

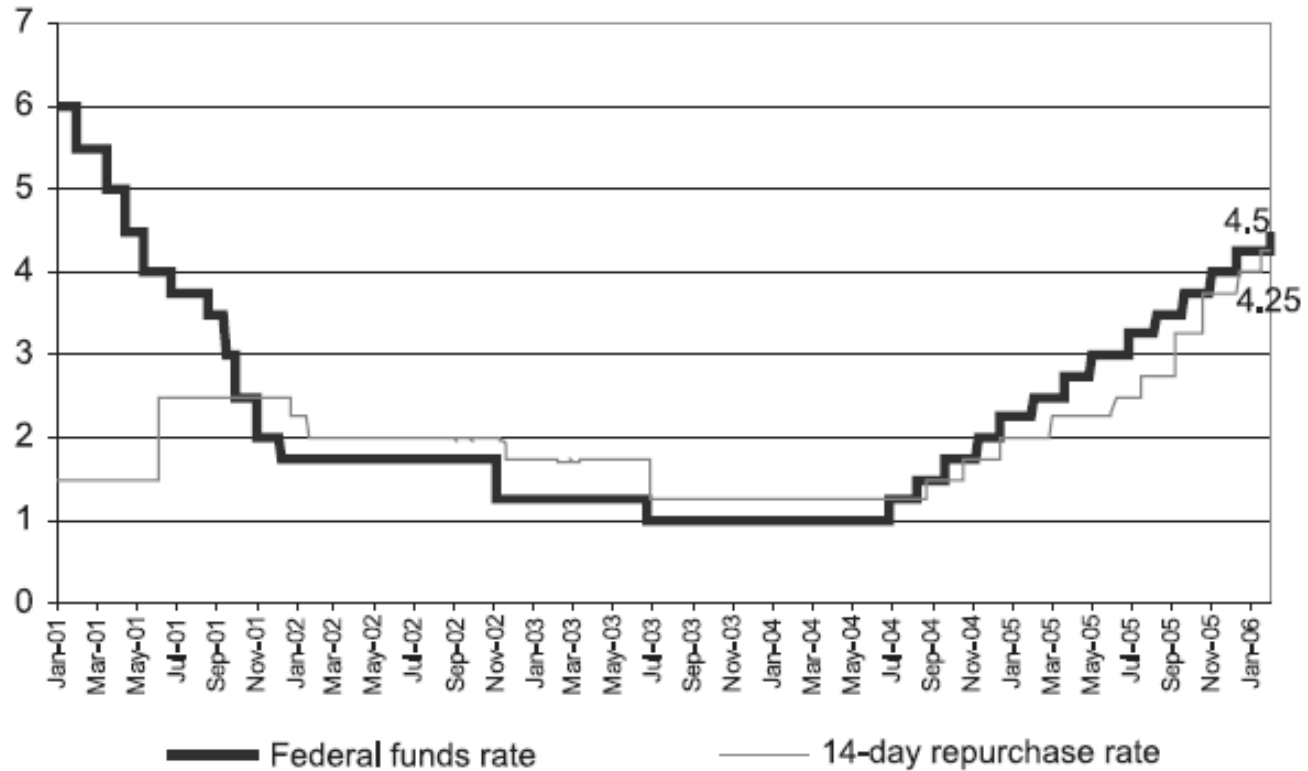
Figure 5. Oil subsidies per day (million baht)



Source: Energy Policy and Planning Office.

