

Buffeting by the Unholy Trinity and the 2006, 2014 Military Coups

Bhanupong

Lecture 7

Asian Economic Papers 5(2), 2006

The Thai Economy after the coup

Outline

- The Avian Influenza
- The 2005 Asian tsunami
- The oil price shock in 2005
- The 2006 military coup
- Capital controls: December 18, 2006
- Return to happiness by the 2014 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

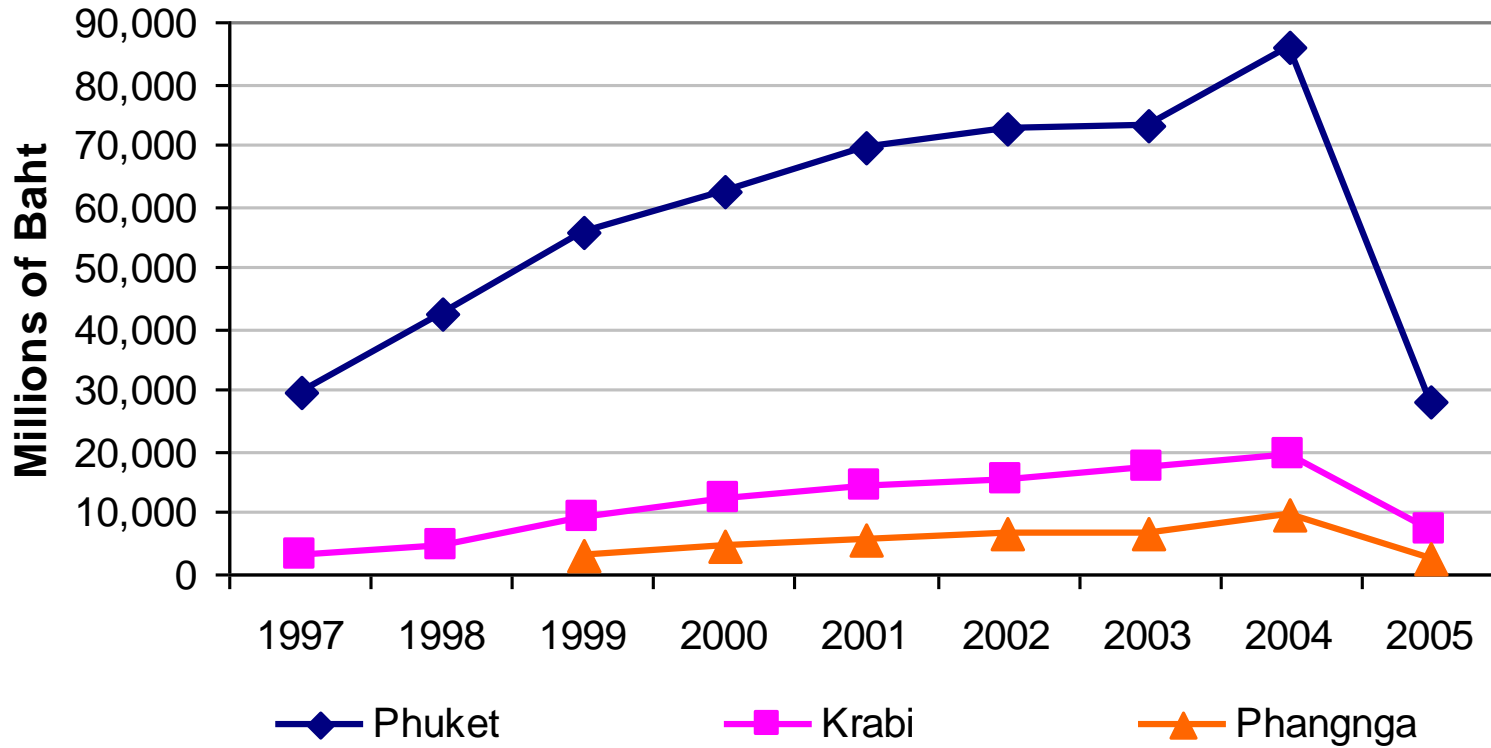
The Asian Tsunami

- 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)

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)
- 2013 Bangkok shutdown
- 2014: Military Coup (May 22)
- 2015: Erawan shrine bomb (August 17)

