

Military Business Cycle, Coups, and Economics of Corruption

Bhanupong
Lecture 26

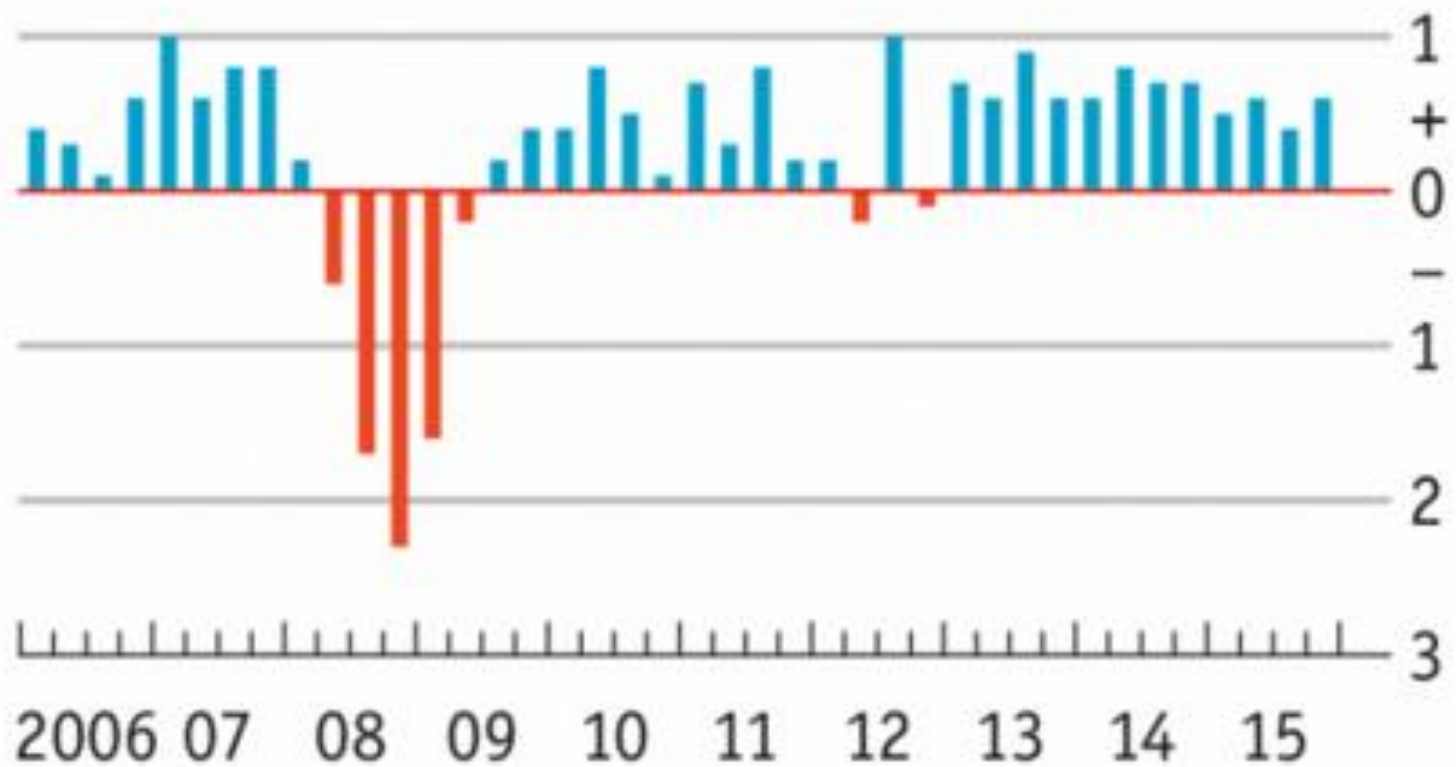
News Analysis: The Brexit

- Preliminary GDP figures released today are expected to show that the British economy grew by 0.4% in the first quarter of this year (1.6% annualised).
- This would represent a small drop from the pace of the past two years, which has averaged about 0.6%.
- The fact that growth is slowing is hardly a surprise: the turmoil in financial markets and a renewed fiscal squeeze is sucking confidence and demand from the economy.