Buffeting of Thailand

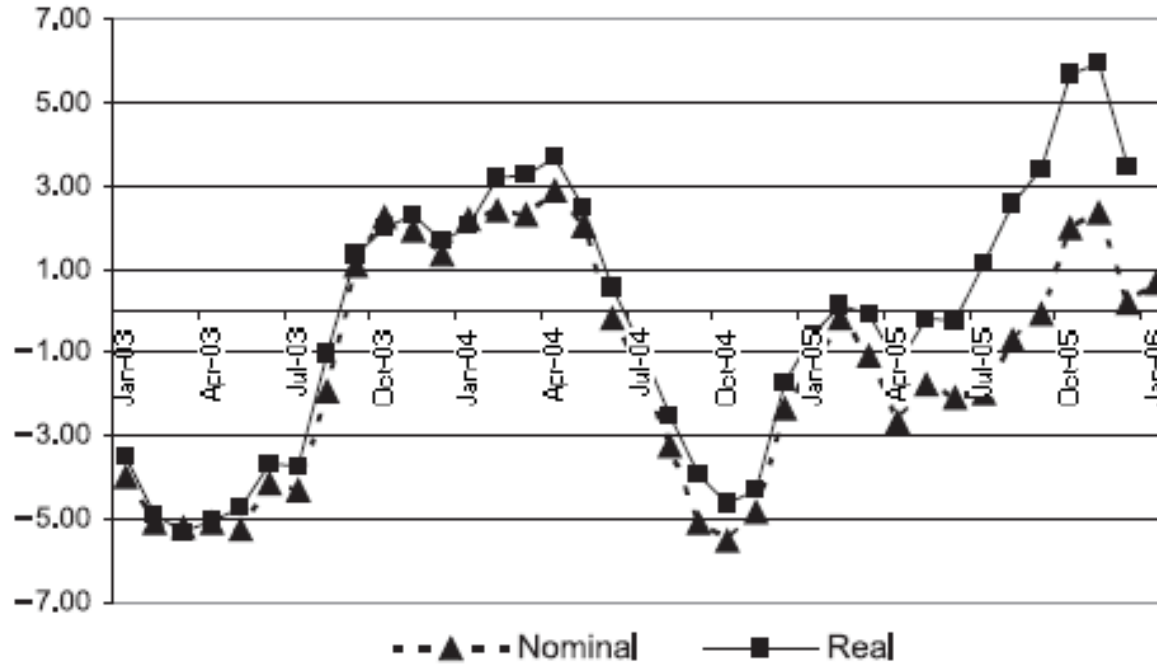
Figure 6. Federal funds and repurchase rates



Sources: Bank of Thailand, Federal Reserve.

Buffeting of Thailand

Figure 7. Real and nominal effective exchange rate (% change year-on-year)



Source: Bank of Thailand.

Appropriate policy responses

The establishment of realistic exchange rates and positive real interest rates by reducing the degree of price intervention will induce economic agents to adjust properly to cushion the impact of external shocks.

Nominal exchange rates must be allowed to depreciate to maintain competitiveness.

Price controls must be employed temporarily to avoid market disruptions and to calm inflationary expectations.

The Thai economy after the coup: 2006-2008

- Coups d'état and the vicious circle
- The importance of capital formation
- Animal spirits of investors

Coups galore

- There have been 20 military coups since June 24, 1932, when absolute monarchy was replaced by constitutional monarchy.
- Only nine coups succeeded.
- June 20, 1933: Phraya Phahol toppled the government led by Phraya Manopakorn.
- Nov 8, 1947: Gen Pin Choonhawan overthrew the government of Thawan Thamsrongdhnawasavad

Timeline of coups d'état

1958 Coup

General Plaek regime (1948-58) was overthrown by

- General Sarit (1959-63)
- General Thanom (1964-1974)

1971 Coup (Nov 17) by Field Marshal Thamom against his own government.

Oct 14, 1973

- PM Sanya (1974)
- PM Kukrit (1975)

Another coup, another constitution, and another election

Oct 6, 1976

PM Thanin

Coup 1977

(October 20) by Adm Sa-ngad Chaloyu overthrew the government of Thanin Kraivichien

