

Military Business Cycle, the Coup, and Corruption

Bhanupong
Lecture 27

Determinants of military spending

- External and civil wars, military spending by potential enemies, population, and democracy.
- Democracy is negatively related to military burden.
- Military spending can be considered as a wasteful spending in time of peace.

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 the government popularity.
- Restrictive policies *after* the election lead to a full circle in economic activity (Nordhaus, 1975)

Abhisit accused of massive vote buy
Billions of baht approved to fund 'populist' projects
Bangkok Post, Published: [4/05/2011](#)

- The Abhisit Vejjajiva administration's last and longest meeting in which tens of billions of baht for budgets was approved has drawn severe criticism as a cynical election ploy.
- The approval of the funds was viewed as a bid to gift massive amounts for its populist projects prior to the general election.
- The cabinet meeting, which dragged on late into the night yesterday, began at 8am. The cabinet pushed through 102 proposals on the regular agenda in the marathon meeting in which 96 off-agenda proposals and 56 reports were also tabled for consideration.

- Among key projects approved was a 25-billion-baht home mortgage subsidy scheme by the Government Housing Bank for first-time buyers of homes worth no more than 3 million baht.
- Borrowers under the scheme will be exempt from paying mortgage interest fees and have interest waived for two years. Loans for first-home buyers will be offered between May 9 and Dec 30. Other approved projects include loans for small businesses in Ratchaprasong and other areas affected by political unrest last year, and the State Railways of Thailand's request for 170 billion baht for its infrastructure investment.
- The cabinet also approved 15.8 billion baht for 10 urgent education reform projects by the Education Ministry, and 10.7 billion baht for the Public Health Ministry's long-term human resources development project.

MEGA-SPENDING

Highlights of projects approved by the Cabinet yesterday at its final meeting. The list does not include the Defence Ministry's proposal for an arms purchase package and other projects approved after 8pm.

■ Interior Ministry

- Establishment of Disaster Prevention and Mitigation Offices in 872 districts.
- Rehabilitation of Udon Thani municipality office which was damaged during the May 19 red shirt riot there..... **B212 m**
- Compensation for BTS skytrain for the loss of income during April-May red shirt demonstrations..... **B5.5 m**
- Regulating street vendors..... **B197 m**
- Budget allocation for the newly-established Bung Kan province..... **B530 m**
- Wastewater treatment project in Pathum Thani province..... **B2.1 bn**

■ Justice Ministry

- Construction of new prisons in Chon Buri, Phangnga, Sakon Nakhon..... **B531 m**
- Construction of a correctional facility for young offenders..... **B330 m**

■ Labour Ministry

- Public relations campaign on social security scheme's benefits..... **B200 m**
- Work skills development for flood-hit villagers..... **B96 m**

■ Education Ministry

- 5% wage increase for university staff..... **B572 m**
- 2012-2018 education reform..... **B5.83 bn**

■ Finance Ministry

- Two-year zero-interest loans for first home buyers..... **B25 bn**

■ Culture Ministry

- Rehabilitation of flood-hit cultural sites in southern provinces..... **B72 m**

■ PM's Office

- Southern Border Provinces Administration Centre's project to improve living standards for villagers in the deep South..... **B180 m**

■ Public Health Ministry

- Campaign for reproductive health and child-rearing training for new parents..... **B415 m**
- Training of 3,000 nurses to work in the deep South..... **B1.27 bn**
- Health promotion activities at the tambon-level..... **B11.7 bn**