Britain's GDP



% change on previous quarter



Source: ONS

The Brexit immediate effect: the British economy

- But another factor behind the slowdown is the ***spectre*** of Brexit.
- Since the beginning of the year, sterling has fallen by about 5% on a trade-weighted basis; construction deals in central London are being delayed.
- Businesses are also ***skimping on*** investment until after the referendum on June 23rd.
- All the talk is about the damaging effects that Brexit would have on the British economy; the reality is that it is already hitting growth.

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

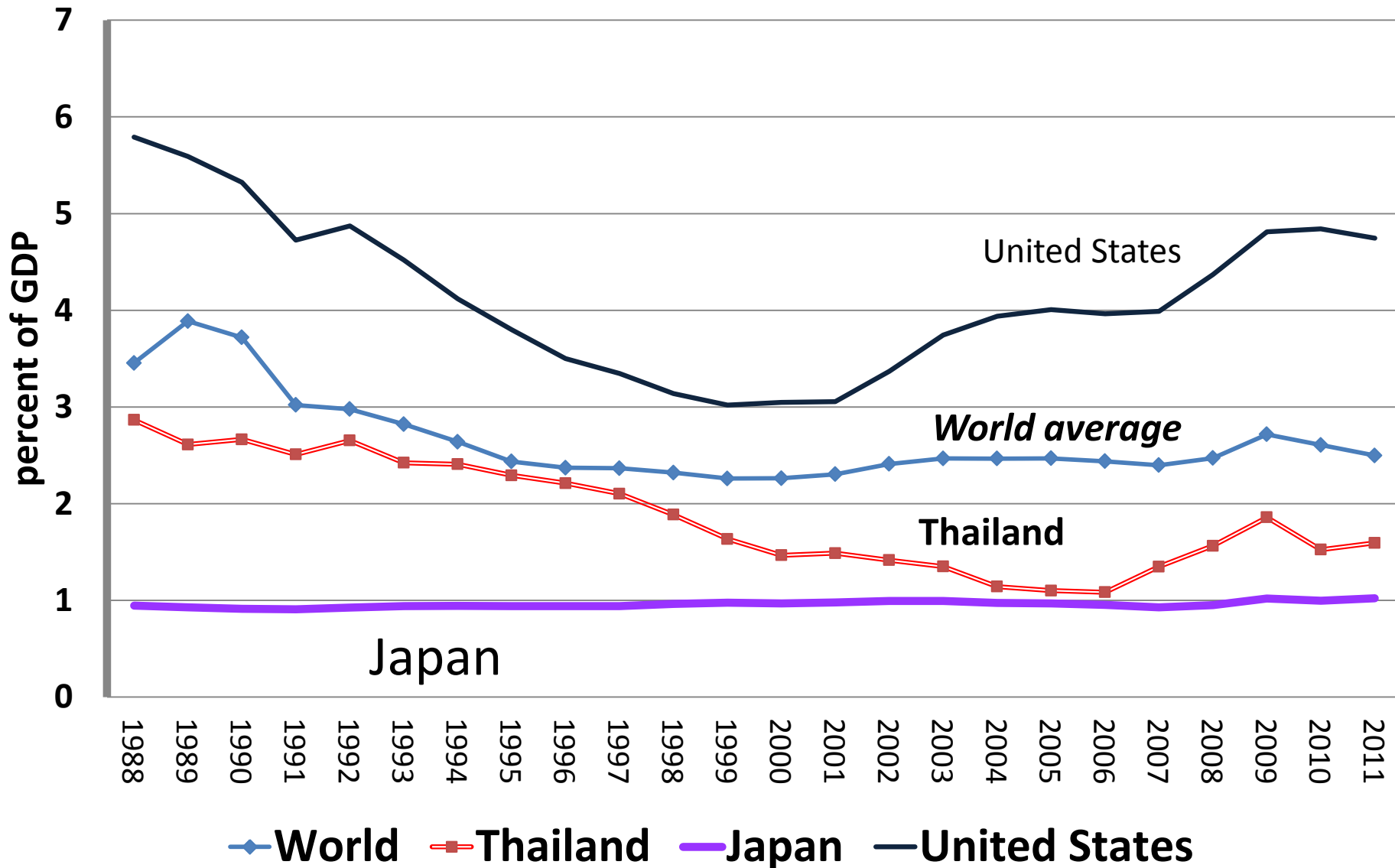
- External and civil wars, military spending by potential enemies, population, and democracy.
- While democracy is negatively related to military burden, other factors contribute to higher defense spending.