General Kriangsak

General Prem 1981

Coup 1981

Coup 1985

PM Chatchai

Coup 1991

A vicious circle

And we thought that we saw the last coup in 1991

Between 1991 and 2005: A period of no coup

PM Anan

PM Chuan

PM Banhan

PM Chawalit

PM Chuan

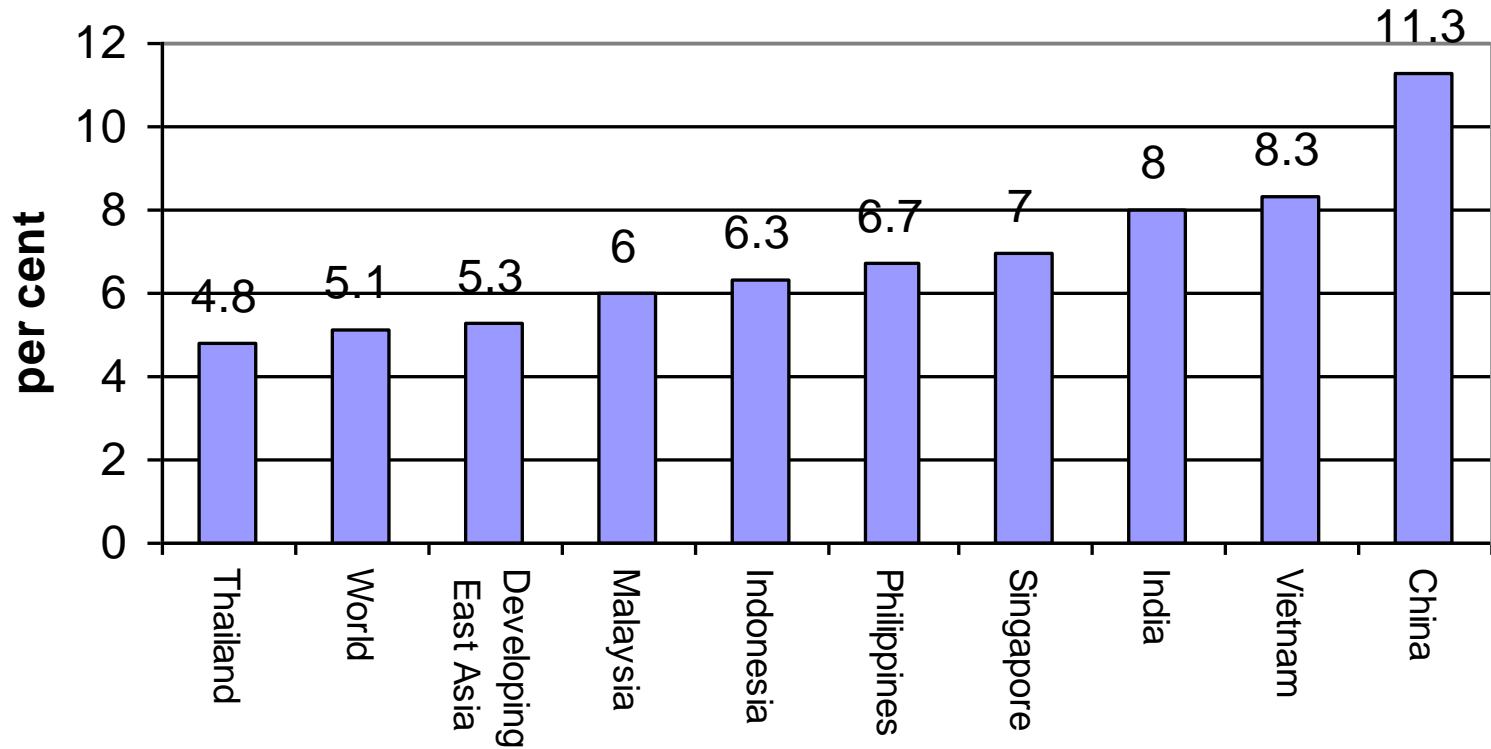
PM Thaksin

Thailand's perennial problems

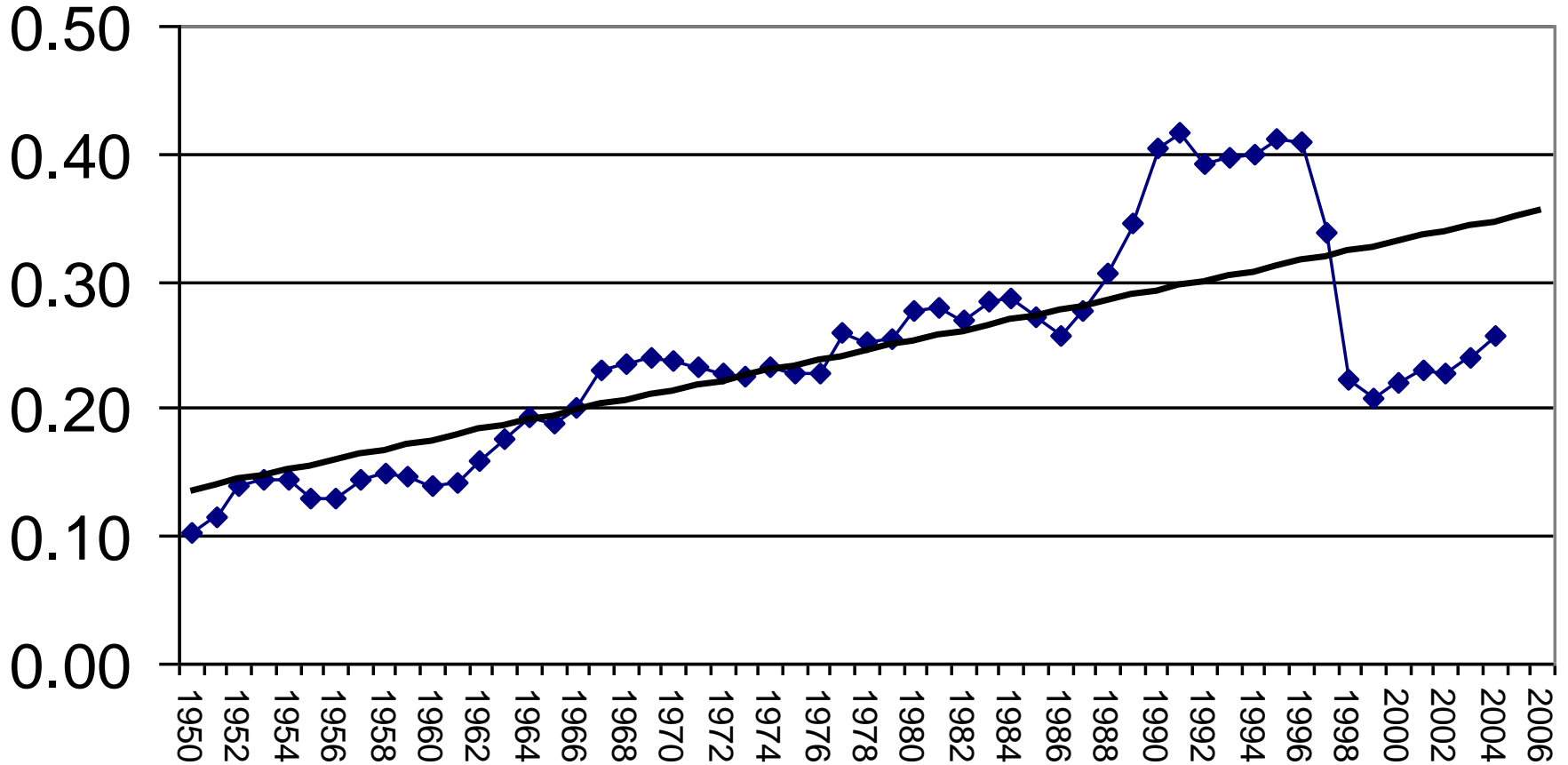
- Exchange rate risks
- Fluctuations of the world economy
- Weak governing institutions
- Coups threat and political disturbances
- Southern violence

The price of the September 2006 coup

Comparison of Growth in 2007



Share of investment in GDP



Capital formation

- Investment causes short-term fluctuations in GDP by affecting aggregate demand.
- Investment also enhances long-term growth by increasing potential, or full-employment national income.
- Investment improves living standards.
- Opportunity cost of growth is precious heritage of natural resources and pollution.

Why growth is good for the poor

- Growth increases the ability to redistribute income among people and reduce unemployment.

