

TRENDS IN MILITARY EXPENDITURE AND ARMS TRANSFERS

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I. Introduction

The end of the cold war brought about a reduction in military expenditure and international arms transfers, both in terms of world totals and in most regions and countries. The level of military expenditure and the level of international arms transfers both reached a peak in 1987, then stayed roughly constant for two years and began a rapid decline after 1989, the year of the fall of the Berlin wall. Towards the end of the decade the reductions have ceased. Since the mid-1990s both military expenditure and the level of global transfers of major conventional weapons have stagnated, the volume of arms transfers has even increased slightly. The total reduction in world military expenditure during the period 1987 was one-third in real terms,¹ while the reduction in the volume of international transfers of major conventional weapons was around 40 per cent.²

In spite of these reductions, the amount of economic resources used for military activities is still significant both in a global perspective and in individual regions and countries. The estimate for total world military expenditure in 1998 was \$745 billion. This estimate is based on official public expenditure data. In addition, there are the costs of war fighting, which are not always included in official figures. Adding the cost of the consequences of war, including both the short term costs for refugees, lost production, etc. and the long term costs of economic reconstruction, military activities represent a significant consumption of global resources—economic, manpower and technological—in a world of scarce resources, poverty and hunger.³

World military expenditure in 1998 represented an average of 125 dollars per capita. By comparison, at least half a dozen countries in Africa had an average gross

¹ Sköns, E., et al., 'Military expenditure', *SIPRI Yearbook 1999: Armaments, Disarmament and International Security* (Oxford University Press, N.Y. 1999), pp. 269-70.

² Hagelin, B., Wezeman, P. D. and Wezeman S. T., 'The volume of transfers of major conventional weapons', *SIPRI Yearbook 1999: Armaments, Disarmament and International Security* (Oxford University Press: Oxford, 1999), figure 11.1, p. 422.

³ According to one calculation, world military expenditure corresponded to the combined annual income in the poorest countries representing 49 per cent of the world population in 1992. The United Nations Development Programme (UNDP), *Human Development Report 1994* (Oxford University Press: New York, 1994), p. 48.

national product (GNP) per capita of less than 250 dollars in the same year.⁴ A comparison with public expenditure on education and health shows that while military expenditure in 1996 corresponded to 2.4 per cent of world gross national product (GNP) the comparable shares of education and health were 4.8 and 5.5 per cent respectively.⁵ If there were some ways to redirect some of the resources currently devoted to military purposes to instead meet the needs of the disadvantaged, this would go a long way to alleviating the most serious suffering. But is this possible?

At the same time there are also great unsatisfied security needs. While there has been a reduction in external armed conflict, i.e. between countries, the internal security needs are great and possibly increasing. During the 1990s alone more than 4 million people lost their lives in violent conflicts, most of which were civilians—nine out of ten casualties in civil wars are civilians—and by 1997 about 35 million people were displaced as refugees or within national borders.⁶ The question that arises is whether military expenditure is the best or most appropriate way of providing security for states and people.

There are no easy answers to these questions. A paper on trends in military expenditure and arms transfers cannot address all these issues, which relate to a large proportion of global, international and national security problems; neither can it ignore them.

Military expenditure is primarily an economic indicator, since it is a measure of economic input. Thus, the decline in world military expenditure shows that there has been a reduction in the aggregate amount of world economic resources devoted to military purposes during the post cold war period. It also shows that there has been a decline of military activity, although there is no clear relationship between the input of economic resources into the military sector and the output in terms of military activity or military strength. The link between military expenditure and security is naturally even weaker, since the level of security depends on a range of other factor than military expenditure or even military strength.

International arms transfers represent the flow of weapons between countries. Only transfers of major conventional weapons are discussed in this paper. There exists no data on international transfers of small arms and light weapons. Most countries lack a domestic capability to produce weapons. For these countries arms trade data shows also their total arms procurement.

The most significant development in the military sector during the post cold war period is probably the changes in the arms industry. Reductions in military

⁴ The World Bank, *Entering the 21st Century: World Development Report 1999/2000* (Oxford University Press, 2000), pp 230-31.