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



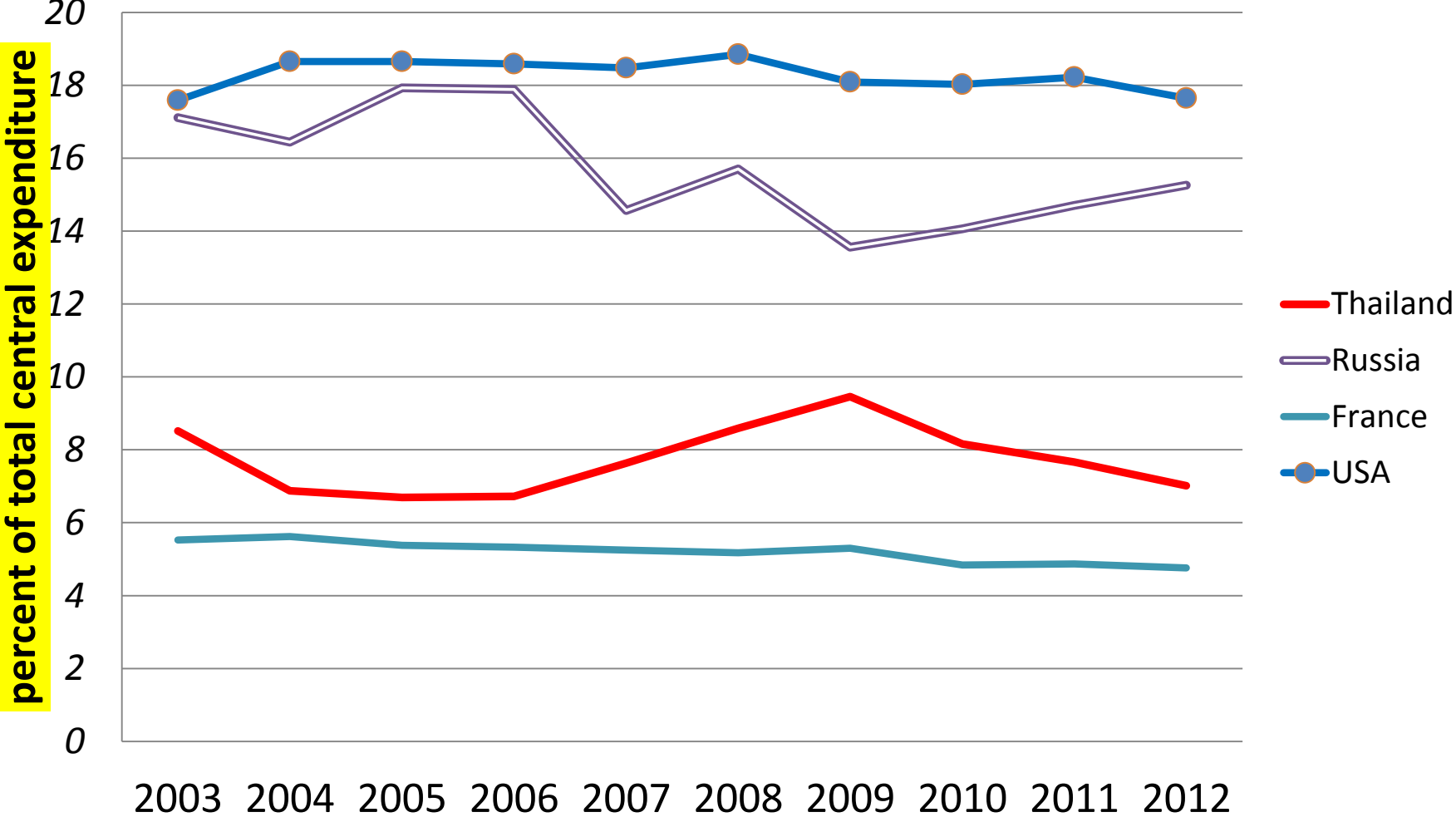
Peace Dividend