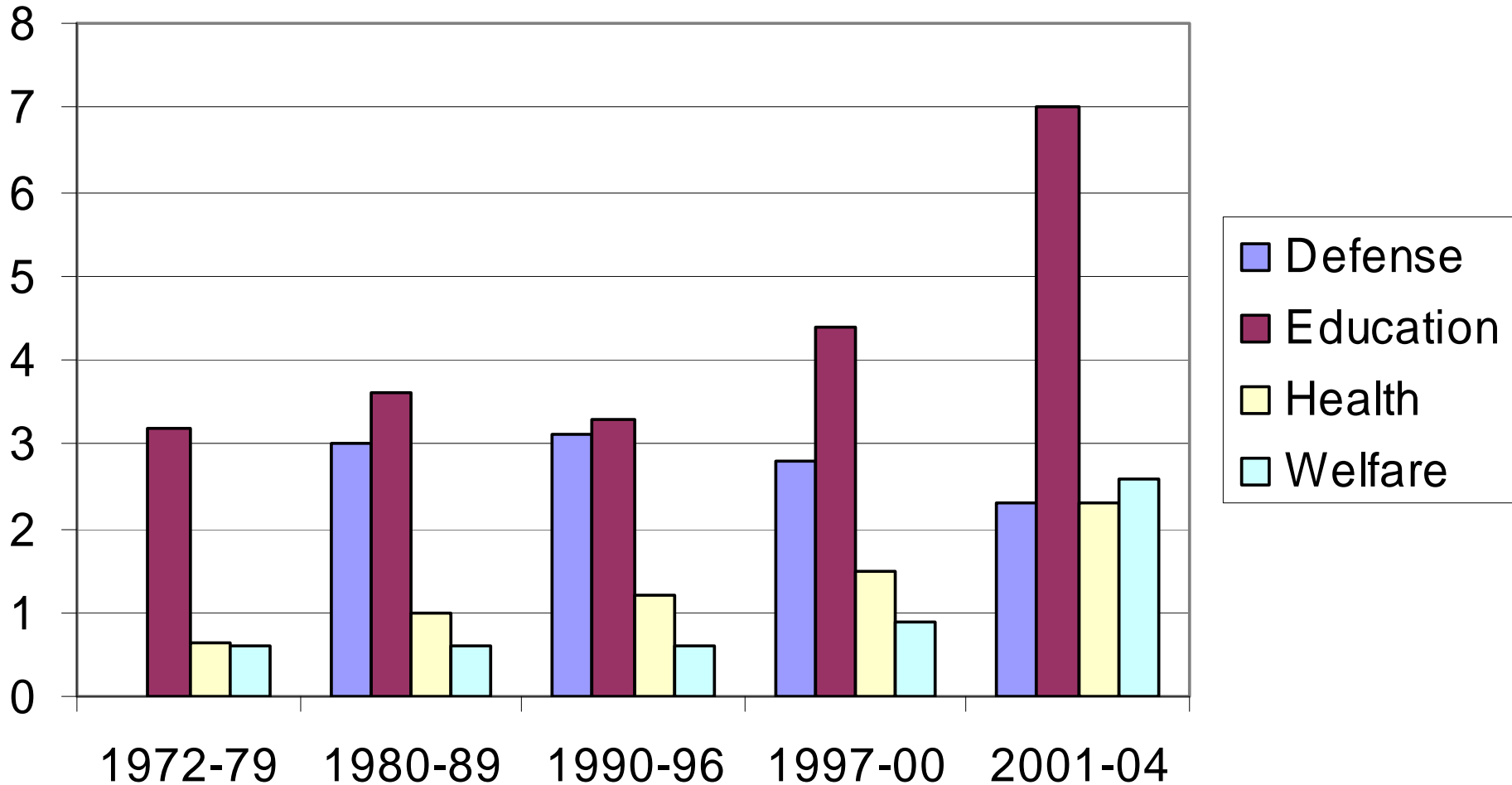
■ Agriculture and Cooperatives Ministry

- Scheme to address the problems of landless farmers..... **B1.6 bn**

■ Royal Thai Police

- The Safety Bangkok crime suppression scheme..... **B123 m**

Thailand's public spending (%GDP)