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

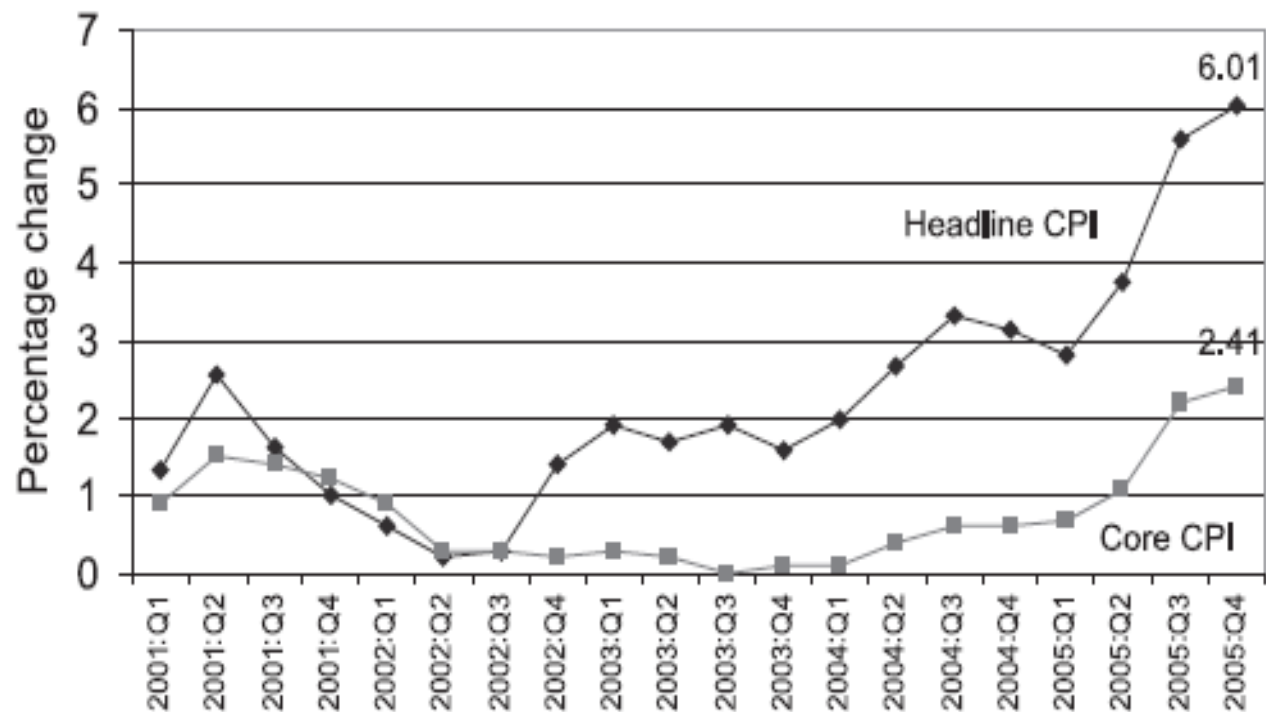
Buffeting of Thailand

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

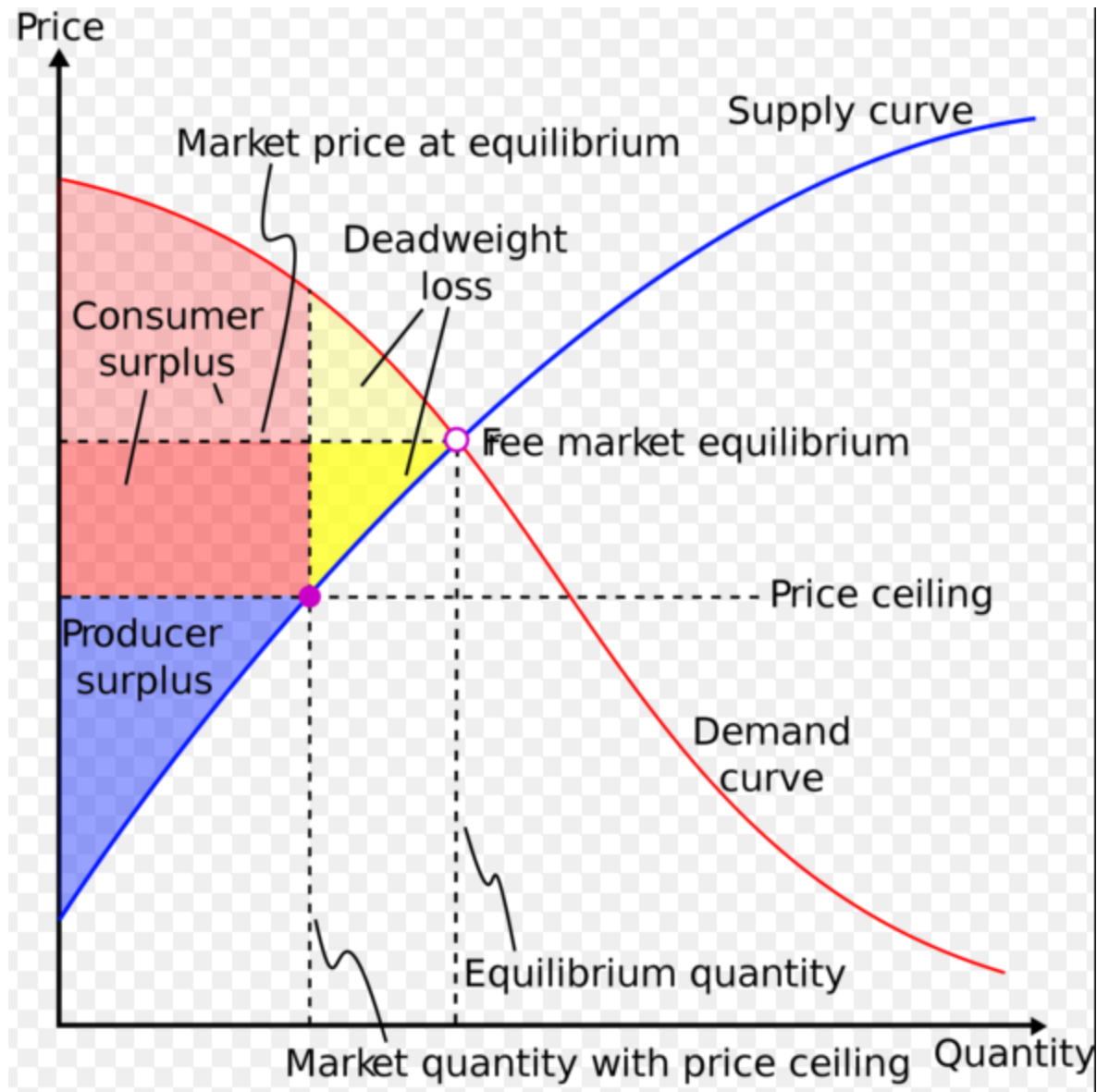


Source: Bank of Thailand.