- 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

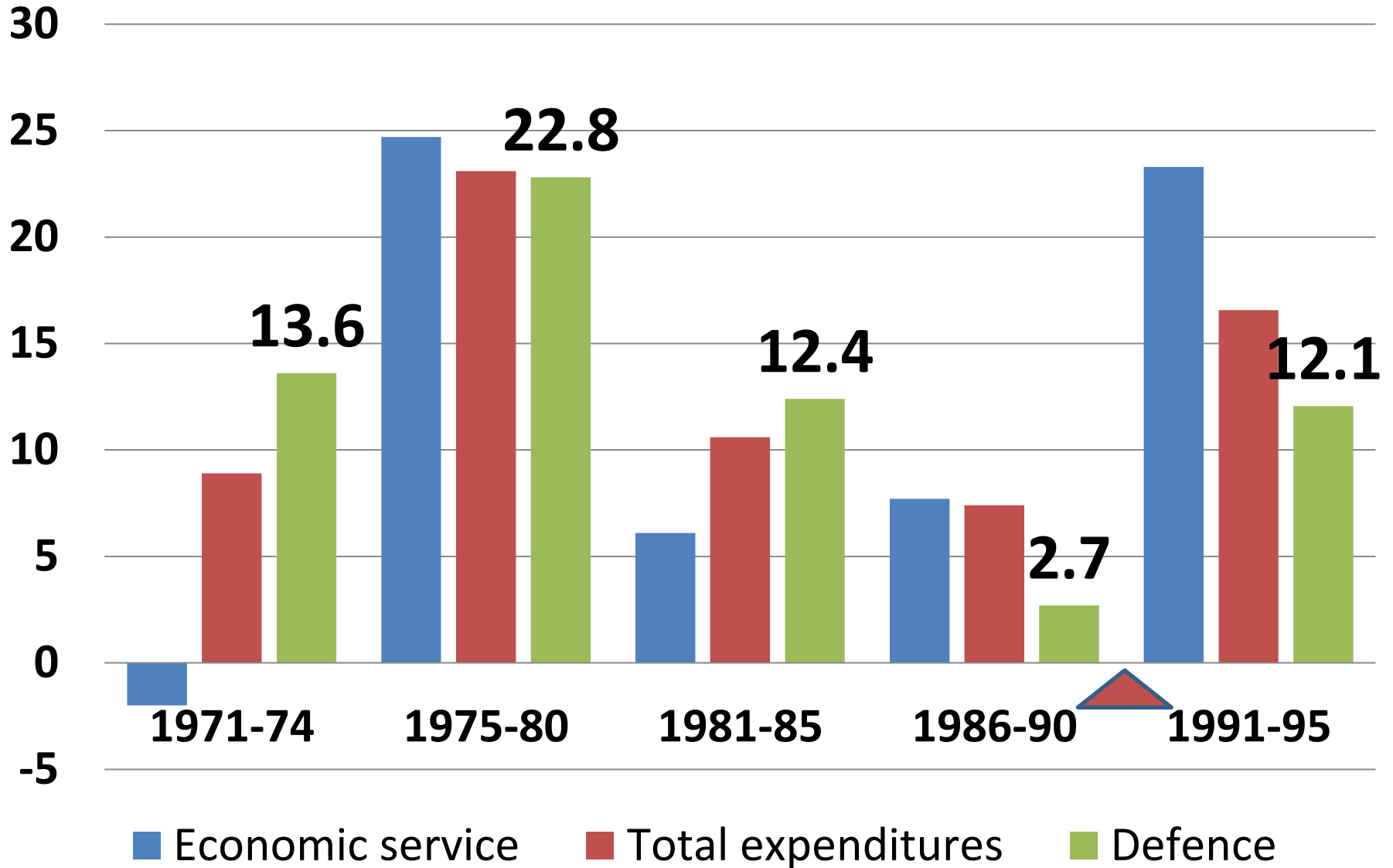


Land of the coups (PM name)