⁵ The United Nations Development Programme (UNDP), *Human Development Report 1999* (Oxford University Press: New York, 1999), appendix table 13, p. 191.

⁶ Mohammed, N.A.L., 'Civil Wars and Military Expenditures: A Note', Paper prepared for the conference on 'Civil Conflicts, Crime and Violence', by the World Bank's Development Economic Research group (DECRG), Washington, DC, 22-23 Feb. 1999, p. 5. Available also at URL: <http://www.worldbank.org/research/conflict/papers.htm>.

expenditure have resulted in a sharp drop in the demand for military equipment, i.e. for the goods and services produced by the arms industry. In combination with the increasing costs for advanced weapon systems, the changing relationship between military and civil technology, and the process of globalization, this has had a profound impact on the arms industry. During the 1990s the changes in the arms industry in most major centres of arms production include, in addition to sharp production cuts, an increased degree of privatization, concentration, internationalization, commercialization and competition. There has been an increased pressure to export from the industry and an increased demand on governments in arms-producing countries to assist the industry in its export efforts. These changes are likely to have a significant impact on arms production, arms procurement and arms exports.

The trends in military expenditure and arms transfers are described in section II. Some insights into the complexity of factors determining military expenditure and arms transfers are given in section III. The impact of globalization is addressed separately in section IV. Economic considerations are often perceived as an impediment to reductions in military expenditure. Arms exports are to some extent a function of excess supply, which in the post-cold war period has been the result of over capacities in arms production. In the process of reducing this over capacity, economic considerations have been even more important. Section V is therefore devoted to the economics of reductions in military expenditure, arms production and arms transfers. Finally, section VI briefly outlines the key challenges for the first years of the new millennium.

II. Trends in military expenditure and arms transfers

Trends in military expenditures

The trends in world military expenditure since the end of World War II can be divided into two periods: first, a period of rapid increase from the end of the war until the peak years of 1987-89; and second, a period characterized by an overall downward trend in expenditure since 1989. The first of these periods roughly coincides with the era of the cold war, which is generally perceived as beginning soon after the end of World War II (1947) and ending with the fall of the Berlin wall in 1989, which marked the beginning of the post-cold war period.

During the *cold war period (1947-89)*, which was characterized by rivalry between the two superpowers the USA and the USSR, world military expenditure was growing rapidly and reached an unprecedented high level. More economic resources were used for military purposes after World War II than ever before. During the 1980s the level of world military expenditure was more than 10 times that in the period 1925-38. This was due primarily to the trends in military expenditure of the two superpowers and to some extent by their allies. By the end of the cold war period the USA and the USSR accounted for 36 and 23 per cent respectively of total world military expenditure.

While expenditure was increasing consistently throughout the cold war period, the rise was not uniform over time. During periods of large-scale wars, there were steep increases in military expenditure. These were followed by periods of decline and levelling-off, but without a return to pre-war levels. This pattern is clearly seen (figure 1) for the period of the Korean War (1950–53) and for the period of US participation in the Viet Nam War (1961–73). During the US presidency of Ronald Reagan (1981–89) the rate of increase was similar to that during these two wars, although the USA was not involved in any major armed conflict. Throughout the 1970s and early 1980s world military expenditure continued to increase until it culminated in 1987 at slightly over US \$1 trillion and remained roughly constant until 1989 whereafter the post cold war decline began.

Figure 1. World military expenditure, 1949–85

During the *post-cold war period* 1989–98 world military spending dropped by more than one-third in real terms (figure 2). This decade can be seen as a period of disarmament, marked by downsizing and restructuring of many armed forces in combination with cuts in arms procurement expenditure and therefore also in arms exports and arms production. Since 1995 world military expenditure has been fluctuating around a roughly constant level and towards the end of the decade there were several indications of a renewed period of growth in the early years of the new millennium.