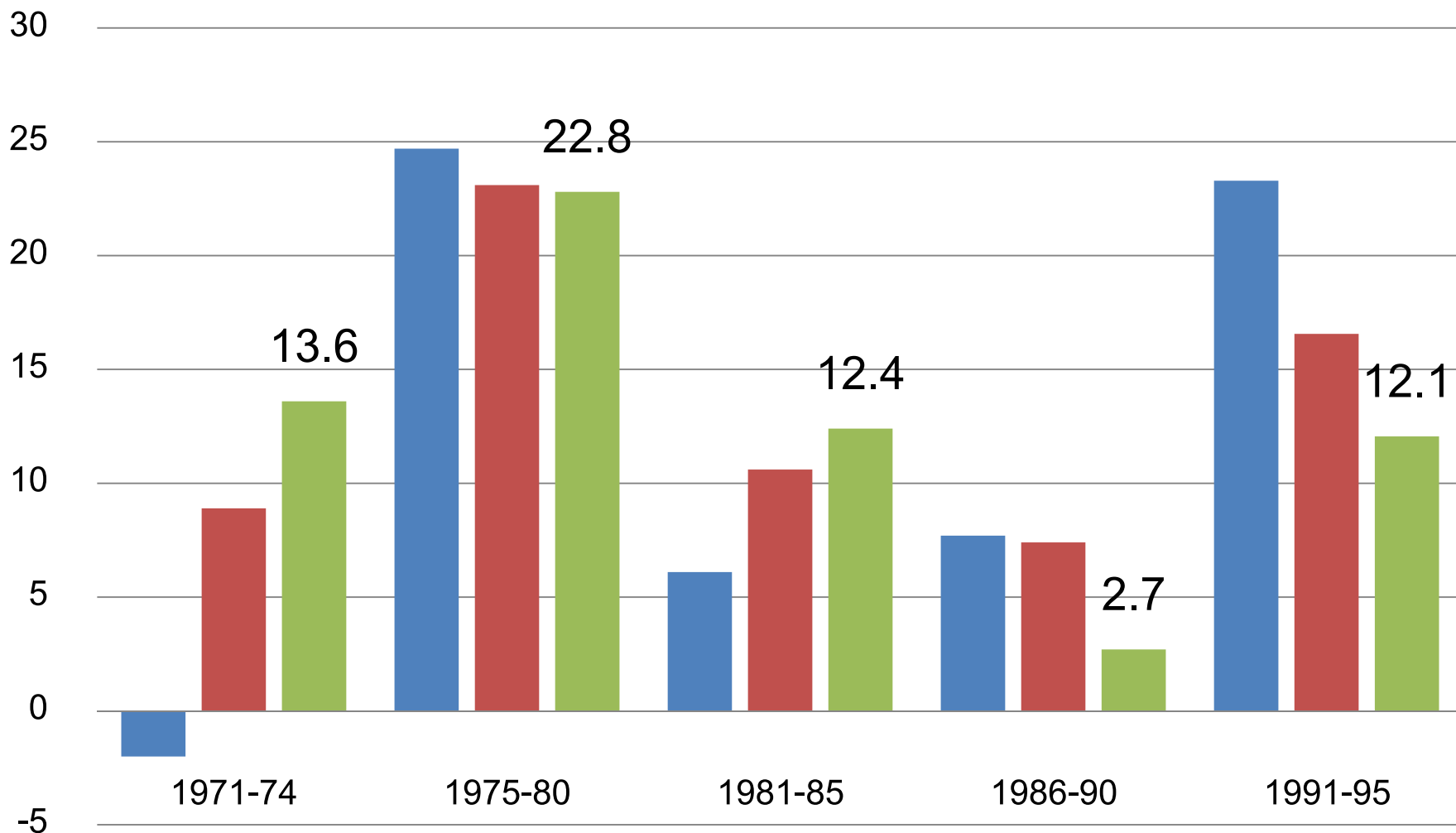


Years of recent coups (PM name)

- 1971 (Thanom)
- 1976 (Seni)
- 1977 (Thanin)
- 1981, 1985 (Prem, coup attempts)
- 1991 (Chartichai)
- 2006 (Thaksin)

Cyclical military spending

(period average growth rate)