- Okun's Law

$$g_t = \alpha - \beta \Delta u_t$$

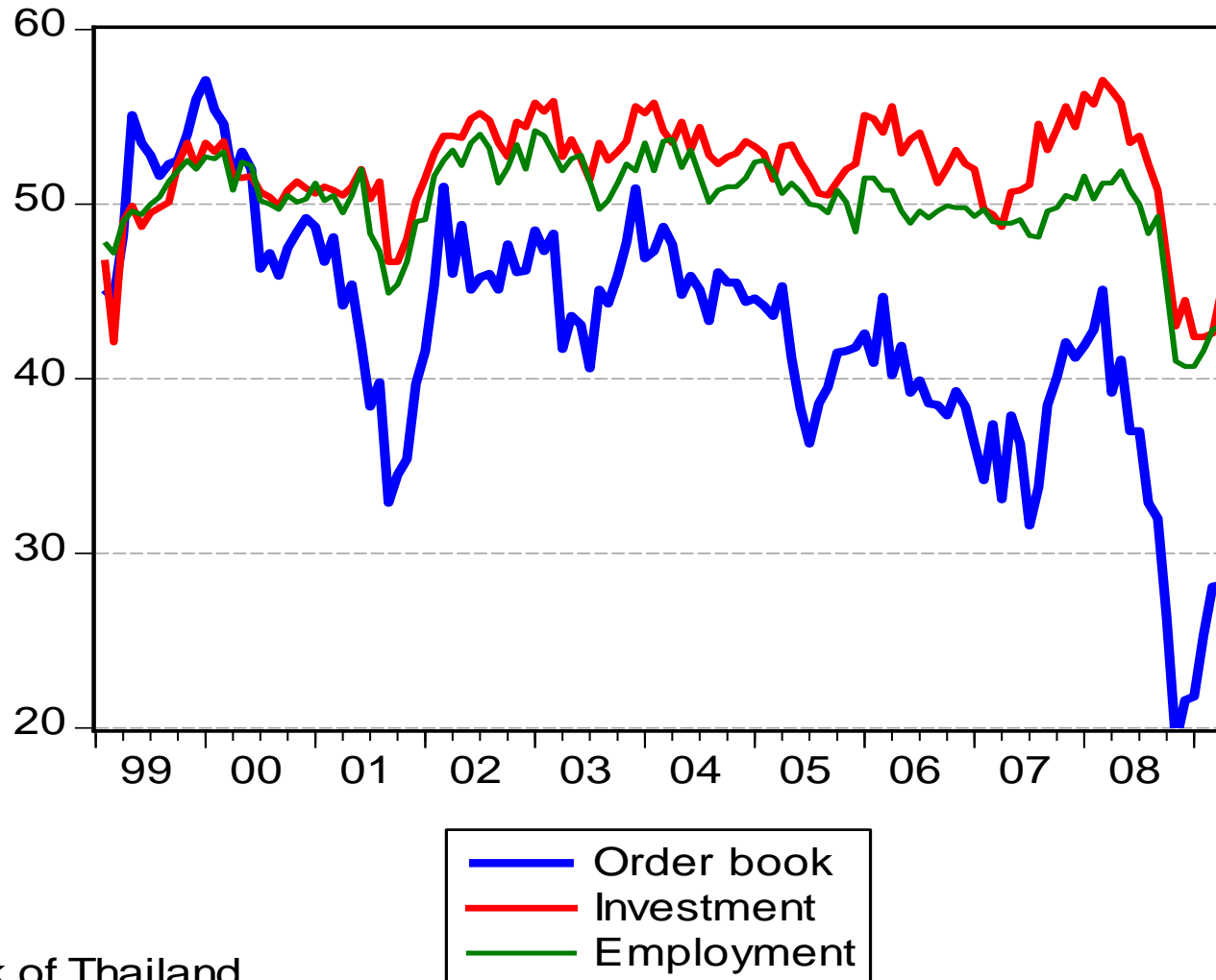
- For every 1% of increase in unemployment rate, GDP will be lower by roughly 2% (In USA).

Animal spirits

- Akerlof and Shiller (2009) extend Keynes' animal spirits from investor confidence to fear, blind faith, corruption, and a concern to fairness, and the stories we tell ourselves about our economic fortunes.
- *No more double standards*
- *We must uphold fairness and social justice*