Figure 2. World military expenditure, 1989–98

While the overall reduction in world military expenditure since the end of the cold war has been one-third, there has been wide variation between regions (table 1). The deepest cuts have been in Russia and other Central and East European countries as a result of the disintegration of the Soviet Union and the dissolution of the Warsaw Pact. By 1998, Russian military expenditure had declined to less than 5 per cent of that of the USSR in 1989. With the other former Soviet republics included in the comparison, their combined military expenditures in 1998 were only 6 per cent of Soviet military expenditure in 1989.

Table 1. Regional military expenditure estimates, 1989-98

Other regions in which substantial reductions in military expenditures have occurred are the African and American continents (cuts of 25 and 30 per cent respectively). In Western Europe the reduction during the same period was only 14 per cent. The only regions in which expenditures continued to rise during the post-cold war period were Asia (+ 27 per cent) and the Middle East (+ 17 per cent). In the Middle East, where military expenditure fluctuated widely during the 1990s, a huge amount of economic resources were still devoted to military activities by the late 1990s.

Trends in arms transfers

The volume of international arms transfers is primarily a measure of military technology transfer between countries, as embedded in weapons. For countries without a domestic defence industrial base, that is, most countries in the world, it is also a measure of their total arms purchases, while for arms-producing countries arms import data reflect only part of their arms procurement. Global trends in international arms transfers are difficult to measure. Only a handful of countries provide statistics on their arms exports and imports and very few provide sufficient information to enable comprehensive statistics on their overall arms transfers expressed in monetary terms. Therefore, available data on international arms transfers are estimates based on the number of weapons transferred between countries, regardless of how these are financed, i.e. whether they are paid in cash, purchased on credit terms, or given away as grant aid. The available data are also limited to the amount of deliveries which can be identified. Thus, SIPRI data on arms transfers are limited to the information that is available in open sources. For this reason, they are also limited to include only the transfer of defined categories of major conventional weapons, each of which is assigned a value according to its estimated military-technological sophistication. Thus, the SIPRI statistics reflect the trend as provided in open sources on the international transfer of major conventional weapon systems. They do not reflect the actual import cost to the recipient country nor the export revenues of the supplier country but rather the amount of military technology transferred. The only other comprehensive arms trade statistics, those of the US Arms Control and Disarmament Agency (ACDA) and the US Congressional Research Service (CRS), are based on similar methods, except they are not based on open sources but on statistics from the US intelligence services. They also have a broader coverage in that they include almost all types of military goods and services.

The longest available time series of world-wide arms transfer statistics are those of ACDA which begin in the year 1965. They show a slow and steady growth from 1965 up to 1974. In 1975 world-wide deliveries suddenly surged and tripled by 1980 in real terms to culminate in the late 1980s.⁷

SIPRI data on the deliveries of major weapon systems are available from the year 1950, but only for transfers to developing countries. These data show the same general trend: a slow increase to 1973, after which there was a rapid increase during the 1970s and constantly high levels during most of the 1980s up to the peak in 1987. For more recent years, SIPRI data cover transfers to both developing and industrial countries. According to these data, two distinct phases can be identified in the global arms trade during the post-cold war period: (a) a transitional period of

⁷ US Congressional Budget Office, *Limiting Conventional Arms Exports to the Middle East*, The Congress of the United States, Congressional Budget Office, Wash., DC, 1992, figure 2, p. 6.

steep decline between 1989 and 1994 (a 40 per cent reduction); and (b) a fairly stable level during the period 1994–98 at this lower level.⁸ (table 2)

Table 2. The volume of imports of major weapons, 1989–98

Developing and industrial countries have shown different trends in arms imports. In the developing countries the volume of imports of major weapons fell by 45 per cent between 1989 and 1992. During the period 1992–97 there was instead a strong increase, a doubling in real terms, followed by another sharp drop (by 30 per cent) in 1998. Arms imports by the industrial countries declined more or less continuously until 1996. Thereafter they have started to rise slightly again.