■ Economic service

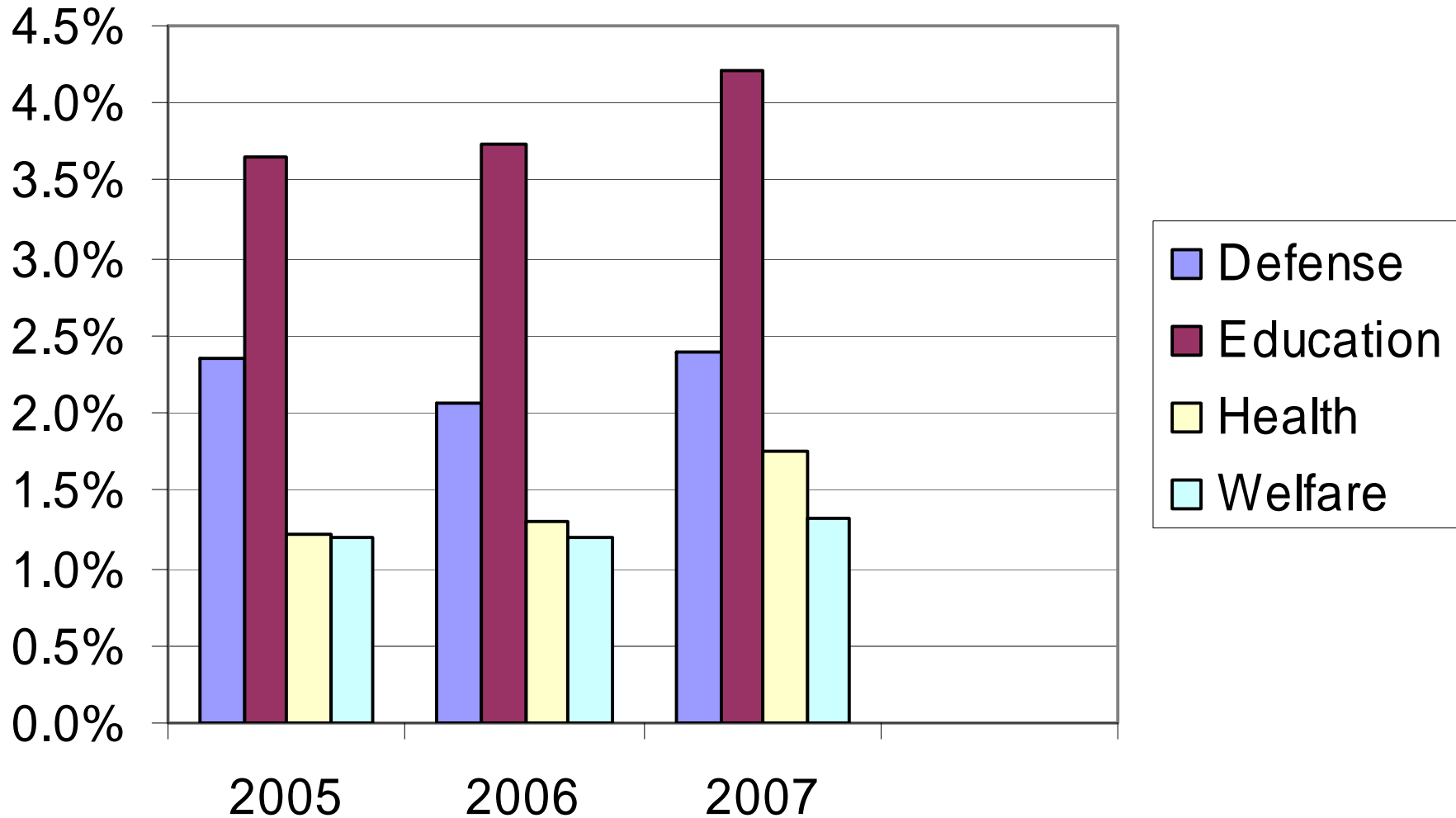
■ Total expenditures

■ Defence

Hypothesis of military business cycle

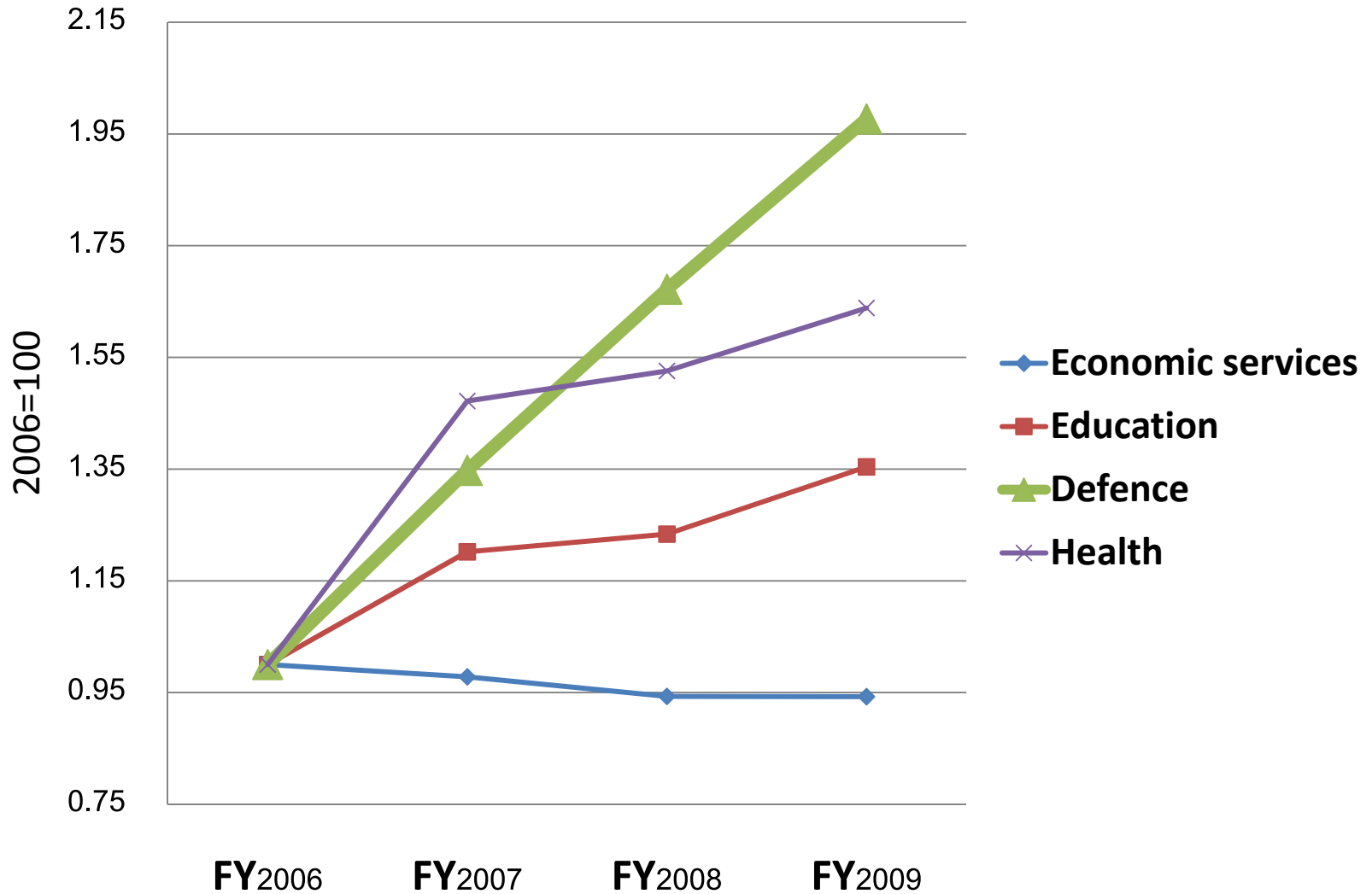
- ***Military spending slump is a leading indicator of a military coup in Thailand.***
- A steep rise in military burden follows a coup and dies off as society regains sensibility.

Public Spending (% GDP)