- 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

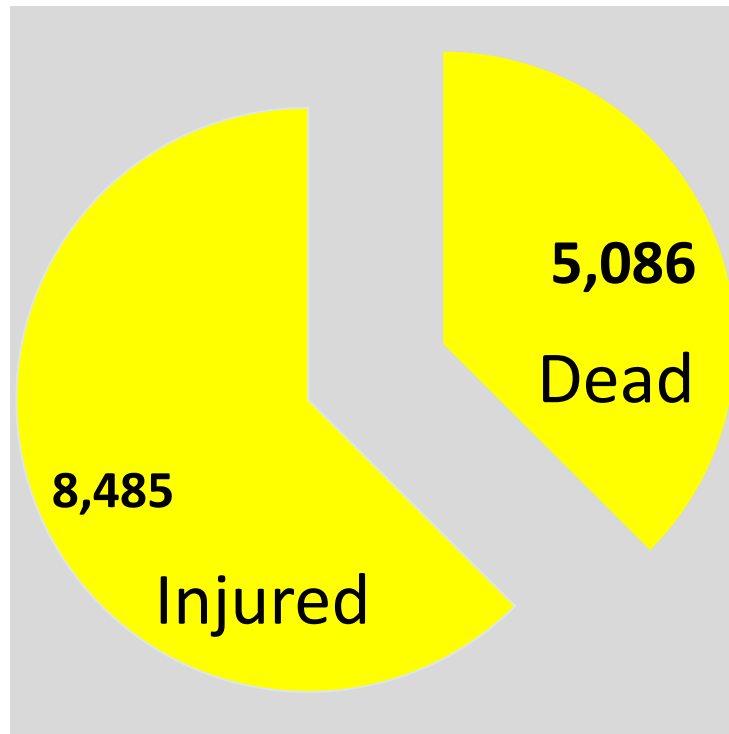
Mauro (QJE, 1995)