It can be clearly seen that throughout the post-cold war period the industrial countries as a group have cut their imports of major weapons more than the developing countries (by one-half and one-quarter respectively). This has resulted in a change in their import shares. While at the beginning of the period the combined arms imports of industrial countries averaged around 40 per cent of the world total, at the end of the period this share had decreased to 30–35 per cent.

A look at disaggregated data for industrial countries shows that the declining trend is once more almost entirely the result of the reduction in arms imports by Russia, the other former Soviet republics and the former WTO allies, while the combined arms imports of North America and Western Europe declined by only 1 per cent between 1989 and 1998.

The supply of major conventional weapons has always been concentrated to a very small number of supplier countries, while the pattern of recipient countries is somewhat less concentrated. During the period 1994–98, the USA accounted for 48 per cent of total world deliveries of major conventional weapon systems, and the five leading supplier countries (incl. the USA) for 83 per cent of the total (table 3).

Table 3. The leading suppliers of major conventional weapons 1994–98.

On the recipient side, the country which received most major weapon systems during the period, Taiwan, accounted for 12 per cent of the total, while the five leading recipient countries accounted for 36 per cent of the total and the 10 leading recipients for slightly more than half (54 per cent) of world total arms transfers.

Future trends in military expenditure and arms transfers

Towards the end of the millennium the decline in world military expenditure had slowed down and there were indications that the trend would be reversed in the early 2000s. Expenditures on arms procurement in the European NATO countries

⁸ Hagelin, B., Wezeman, P. D. and Wezeman S. T., 'The volume of transfers of major conventional weapons', *SIPRI Yearbook 1999: Armaments, Disarmament and International Security* (Oxford University Press: Oxford, 1999), pp. 422–23 and appendix 11A.

has been increasing by 14 per cent since 1995.⁹ Defence plans in some of the major spender countries also point towards future increases. The USA, which accounted for more than one-third of world military expenditure in 1998, presented a defence budget for fiscal year 2000/2001, which represented a 1 per cent increase in real terms, while procurement expenditure is planned to increase by 19 per cent over the five year period 2000-2005. Russia appeared in 1999 both politically and economically prepared to halt the rapid fall in its military expenditure and announced a planned 50 per cent increase in arms procurement. In Europe new requirements are arising out of new doctrines of military intervention in areas of conflict, which are likely to lead to increased military budgets. In Asia the simmering conflict between China and Taiwan has already resulted in increased military budgets and the 1997 Asian financial crisis has not had a strong impact on military expenditure in these countries. In Africa, where military expenditure has been on a long-term decline, the bottom was reached in 1995 after which there has been a gradual increase—probably more than SIPRI data show, because of the hidden cost of armed conflicts in the region. Overall, therefore, unless current plans are changed, it can be expected that the first years of the third millennium will become a period of increasing military expenditure.

As regards future trends in arms transfers, most observers agree that although the early post-cold war decline in the volume of international arms transfers has been halted, there will not be a return to the previous, cold war, levels of arms transfers within the near or medium-term future. In the three major arms-importing regions—Asia, Europe and the Middle East—there are no indications of a significant future growth in their arms imports.

The financial crisis in Asia, which started in August 1997, has resulted in the cancellation of orders and arms import programmes in the affected countries. While some of these economies are now recovering, and are likely to revive some of their cancelled programmes, this will not suffice for a return to previous levels.

In Europe, the Central and East European countries have expressed significant requirements for new arms imports, but they lack the financial means to implement these. In the West European countries the change from territorial defence forces to forces for military action in conflicts abroad is likely to lead to demands for new equipment for peacekeeping forces. However, this emerging demand will be met both by domestic production and imports, and while the degree of imports is difficult to assess, it is not a matter of the huge quantities of cold war imports of large and sophisticated weapon platforms.

While the demand for weapons in the Middle East continues to be significant, there is a general consensus that Middle East arms purchases are not likely to return to previous levels. This is due to (a) domestic pressure to spend more of oil revenues on social programs to accommodate growing populations, (b) the turbulence in oil markets which has led to new caution in making major economic

⁹ NATO, *Financial and Economic Data Relating to NATO Defence*, Press release M-DPC-2 (1999)152, 2 Dec. 1999, URL <<http://www.nato.int/docu/pr/1999/p99-152e.htm>>, version current on 2 Dec. 1999.

commitments for the future; and (c) problems of absorbing weapons already received.