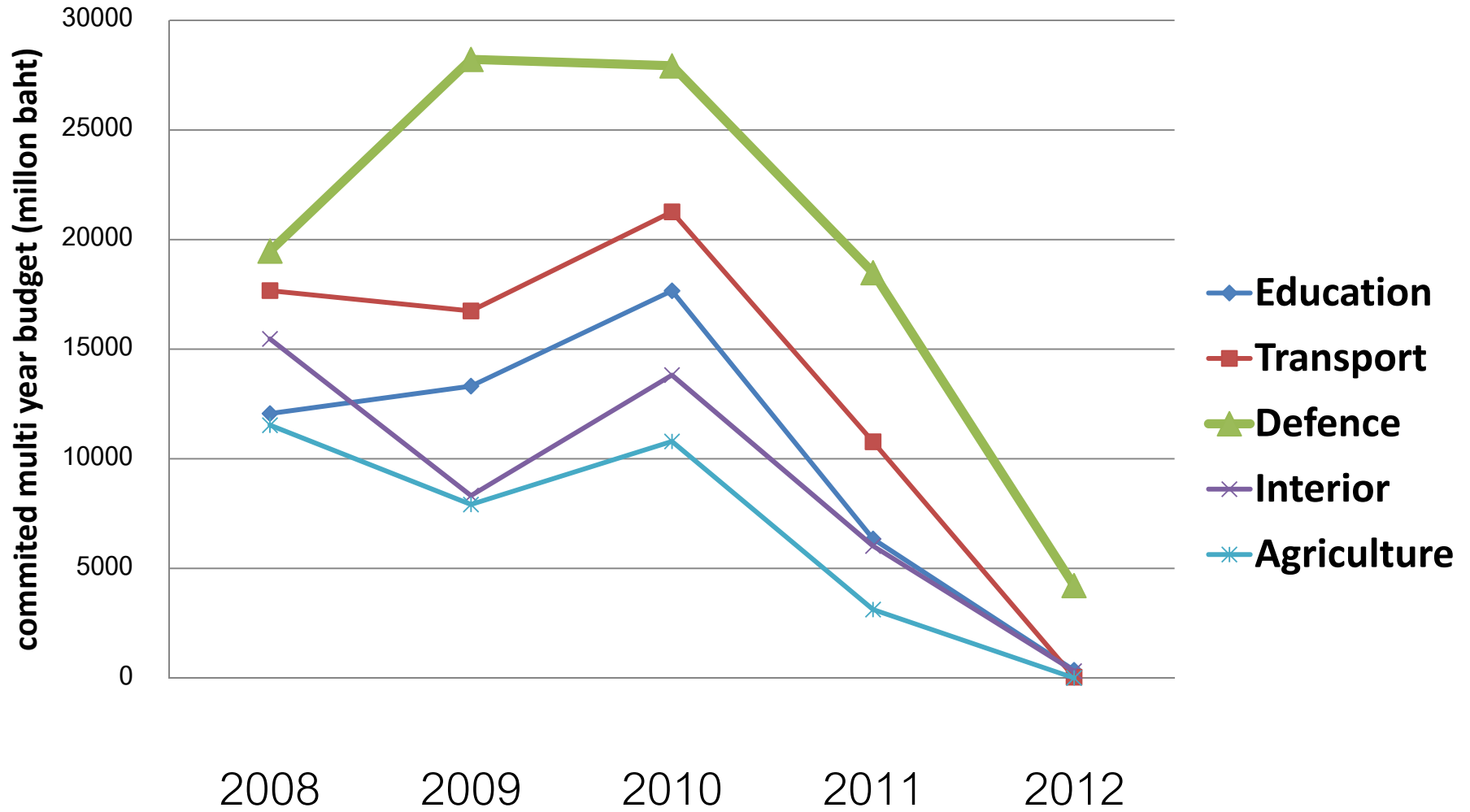


Budget appropriation after the coup

Source: Bureau of the Budget



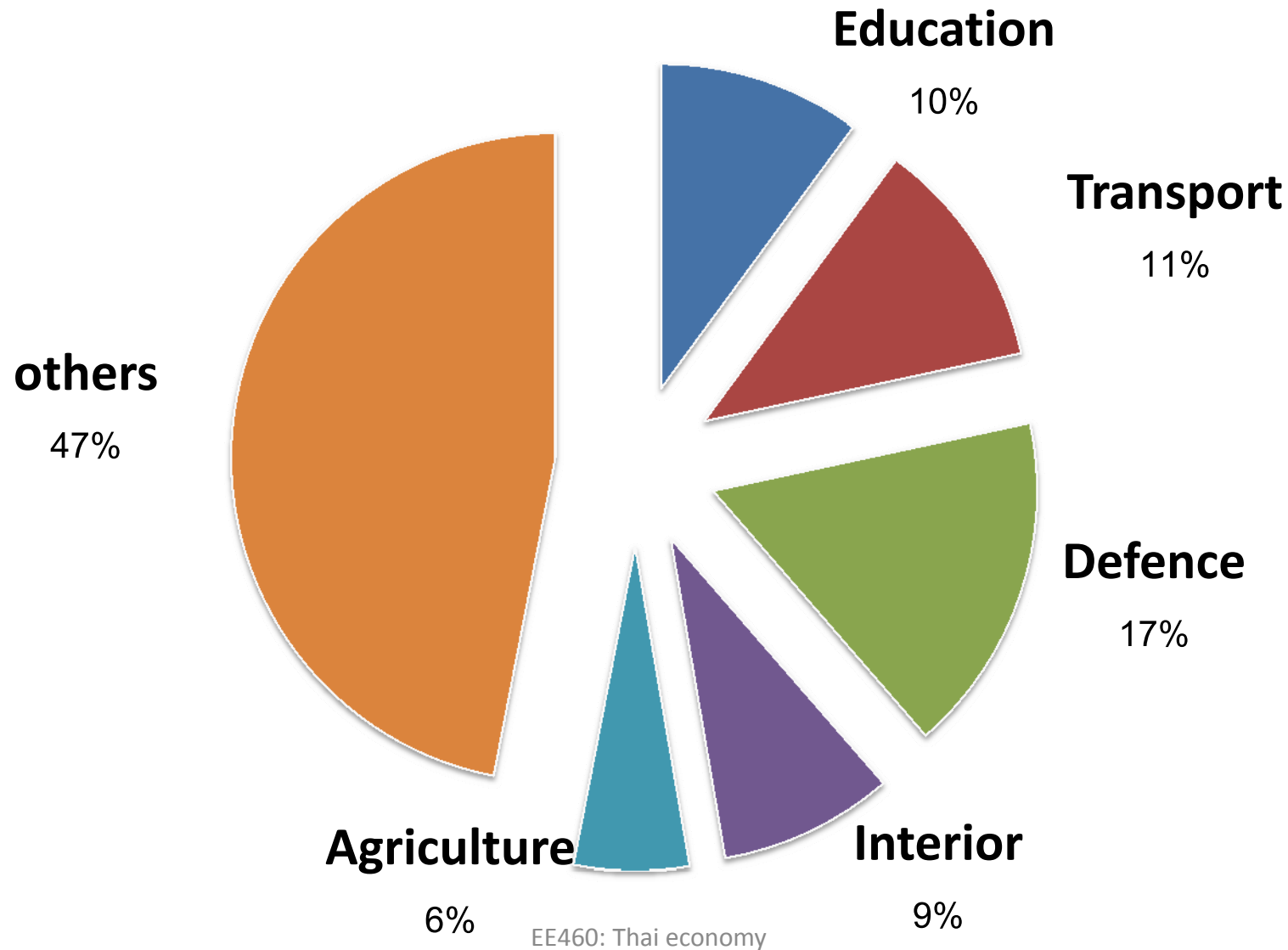
Multiyear-budget overshooting after 2006