Harberger's triangle

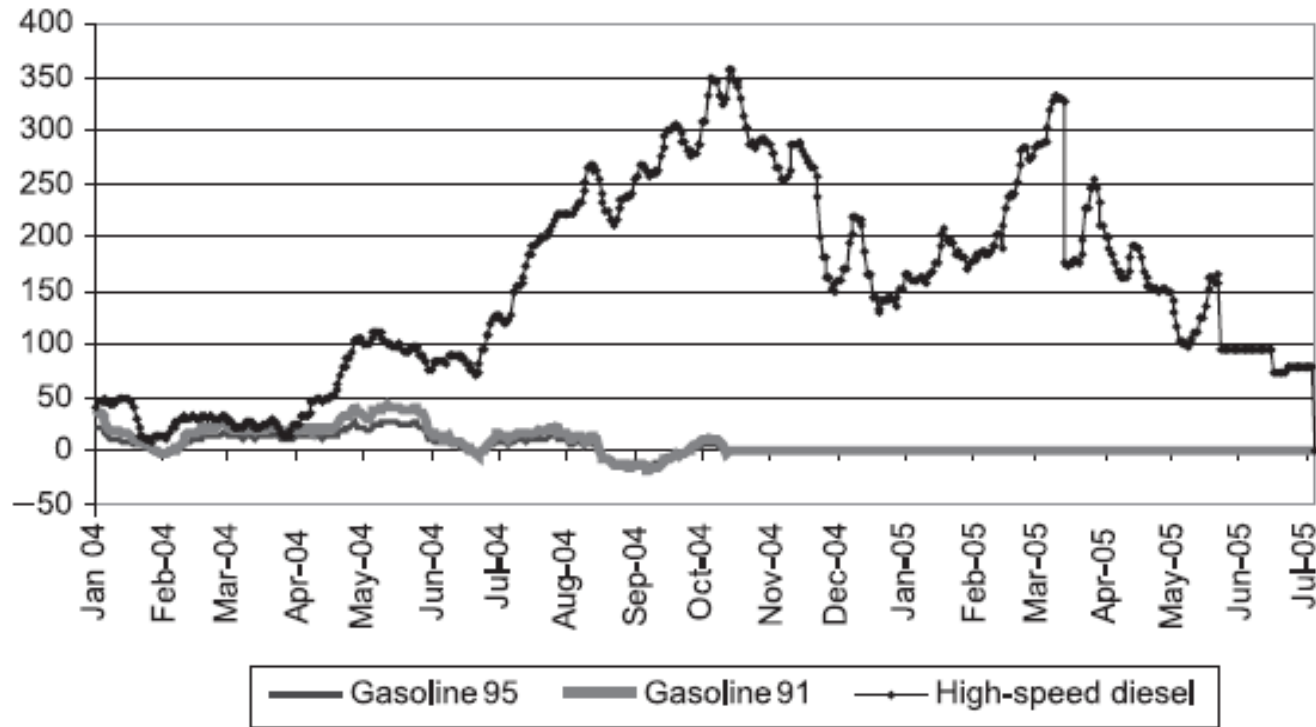
- Harberger's triangle, generally attributed to Arnold Harberger, refers to the deadweight loss (as measured on a supply and demand graph) associated with government intervention in a perfect market.
- It can happen through price floors, price caps, taxes, tariffs, or quotas.
- It also refers to the dead weight loss created by a government's failure to intervene in a market with externalities.

A deadweight loss: Harberger's Triangle



It takes heaps of Harberger triangles to fill an Okhun's Gap

Figure 5. Oil subsidies per day (million baht)



Source: Energy Policy and Planning Office.