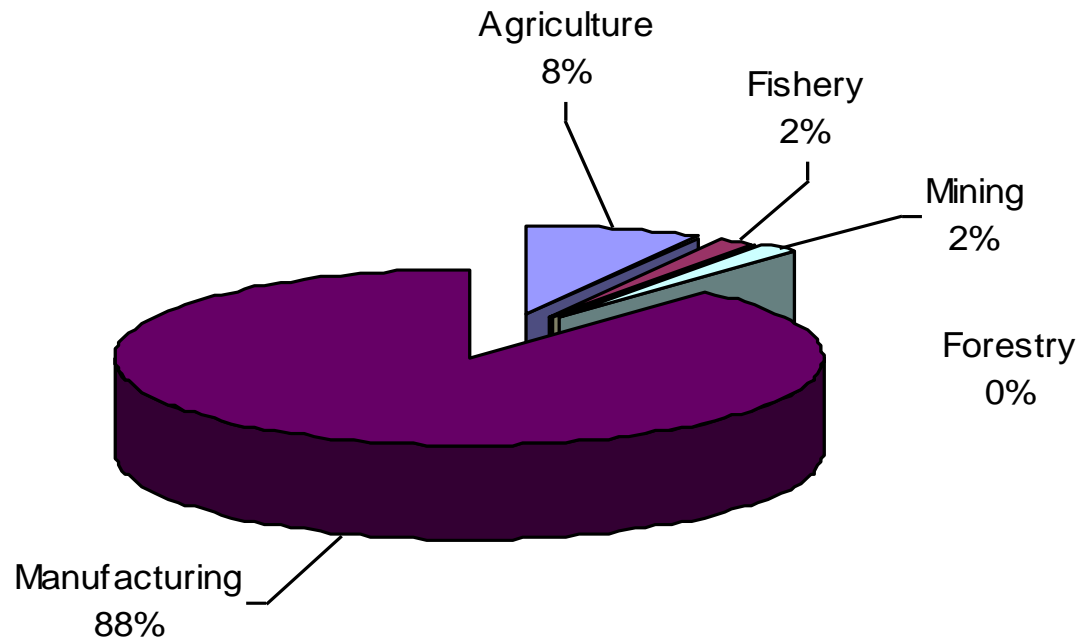
Business sentiment Index

How can we rekindle favorable investment climate?



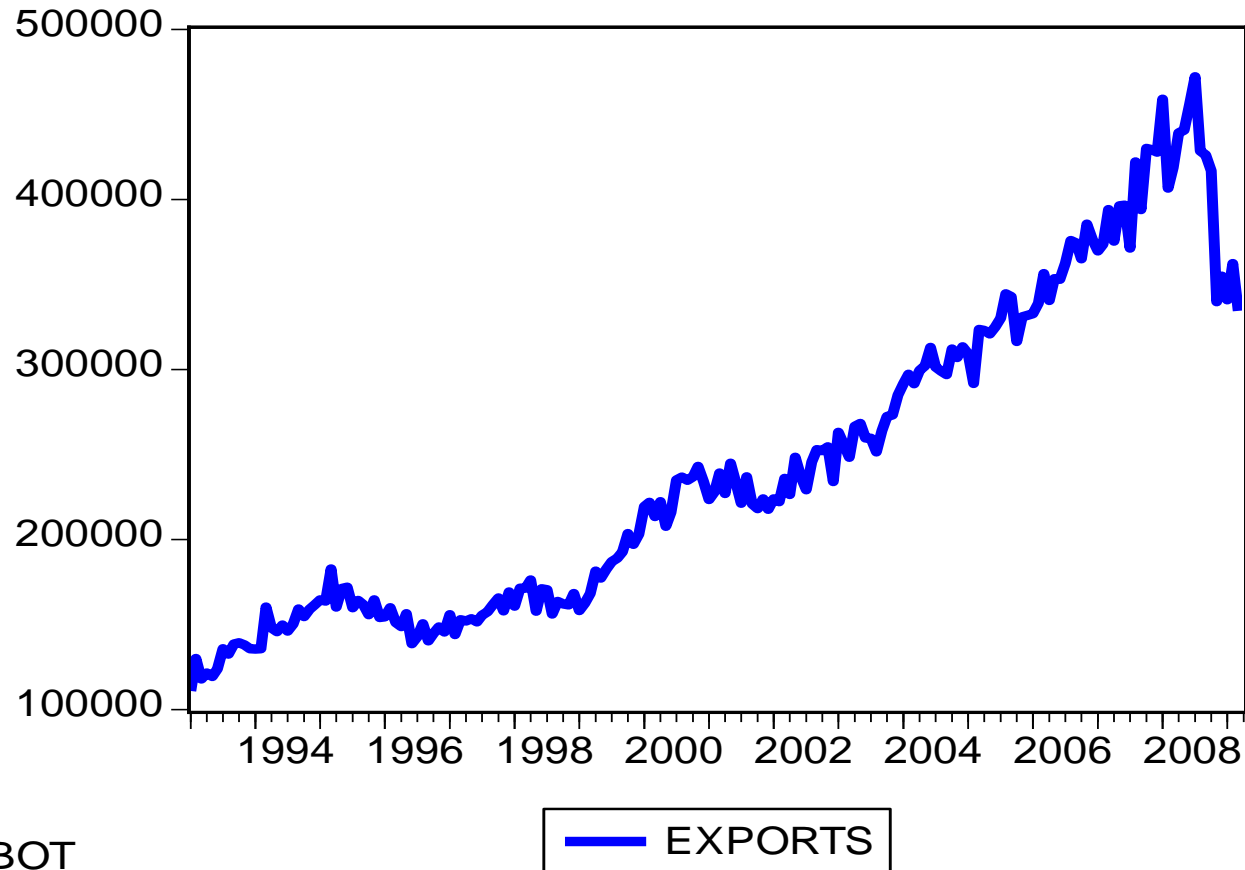
The export-led growth

Export structure: 2006



■ Agriculture ■ Fishery ■ Forestry ■ Mining ■ Manufacturing

The collapse of the last engine of growth



Source: BOT

Fiscal budget under the military-backed government (Gen. Surayud)