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)

Total multi-year commitment budget FY 2008-2012



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

- Optimistic prediction on key macroeconomic variables.
- Optimistic forecasts of the effects on the budget of various new policies.
- Creative and strategic use of what is kept in and off the budget.
- *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.*

Corruption and fiscal stimulus

- Corruption activities are related to the amount and types of fiscal spending.
- The fear of recession was used as an excuse to splurge about 1.7 trillion baht in FY 2010.
- ***Fragmented*** fiscal spending increases corruption exposure.
- The need for secrecy makes the corruption much more distortionary and costly to economic development than taxation.

An 800 billion baht mistake

- In addition to 1.7 trillion baht FY 2010 budget, the government borrowed additional 800 billion baht to stimulate the economy.
- The average interest rate on the stimulus package is 4%.
- The additional borrowing costs extra debt service by 3 billion baht annually.

Fiscal indiscipline

- Fiscal prudence cannot be ignored.
- Multi-year budget is detrimental to fiscal flexibility and efficiency.
- Un-transparent budgetary procedure would lead to rising corruption.
- ***Tax payers are financing corruption activities.***

Indicators of institutional inefficiency

Mauro (QJE, 1995)

- Political change—institutional: Possibility that institutional framework will be changed within the forecast period by elections or other means.
- Political stability—social: 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
- Stability of labor: Degree to which labor represents possible disruption for manufacturing or business activity.
- Relationship with neighboring countries
- Terrorism

Indicators of institutional inefficiency

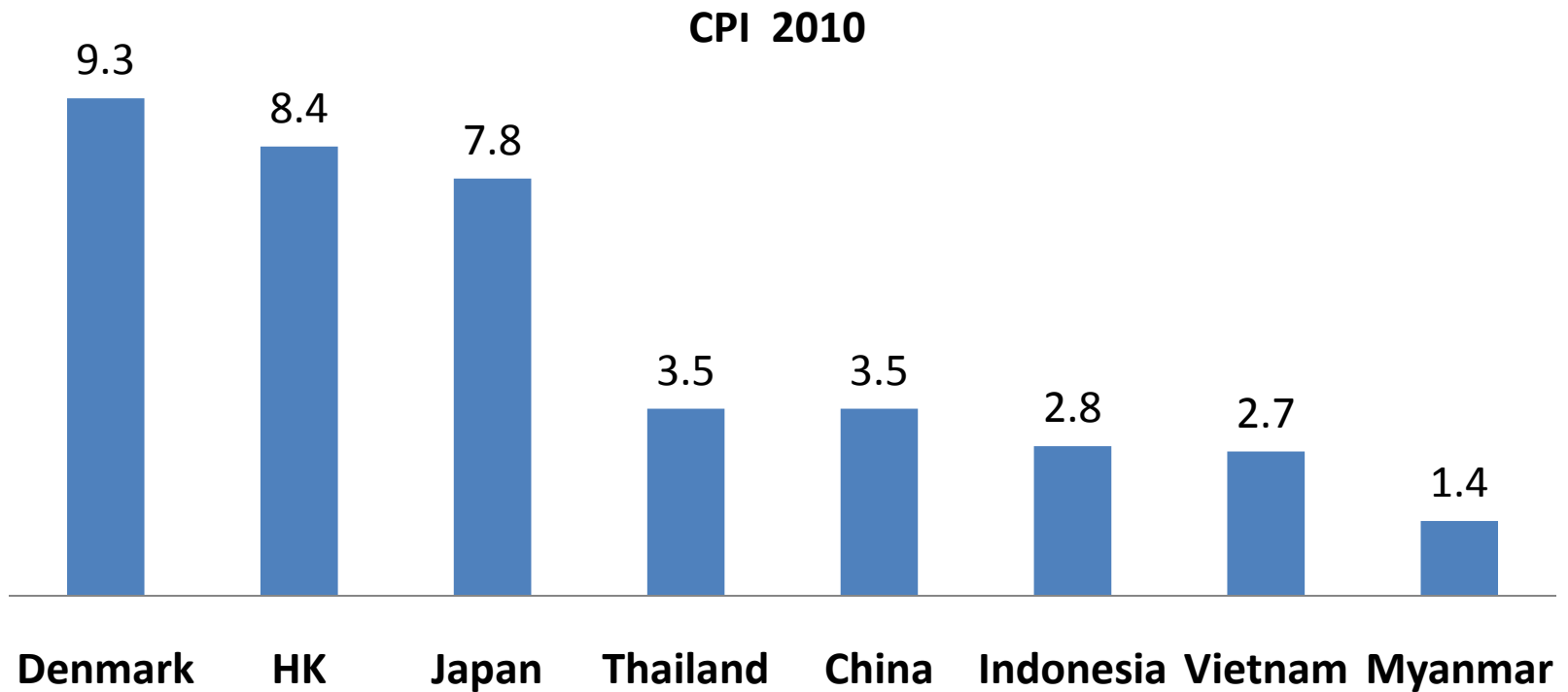
- Legal system, Judiciary: Efficiency and integrity of the legal environment as it affect business.
- Bureaucracy and red tape
- Corruption: the degree to which business transactions involve corruption or questionable payments