III. Determinants of military expenditure and arms transfers

Determinants of military expenditure

The determinants of military expenditure include both the driving forces for increasing military expenditure and the various forms of constraints which set limits on these forces. Actual military expenditure trends can be seen as a synthesis of these two types of determinant: the driving forces, seeking to maximize military expenditure, and the constraints.¹⁰ The main conventional rationale for military expenditure is related to international security, to protect state and people against external armed aggression. However, with the end of the cold war this factor is diminishing in importance. The prevalence of international armed conflict has decreased dramatically. Most major armed conflicts are internal today.¹¹ At the global level there is little similarity between the patterns in global military expenditure and in armed conflict: military expenditure is concentrated to the industrial world (table 1), but the majority of armed conflicts are located in the developing world. However, this is not always true at the regional and national level. In a study of 40 African countries covering the period 1960-91, a positive correlation was found between wars and military expenditure in 71 per cent of the countries.¹² Also, if the level of military expenditure is compared with national output, it is clear that most of the countries with the highest ratio of military expenditure to national output (GDP) are countries involved in major armed conflict (table 4).

Table 4. Military expenditure as a share of GDP for the countries with the highest shares

While security-related factors and the prevalence of armed conflict belong to the driving forces of military expenditure, these also include non-security related factors. Political and economic factors, often purely domestic in character, also act as driving forces. Nation building and the positioning of states in the international power structure are to some extent based on the build-up of a strong defence establishment. Military forces are not used exclusively for territorial defence but also for domestic repression of a country's own population, i.e. to secure the power of regimes without a democratic power basis. Driving forces of an economic nature are best exemplified by those of the military industrial complex, that is, the interplay of interests of the arms industry, government and the military establishment, and

¹⁰ Smith, R., 'The demand for military expenditure', in K. Hartley and T. Sandler (eds.), *Handbook of Defense Economic*, Vol. 1 (Elsevier: Amsterdam, etc., 1995), chapter 4.

¹¹ Sollenberg, M., Wallensteen, P. and Andrés, J., 'Major armed conflicts', SIPRI Yearbook 1999 (note 3), chapter 1.

¹² Mohammed, N.A.D., 'What determines military allocations in Africa: theoretical and empirical investigation', *Defence and Peace Economics*, vol. 7 (1996), no. 3, pp. 203-231.

manifesting itself in, for example, the lobbying of arms-producing companies, the inter-service rivalry and the efforts of politicians to support military contracts to their local home electoral constituencies.¹³ During the cold war, the main driving force for high and rising military expenditure was the competition for strategic military superiority between the United States and the Soviet Union, reinforced by exaggerated threat perceptions on both sides (political) and the pull from the military industrial complex in both countries (economic and political).

The constraints on high military expenditure are mostly economic in nature but, at least in democratic countries, there are also political constraints, in terms of competing demands on public resource allocation by the electorate. Economic constraints have been one of the most important factors behind the sharp reduction in Russian military expenditure. The disintegration of the Soviet Union in 1991 and the subsequent transition of the economic, political and military system of its successor state, the Russian Federation, led to a dramatic reduction of Russian military expenditure. The largest cut in Russian military expenditure actually occurred in 1992, under the pressure of the liberal economic reforms of Finance Minister Gaydar. Later into the decade difficulties to implement adopted defence budgets into actual expenditures have continued to undermine Russian military expenditure plans. In Africa too, the long-term decline in military expenditure was the result more of scarce economic resources than of the absence of wars and internal conflicts, of which there were plenty on the continent, particularly in the Horn of Africa and in Southern Africa. Also in Europe, although to a lesser extent, the cuts in military spending have been reinforced by the coincidence in time with periods of restrictive overall budgetary policies.