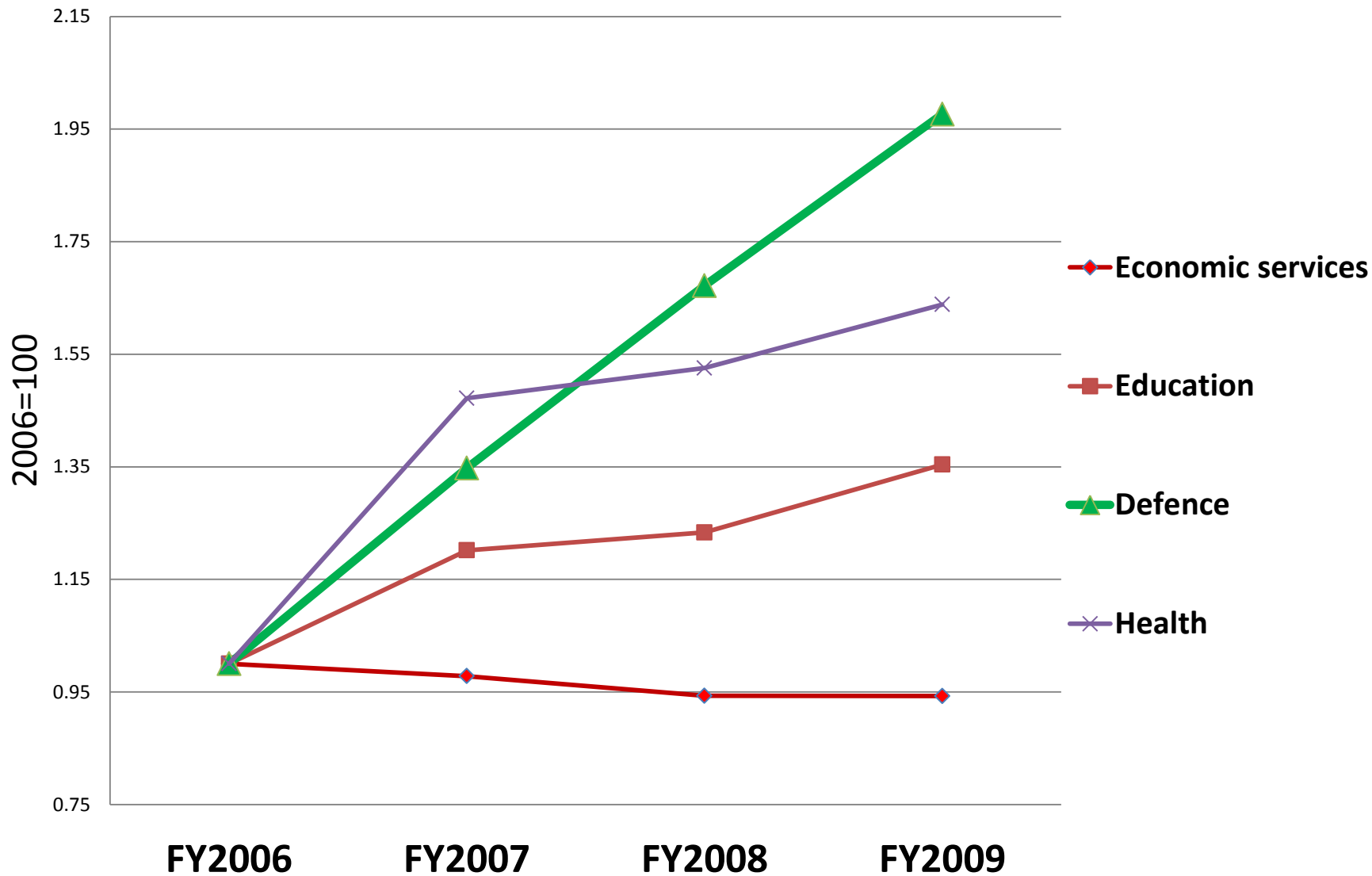
	FY 2007	FY 2008	% Change in value
Defense	7.3	8.6	24.3
Education	18.0	18.1	6.7
Public health	4.0	3.9	4.7
Central fund	12.6	14.8	24.3
Agriculture	4.1	3.9	0.6
Total amount (bill baht)	1566.0	1660.0	6.0