Impact on investment and growth

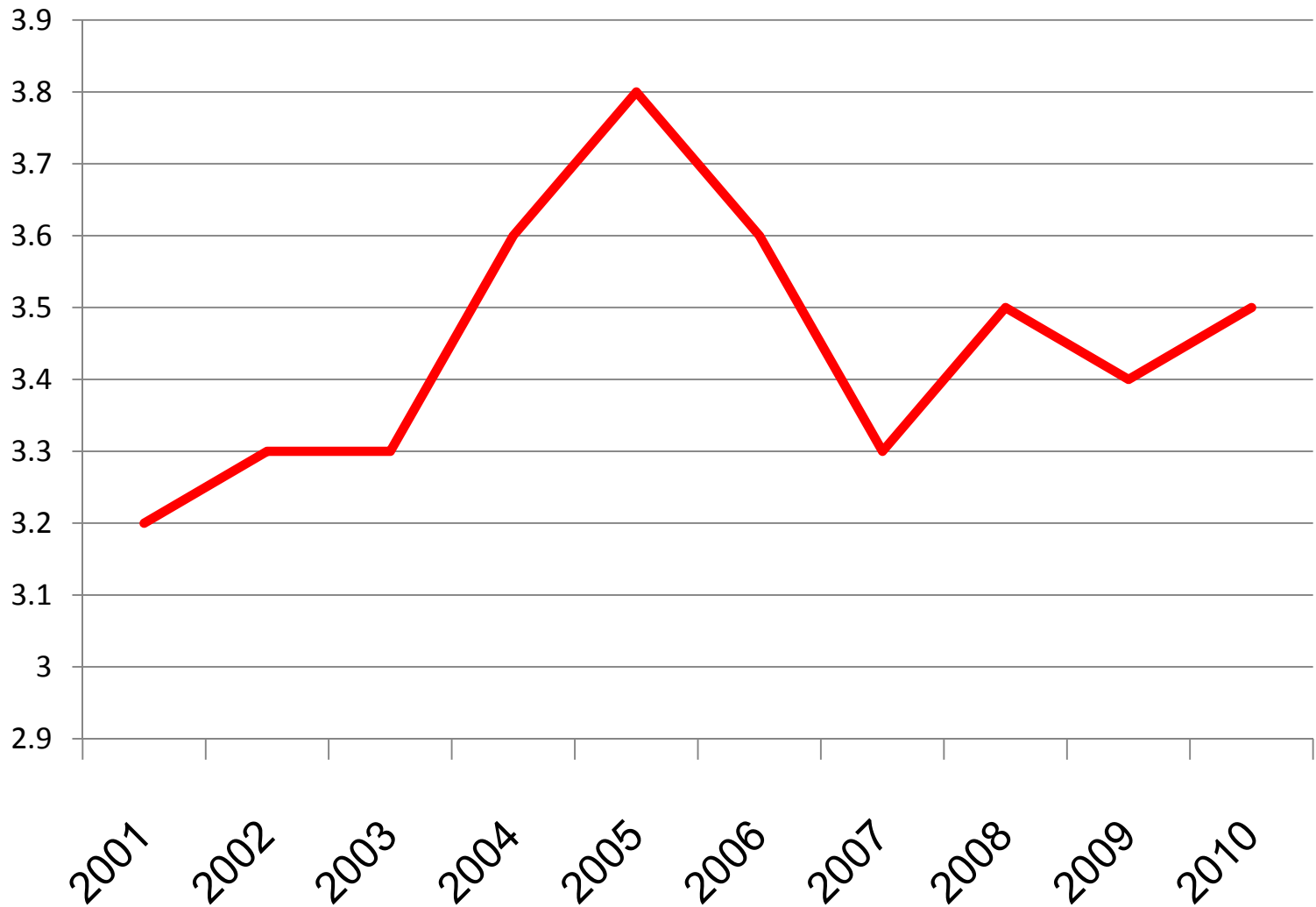
- Corruption lower investments by reducing the private marginal product of capital; thereby lowering economic growth rate.
- Revolutions and coups, political assassinations tend to lower long-term growth (Barro, QJE 1991)
- Institutional inefficiency causes low growth.