- 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

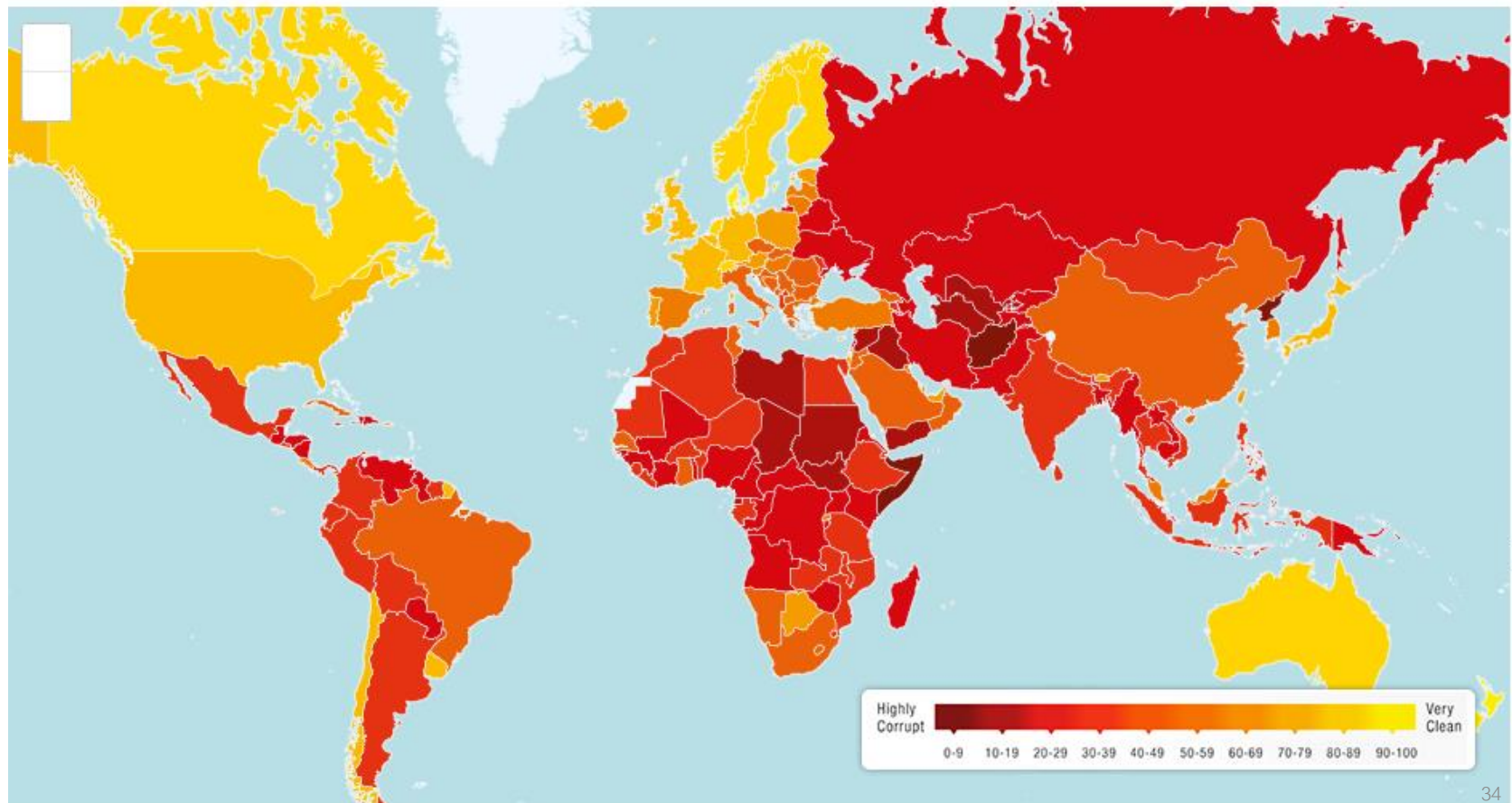
The degree to which business transactions involve corruption or questionable payments
Corruption Perception Index (CPI)

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](#)