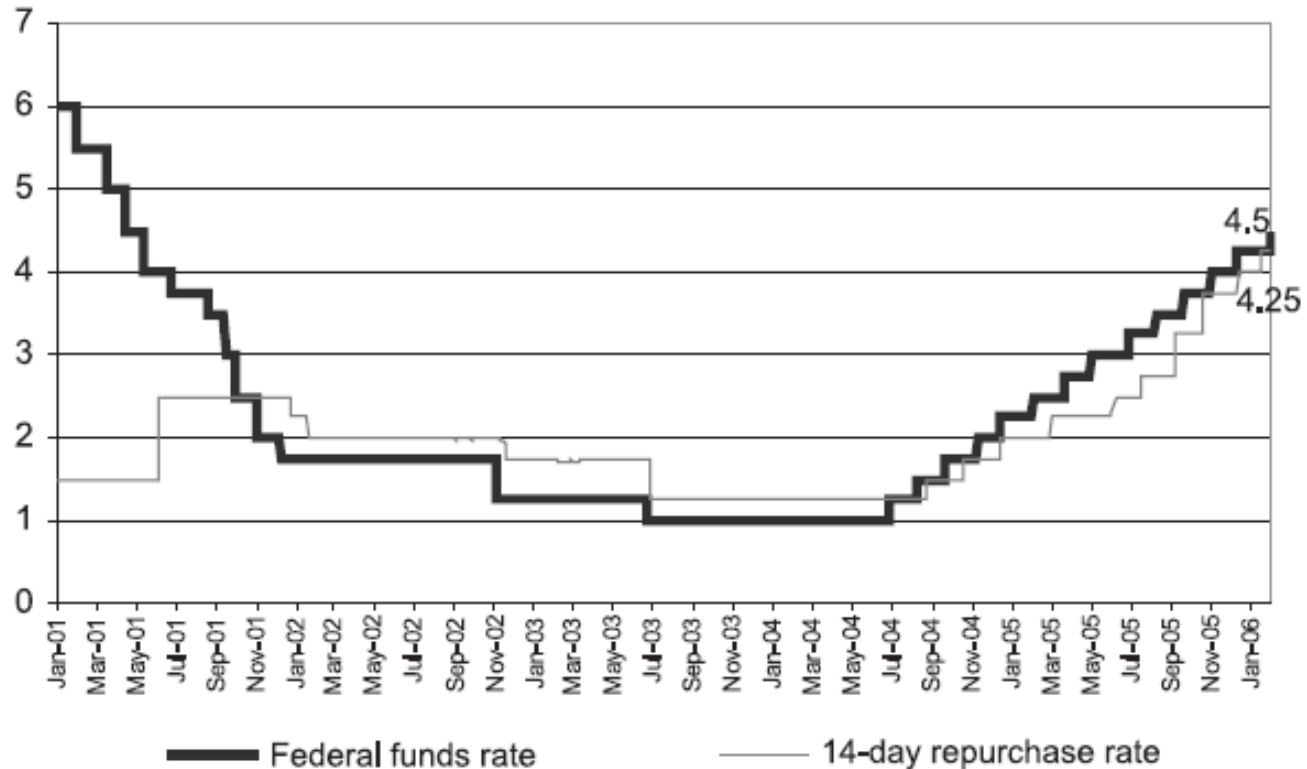
Okun Gap

- The situation when an economy's potential gross domestic product (GDP) differs from its actual gross domestic product (Okun 1962).
- The gap can either be recessionary or inflationary, but will depend on the economy's current state, including levels of inflation and the unemployment rate.

Three implications on monetary policy

Buffeting of Thailand

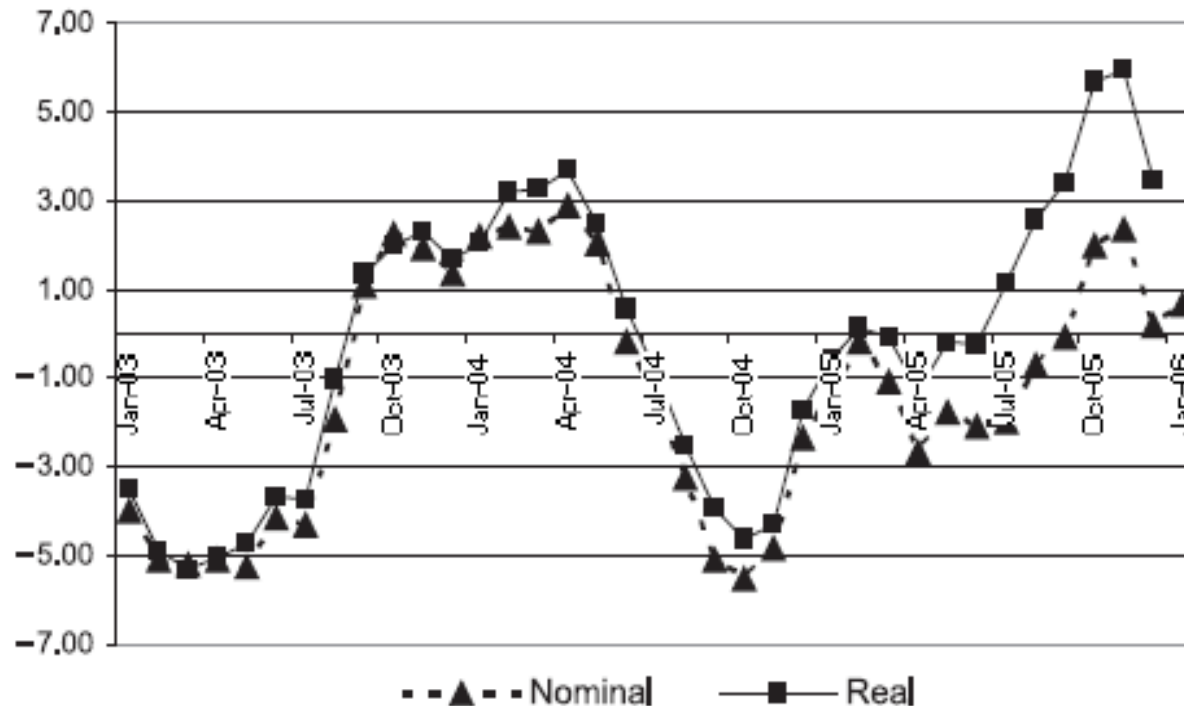
Figure 6. Federal funds and repurchase rates



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.

Upward: loss of competitiveness due to appreciation

Downward: gain in competitiveness due to depreciation

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 cycle
- The importance of capital formation
- Animal spirits of investors

Coups galore

- There have been 21 military coups since June 24, 1932, when absolute monarchy was replaced by constitutional monarchy.
- Only **ten** 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 Thamsrongdhnavasavad

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 cycle

And we thought 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 (September 2006)