In Asia and the Middle East, on the other hand, many countries have experienced little economic constraints, at least until recently. Thus, it has been possible to raise military expenditure significantly due to high economic growth rates in Asia, high oil revenues in some of the Arab Middle East states and large amounts of US military and economic aid to Israel).

Determinants of arms transfers

International arms transfers are determined by three broad categories of factors: politico-military, technological and economic. These factors all operate at the international, regional and national levels in the major supplier and recipient countries that dominate the arms trade.¹⁴ The arms transfer and production system can be perceived of as located at the intersection of three important sets of forces for change in international relations that are seldom considered together: the pursuit of

¹³ Chapman, G. and Yudken, J. (1992), Briefing Book on the Military-Industrial Complex, Council for a Liveable Education Fund, Dec. 1992; Dunne, J. P., 'The Defense Industrial Base', in K. Hartley et al. (eds.) (note 4), chapter 14.

¹⁴For theories on the determinants of arms transfers, see Krause, K., *Arms and The State: Patterns of Military Production and Trade* (Cambridge University Press: Cambridge, 1992); and Neuman, S.G. and Harkavy, R.E., *Arms Transfers in the Modern World* (Praeger: New York, 1979).

wealth, power and victory in war.¹⁵ First, the production of and trade in weapons are to some degree subject to the same economic pressures as are non-military goods; second, attempts by states to change their position in the arms transfer and production system reflect shifts in the international power hierarchy; and third, war often provides a dramatic catalyst to military innovation and production.

The system itself is based on a three-tier structure of arms-producing countries. The first tier, which during the cold war consisted of the USA and the USSR. Their near-monopoly of modern military technology granted them a capability to use arms transfers as effective tools of foreign policy. The second tier, which consisted of 10-15 other industrial countries with less, but still significant, capabilities in arms production and innovation. Their motivation for participating in the arms transfer system is different from that of first-tier suppliers: low levels of domestic procurement and relatively small research and development establishments force a greater reliance on arms exports.

Throughout the 1970s and 1980s sophisticated weapons were further diffused throughout the system to what became the third-tier: several states in the developing world (Brazil, China, Egypt, India, Israel and others) which sought to acquire not only the weapons but also the means of reproducing them, in order to establish a strong regional political or military presence. However, the advance of third-tier producers was hindered by their weak economic, industrial and technological infrastructures. These states therefore relentlessly pursued arms exports in order to maintain their fragile defence industrial bases, although with limited success.

During the post cold war period the system of world arms production and trade has maintained the three-tier structure, while the positions of the participating states have changed fundamentally. During the mid-1980s, the two superpowers each accounted for roughly one-third of global arms production, 13 second-tier, industrial countries accounted for another 25 per cent of the world total, while 15 third-tier states in the developing world accounted for the remaining 10 per cent.¹⁶ By the mid-1990s there was still a strong concentration of world arms production. The 10 largest arms-producing countries accounted for close to 90 per cent of world arms production. The main change is that the first tier has been reduced to one country, the USA which alone accounted for almost 50 per cent while Russia, which took over most of the arms production of the Soviet Union, ranked fifth in size and accounted for only 3-4 per cent of global arms production.¹⁷ During the years since 1996, the concentration in global arms production has, if anything, become even greater.

The post cold war period has also seen another significant change in the international arms transfers and production system: towards a diminishing role for political factors and a growing role for economic factors. This is primarily the result of (a) the end of superpower rivalry and its replacement by a unipolar system, in

¹⁵ Krause (1992), p. 2. and 97-98.

¹⁶ Krause (1992), table 10, p. 93.

¹⁷ Sköns, E. and Weidacher, R., 'Arms production', *SIPRI Yearbook 1999* (note 1), table 10.7, p. 408.

which foreign policy incentives have less relevance; and (b) the decline in domestic armaments markets in almost all arms-producing countries, including the only remaining superpower, the United States. These two factors have contributed to an increased pressure for exports and intensified competition among weapon suppliers to win the few large contracts on the now smaller world arms market. Companies are lobbying for financial and other support from their home governments, such as for the promotion and marketing of their weapon systems. Governments are becoming increasingly involved in the negotiation of large arms deals and of the various types of offset offers which constitute a normal part of any large arms deal today. Such offset agreements are normally worth as much as the arms deal itself, often reaching more than 150 per cent of the original deal. Thus, while offsets are regarded as an unfair trading practice in most sectors of the civil foreign trade, in the international arms trade they constitute the norm.