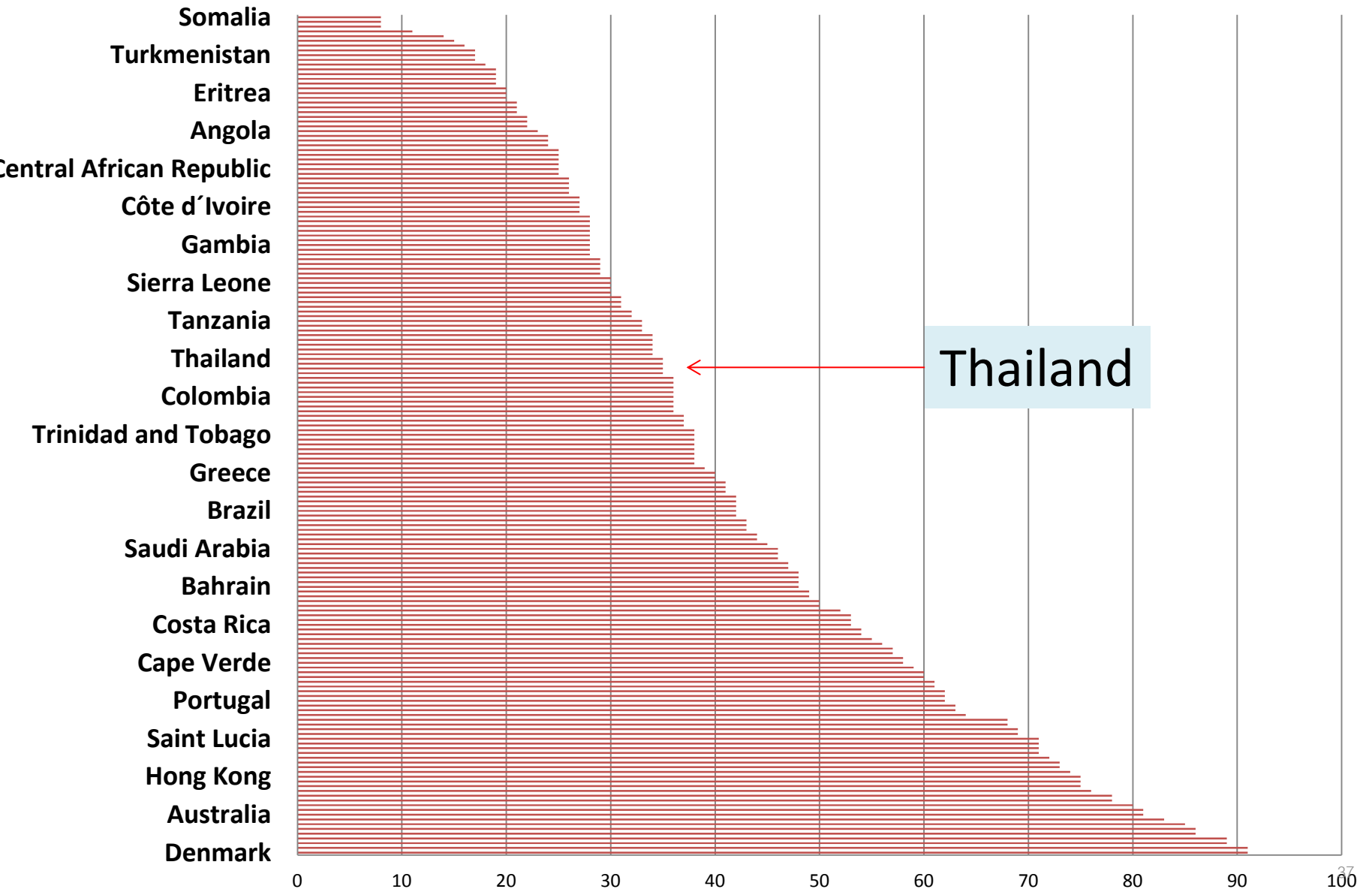


Corruption Perception Index: 2013

	score	Rank (177)
Somalia, N. Korea	8	175
Thailand	35 < 50	102
China	40	80
USA	73	19
Japan	74	18
Netherlands	83	7
Singapore	86	5
Denmark	91	1

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

Corruption Perception Index: 2013



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.

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.

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

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.

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.

Real Fear? Too heavy T69

- 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.