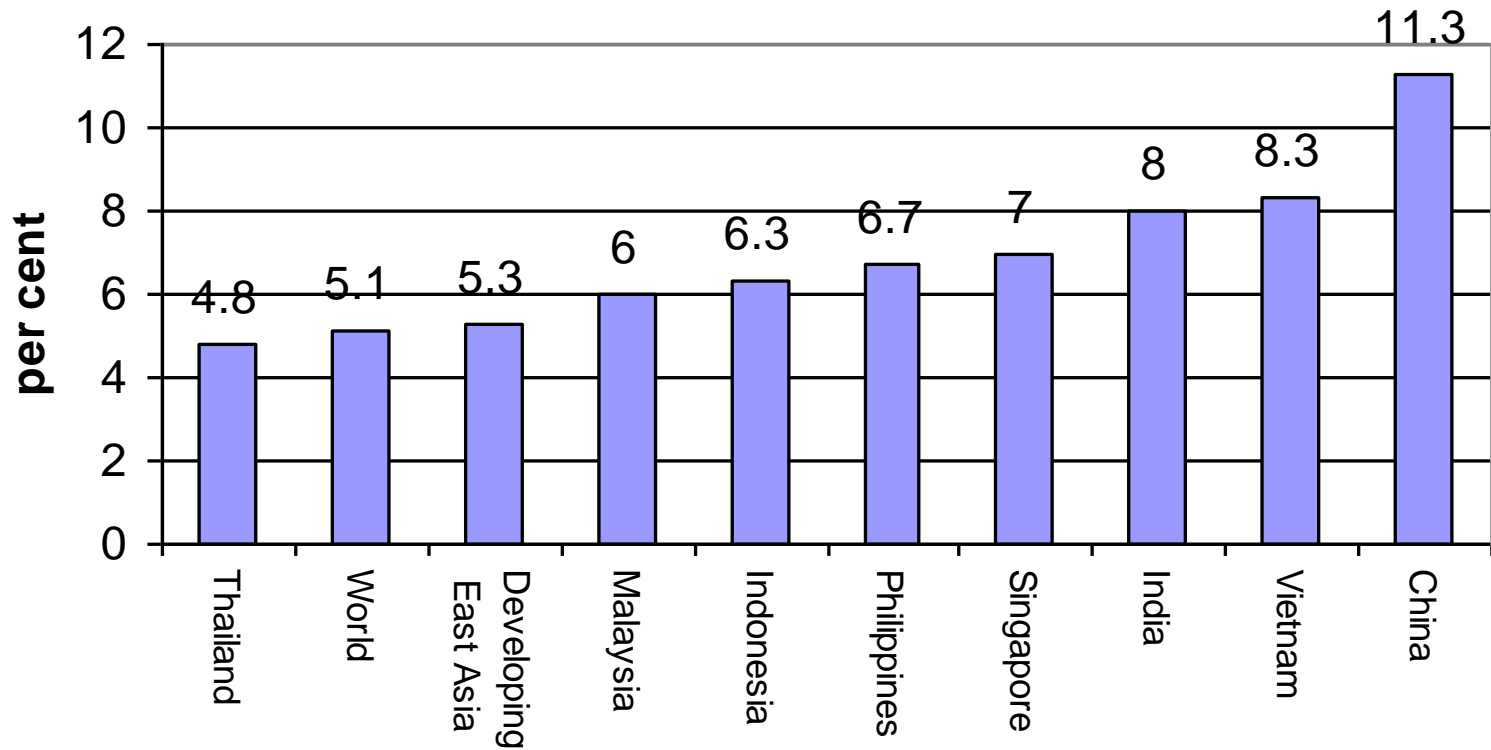
PM Yingluck (May 2014)

Thailand's perennial problems

- Exchange rate risks
- Fluctuations of the world economy
- Weak governing institutions: the rule of law
- Political and Southern violence
- *Military and judicial coups threat*

The price of the September 2006 coup

Comparison of Growth in 2007



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.

Okun's law

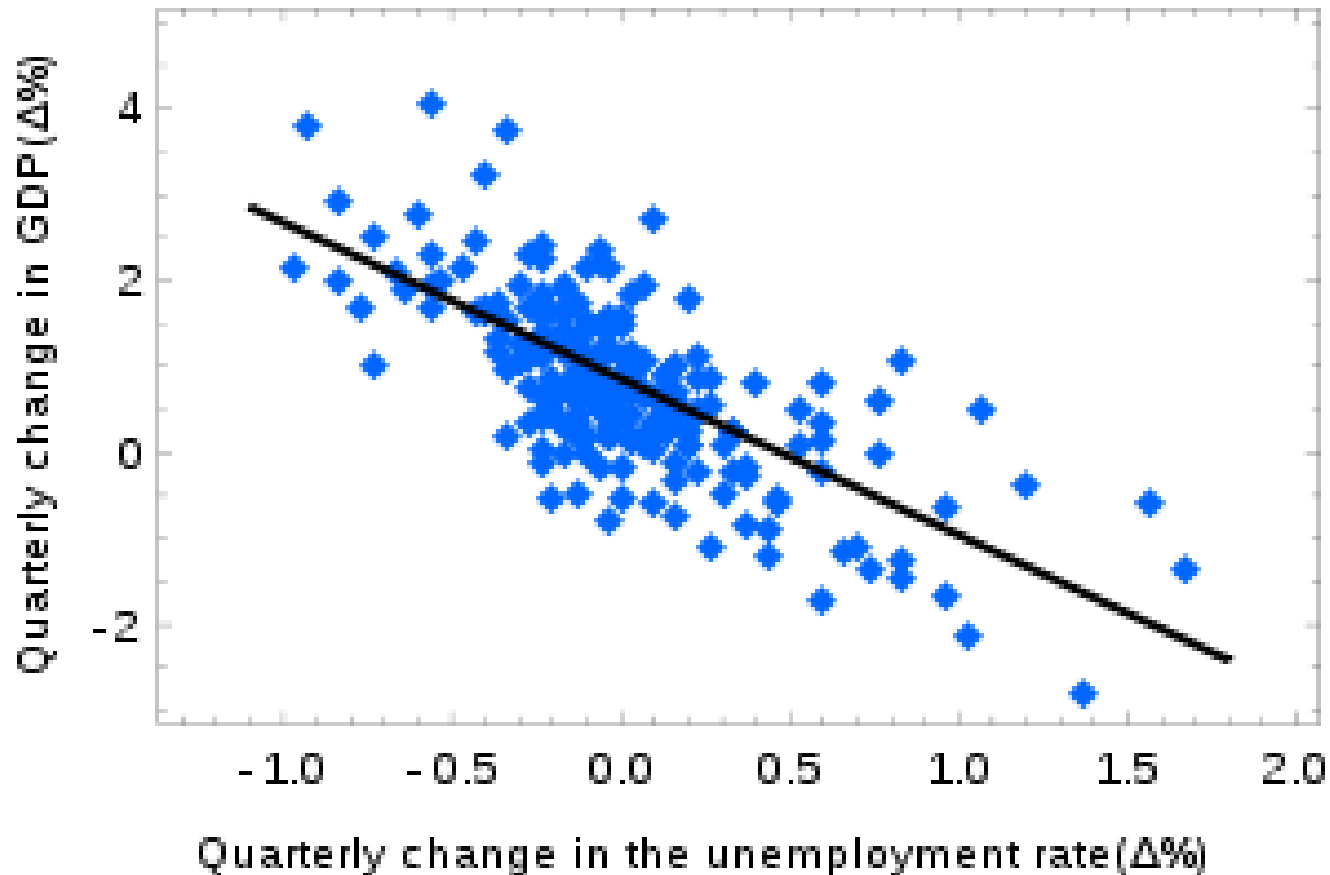
- Okun's law states that a one point increase in the cyclical unemployment rate is associated with two percentage points of negative growth in real GDP.