Defense spending and health capital

- Determinants of military spending: external and civil wars, military spending by potential enemies, population, and democracy.
- Democracy is negatively related to military burden.
- Cross-country evidence shows a negative impact of military spending on economic performance.
- Grossman, M (1972) *“On the concept of health capital and the demand for health”*
Journal of Political Economy, 223-255.

Budget appropriation after the coup

Source: BOB



Concluding remarks

- The long term economic cost of the coup was underestimated.
- Political instability damages economic performance and derail the return to the pre-shock growth path.
- Domestic demand must be stimulated to offset the shortfall in exports in 2009 caused by the GFC

GFC: Gold price as an indicator of the lack of consumer confidence

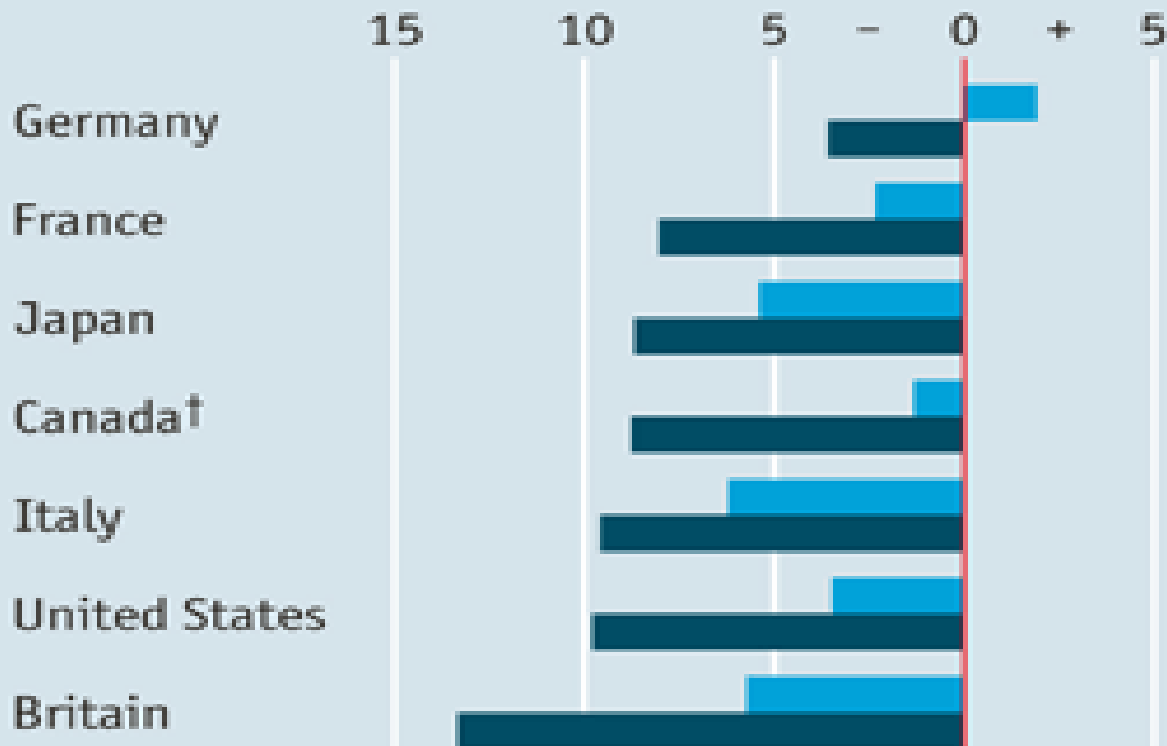


The cost of the crisis

Real GDP per person, Q2 2011

■ % change since Q4 2007

■ % change relative to trend*



*Assumes growth continued at average pace 1997-2007
†Q2 2011 estimate

Sources: Haver Analytics;
IMF; JPMorgan; *The Economist*