Corruption Perceptions Index

(longer bar, less corrupt)



Corruption Perceptions Index: Thailand



Source: Transparency.org

FF460: Thai economy

Concluding remarks

- Too low military spending may be dangerous to democracy because the military need to be pacified.
- Justification for the 2006 coup?
- Bad decisions in the past do have a long lasting impact in the future.
- Political dynamics would make it difficult to cut current 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.
- Ultra-populism policy is a legal means of vote buying.

The Army

- 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 in human rights violations against civilians, particularly in the South.
- The army is having trouble with the world's only blimp ever designed to be used in a counter-insurgency role.
- The 350-million-baht "Sky Dragon" dirigible cannot yet even fly right.

Biggest boondoggle

- The list 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.
- But if the mothballed and virtually useless HTMS Chakri Naruebet is the all-time biggest boondoggle, ***there have been plenty more.***

The Air force and the Gripen

- Vertical takeoff jets bought with the aircraft carrier, which have never effectively flown in combat or war exercises.
- To them, add the equally ground-bound Alpha jets purchased against massive public opposition, and the recent Gripen fighter purchases.
- The purchase of the Ukrainian armoured cars was another expensive exercise in poor military judgment.

And 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 aircraft carrier HTMS Chakri Naruebet was sent out to rescue people stranded on islands like Koh Tao.

Army's wasteful defense spending

- Bangkok Post, published: 27/07/2010
- In recent years the army has entered into a host of controversial deals - including the dubious GT200 bomb-dowsing rod, an airship which leaks and can reach only one-third of the altitude the makers claimed it can, and a fleet of armoured personnel carriers (APCs) which still have no engines.
- The army's plan to dump a fleet of 25 decommissioned Chinese-made T69-2 medium tanks into the sea off Narathiwat and Pattani provinces is both good news and bad.

The Army and the environment

- The good news is that the army has 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 reef, a shelter for fish and other marine life in the sea off the two southernmost provinces.
- The bad news is that the tanks are a complete waste of money and should never have been bought in the first place, even if they were very cheap.
- 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.

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.

Too heavy tanks

- Although the deal was justified from the military perspective by the need to meet an immediate security threat, it was a complete waste of money.
- The Chinese-made tanks were found to be too heavy and became stuck in the muddy terrain on the eastern border, especially during the rainy season.
- This meant the tanks were never positioned near the border, particularly at the Aranyaprathet-Poipet border, where it was feared Vietnamese armour would make its move if there was an invasion.

Tip of the iceberg

- But the Chinese tank deal represents just the tip of the iceberg when we look at how the taxpayers' money has been squandered by the army under the pretext of arms procurement for the defence of the country against real or perceived threats, externally or internally.
- And it is not just the army alone that has wasted the defence budget. The navy and the air force each have a similar track record of controversial spending.

Just a few examples

- The following are just a few examples of the apparent outrageous misuse of defence spending for weapons procurement:
- The GT200 bomb detector, or dowsing rod, used widely in the deep South by security forces.
- Altogether 535 units were bought at an average price of one million baht apiece;
- Ukraine BTR-3E1 armoured personnel carrier(APC). None have been delivered yet and they have no engines.

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



Accountability

- The Office of the Auditor-General has voiced reservations about the Ukrainian APCs deal, pointing out that the supplier's promise to replace the unavailable Deutz engines with MTU engines, both German-made, does not meet the contractual specifications, and it raises suspicions about the quality of the two engines.
- MTU engines are for boats and, therefore, it is questionable whether they are appropriate for use in the APCs
- Should the army persist in its intention to buy the Ukrainian armour, despite the strong criticism of the deal, then someone must be held accountable.

Unperturbed and unlikely

- Despite the OAG's reservations and criticism from other quarters, Army Commander-in-Chief Gen Anupong Paojinda and Defence Minister Gen Prawit Wongsuwan appear ***unperturbed***.
- Not only will they not cancel the contract to purchase the 96 BTR-3E1 APCs, they also intend to sign a new deal to obtain another batch from the same supplier - this time 121 APCs of similar type.
- The Abhisit government is ***unlikely*** to review the two deals anyway, not wanting to fail to appease the army for its role in propping up the government and in dealing with the red-shirt protest in Bangkok.

Expensive toys

- But the fact that the government is submissive to the army's wish-list for new toys, despite all the criticism of past fishy arms deals, should not be misinterpreted by the powers-that-be in the armed forces as a signal that they can do whatever they like, or have whatever they want, without being held accountable to the people. It is the taxpayers – not the government -- who have to foot the bill for all their expensive toys.

The U-boats

- **The Navy is pushing for 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



Shallow water

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

Here, we go again

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