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

- The relationship varies depending on the country and time period under consideration.

Okun's rule of thumb

(high variance of the estimated slope coefficient)



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).

Several reasons why GDP may increase or decrease more rapidly than unemployment decreases or increases

- As unemployment increases, a reduction in the multiplier effect created by the circulation of money from employees
- Unemployed persons may drop out of the labor force (stop seeking work), after which they are no longer counted in unemployment statistics
- Employed workers may work shorter hours
- Labor productivity may decrease, perhaps because employers retain more workers than they need.
- One implication of Okun's law is that an increase in labor productivity or an increase in the size of the labor force can mean that real net output grows without net unemployment rates falling (the phenomenon of "jobless growth")

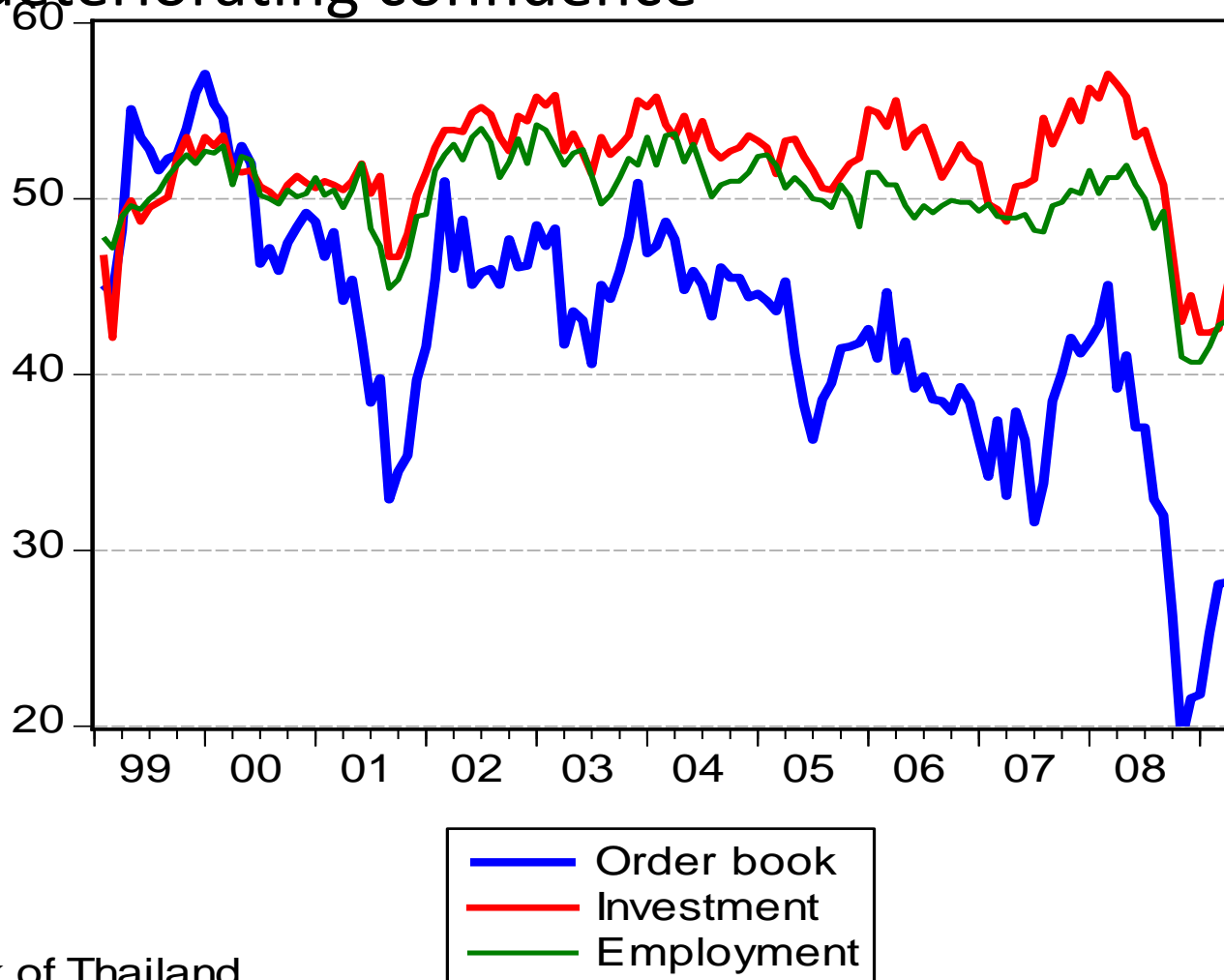
Animal spirits

- 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.
- *We must uphold fairness and social justice: no more double standards*

Business sentiment Index

How can we rekindle favorable investment climate?