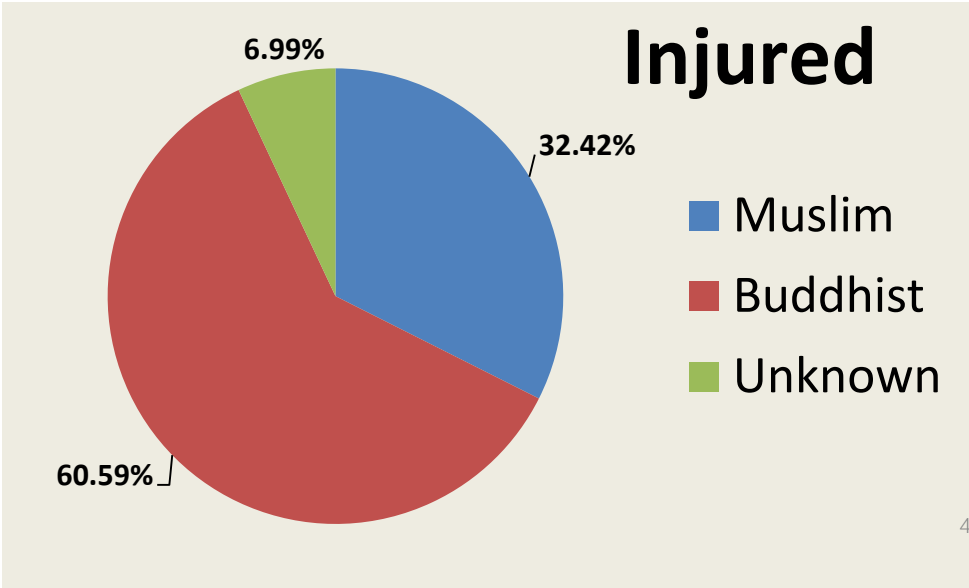
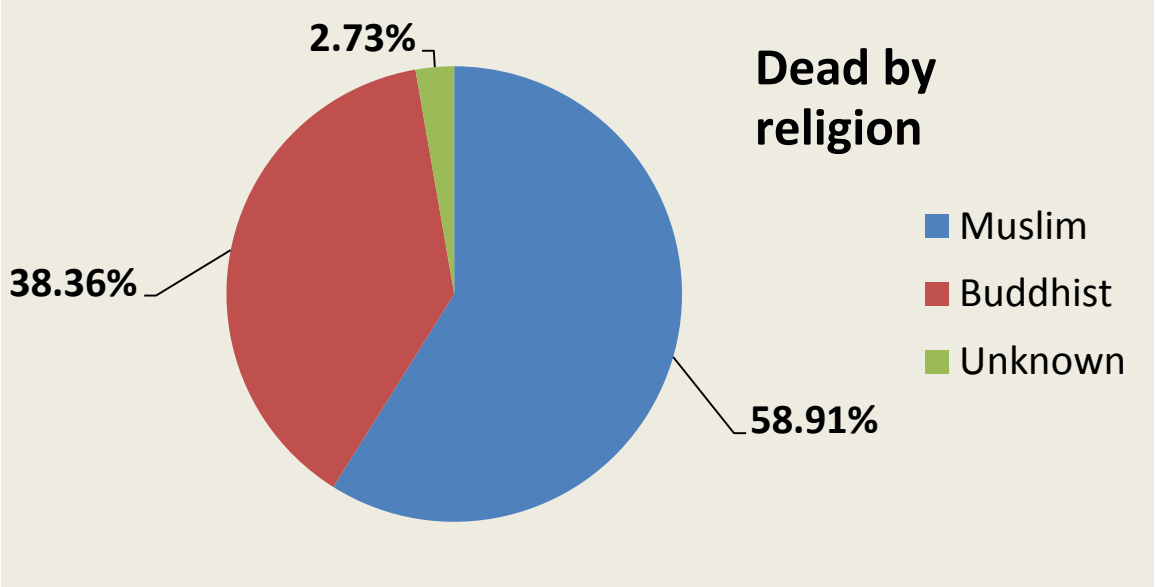
Decommissioned tanks and care for environment: Army's wasteful defense spending

- *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

- 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](#)

Violence in the South (2004-2012)



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

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 U-boats

- The subs -being **decommissioned** by the German navy - are more than 30 years old but are expected to be good for another 10 years.
- This is essential for training the crews before we can afford a brand-new submarine.

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 6, Malaysia 2. Indonesia 2+3

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.”