Below 50: deteriorating confidence



Source: Bank of Thailand

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

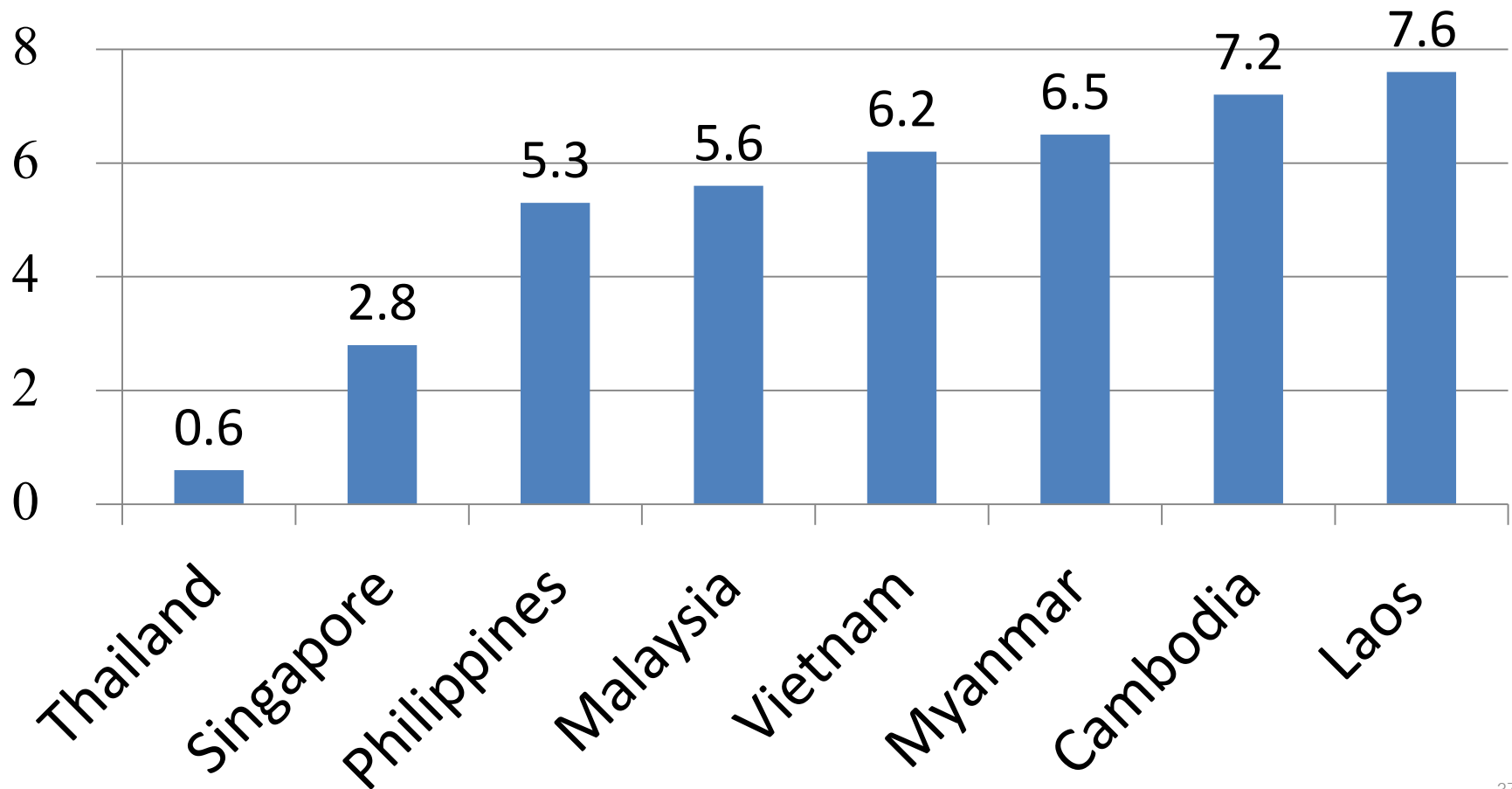
| | FY 2007 | FY 2008 | % Change in value |
|---------------------------------------|----------------|----------------|------------------------------|
| Defense | 7.3 | 8.6 | 17.8 |
| Education | 18.0 | 18.1 | 0.56 |
| Public health | 4.0 | 3.9 | -2.56 |
| Central fund | 12.6 | 14.8 | 17.4 |
| Agriculture | 4.1 | 3.9 | -4.88 |
| Total amount (billon 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.

The high price of the May 2014 coup

GDP Growth Rate (Y-o-Y) in 2014



Long gone is the stable growth path

GDP Growth



Thai coup adds to challenges for the Thai economy

24 May 2014 , AP

- Thailand's economy was already struggling before the country's military seized power in a bloodless coup Thursday, saying it needed to restore order after six months of protests aimed at ousting the elected government.
- The military takeover, the second since 2006, could ensure stability in the short term.
- But analysts fear the army's intervention will result in Thailand's political divide becoming even sharper, holding back the economy and living standards in the longer run.

Thai junta boosts spending on defense, and education in draft budget

- BANGKOK, Aug 18, 2014 (Reuters) - Thai junta leader General Prayuth Chan-ocha, stressing that the military had a "limited time" in power before a return to civilian rule, submitted a draft fiscal 2015 budget on Monday, with defense and education receiving hefty increases.
- The military seized power in May after months of street demonstrations which led to the ouster of Prime Minister Yingluck Shinawatra.

Guns vs. Schools

- The Ministry of Education was allocated 498.16 billion baht (\$15.66 billion), a 3.2 percent increase from last year's budget and 19.5 percent of the total budget allocations.
- Prayuth has called for education reforms as part of his plans to reshape the country and restore political stability.
- Defense spending, which typically increases in Thailand after a coup, grew 5 percent from last year's allocation to 193.07 billion baht (\$6.07 billion).

Rosy prediction after the coup

- **"If we don't increase the budget and purchase new weapons, then nobody will fear us,"** Prayuth told reporters.
- The 2.58 trillion baht (\$81.08 billion) draft budget, up around 2 percent from 2014, was submitted to the military-dominated National Legislative Assembly and will be considered by ad-hoc committees and adopted in the coming weeks.
- "The NCPO wants every ministry to put the budget to the best use possible because we have a limited time in power," Prayuth said, referring to the National Council for Peace and Order, as the junta is formally known.
- The economy may expand 3.5 percent to 4.5 percent next year (2015), he added, as the political situation stabilizes.

The National Economic and Social Development Board (NESDB)

- NESDB compiles gross domestic product data, on Monday **trimmed its 2014 full-year growth forecast to 1.5-2.0 percent** from a 1.5-2.5 percent range.

(The actual GDP growth in 2014 was 0.8%)

- Thailand avoided recession in the second quarter, the state planning agency said, but questions remain about the pace and depth of growth.
- The board said it expected to see steady economic recovery in the second half of the year.
- Prayuth, who led the May 22 coup, became the prime minister.
- He outlined a three-phase plan of reconciliation, formation of a government and elections in 2015.

The General's wishes

- "I hope that in 2015 the country will come into its own," Prayuth said. "We seized power in order to improve confidence in the country."
- Since taking power, the junta has made delayed payments to rice farmers, capped fuel prices and made a point of reassuring foreign investors that Thailand will return to democracy within a year. It has also approved urgent infrastructure projects.
- The moves appear to have helped consumer confidence which rose to the highest in 11 months in July 2014, (\$1 = 32 baht).
- The dollar cost 36 baht in September 2015

ECONOMIC STIMULUS

As of Jan 25, 2016

| Measures | Progress |
|---|---|
| 1. 59-billion-baht interest-free loan to Village Funds | ▶ 43.3 billion baht taken out by 48,200 villages |
| Note: Deadline extended to March from December last year | |
| 2. 5-million-baht budget per tambon | ▶ 2.49 billion baht disbursed (as of Jan 29) |
| Deadline extended to March from December last year | |
| 3. Accelerated disbursement of 40-billion-baht budget for small-scale projects | ▶ 27.5 billion baht drawn down (as of Jan 29) |
| Deadline set for end of this month | |
| 4. Soft loans for SMEs | ▶ First 100 billion baht and another 40 billion of additional loan taken out |
| Deadline set for June | |
| 5. 100-billion-baht credit guarantee scheme | ▶ All approved |
| 6. 6-billion-baht venture capital funds | ▶ Funds already injected money into two SME operators with a combined investment of 15 million baht |
| 7. Tax cuts for SMEs | ▶ Pending deliberation by the Office of Council of State |
| 8. Tax allowance on first home purchase priced below 3 million baht | ▶ Pending deliberation by the Office of Council of State |
| 9. Cuts in housing transfer and mortgage fees for homes priced below 3 million baht | |
| Effective until April 28 | |
| 10. Cheap mortgages | ▶ GH Bank already approved applications worth 15.5 billion baht |
| 11. Corporate income tax deduction of up to two times depreciation costs under the quick-start investment scheme | ▶ Pending deliberation by the Office of Council of State |
| 12. Single financial accounting promotion | ▶ Registration is available through March 15 |

Stimulus stuck in slow lane

Bangkok Post, February 8, 2016

Deputy Prime Minister Somkid Jatusripitak's appointment at the economic helm late last August was followed by rapid-fire launches of stimulus measures to revive the slowing economy.



Measures worth more than 400 billion baht were announced but disbursement of the funds was slow, snagged by red tape.

The 36.3-billion-baht scheme to distribute 5 million baht to each of 7,255 tambons nationwide has progressed at a snail's pace even though it was among the first batch of measures launched in early September.

A meagre 2.49 billion baht or 6.8% of the budget had been taken out as of Jan 29, according to the Comptroller General's Department. The slow budget disbursement has caused the government to push back the project's deadline to March from December last year.

The Interior Ministry is the core agency responsible for budget allocation for each tambon to implement any project related to building or repairs and development projects in line with the sufficiency economy.

The Comptroller General's Department data also showed that 27.5 billion baht of the budget of 40 billion for quick disbursement for small projects worth less than 1 million baht nationwide had been drawn down as of Jan 29.

The government wants the budget to be fully disbursed by this month.

Yet another stimulus measure, to direct 59 billion baht in cash handouts to grass-roots communities through the Village Funds, has also made slow progress.

According to Fiscal Policy Office data, 43.3 billion baht had been taken out by 48,200 villages as of Jan 25. The scheme's deadline has also been extended to March from the end of last year.

The scheme offers funding of 1 million baht for 59,000 villages ranked grade A and B, featuring interest-free soft loans for the first two years and only 1% plus financing costs for the subsequent three to seven years.

Despite the slow disbursement of stimulus funds, the cabinet last month approved an additional 35 billion baht to inject 500,000 baht into each of the 70,000 villages nationwide to boost the rural economy hurt by soft agricultural prices and drought.

The wave of stimulus packages was rolled out as short-term measures to maintain growth momentum and help vulnerable groups get through hardship while exports are sagging and public and private investment remain tepid and, in any case, takes longer to bear fruit.

The government has introduced a wave of measures to revive the economy, but red tape is delaying disbursement funds

Cash injections through banks have appeared to be the most efficient pump-priming tool.

The 100 billion baht in soft loans to small and medium-sized enterprises (SMEs) was fully taken out in a few months after the government threw the lifeline last September.

The Government Savings Bank extended the soft loans to commercial and state-run banks at 0.1% interest. The banks then relent the money to SME operators at a 4% rate.

Demand for the SME loans was so strong that the government approved an additional 50 billion baht: some 40 billion of the new funding was drawn down in less than a month.

Concluding remarks

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