Another indication of the strong export pressure in the current arms trade is the fact that governments also provide financial support for arms exports, in the form of export credit guarantees, but also in more direct forms. A recent study of US Government funding of foreign arms purchases from US corporations shows that more than half of US weapon sales are now financed by taxpayers instead of foreign arms purchasers. These subsidies included loans, grants and government promotion activities for US arms exports.¹⁸ Similar tendencies have been identified in other major arms supplier countries.¹⁹

Table 5. The 10 largest arms-producing countries and their share in total world arms production

IV. The impact of globalization on military expenditure and arms transfers

Although the term 'globalization' did not appear until recently, the notion of globalization has existed for a long time.²⁰ The concept is being used for a wide variety of phenomena and trends and the descriptions of current trends in globalization and the conclusions as regards its impact differ accordingly. There exists not one discourse of globalization but several. In a recent survey of the debate and the literature, five major discourses on globalization are identified, basically falling into the areas of economics, sociology, political science, culture and ecology.²¹ All these aspects of globalization, together with the globalization of

¹⁸ Hartung, W. D., 'Corporate welfare for weapons makers: the hidden costs of spending on defense and foreign aid', *Policy Analysis*, Cato Institute, Wash., DC, no. 350 (12 Aug. 1999).

¹⁹ US General Accounting Office, *Military Exports — A Comparison of Government Support in the United States and Three Major Competitors*, Report to Congressional Committees, GAO/NSIAD-95-96, US General Accounting Office: Wash, DC, May 1995.

²⁰ Rothschild, E., 'Globalization and the return to history', *Foreign Policy*, Summer 1999, pp. 106-116.

²¹ Therborn, G., Challenges and issues of globalizations, Paper presented to the Conference on Globalizations, Swedish Council for Planning and Coordination of Research (FRN),

technology, have an impact of the trends and patterns in military expenditure and arms transfers, directly or indirectly by their impact on the causes of military expenditure, arms production and arms transfers.

The process of globalization has gone through several phases during which the various aspects have assumed different importance. During the cold war period, the political aspects were predominant. The impact of this phase of globalization on trends and pattern of military expenditures and arms transfers was significant and is well documented. During the subsequent, current, phase of globalization, the politico-military dynamic of the cold war has been overtaken by a mainly financial phase. It began in the second half of the 1980s, with the enormous expansion of trading in foreign currency after the breakdown in the 1970s of the international Bretton Woods currency system, and has resulted in the abolishing of state controls of capital markets and opening up of new financial world markets, in privatizations of public enterprises and services, in a break-up of national champion monopolies, and in a general encouragement of global competition. Simultaneously with the globalization of financial and economic activities, the end of the cold war has meant a deglobalization of political action.

These factors, around the existence of which there is fairly broad consensus, have an impact on military expenditure and arms transfers in several ways, perhaps primarily through its effect on the arms industry. While the military sector has been the sector most resistant to privatization, commercialization and reduced political control, all these trends are currently affecting the production, procurement and international transfers of arms. The arms industry is increasingly being privatized and commercialized. The European arms industry is going through a process of internationalization, until now relatively limited and primarily through cross-border joint ventures, but more recently (during 1999) also through cross-border mergers of arms producing companies. European companies are also acquiring arms-producing companies in other continents, recent examples include Australia, South Africa and South Korea, while transatlantic military-industrial links are still rare in spite of the lively debate on both sides of the Atlantic about their potential.

The increasing privatization, commercialization, competition and internationalization of arms production, have resulted in an increased pressure from the arms industry to export their excess supply of weapons, and thus to increased commercialization also of the arms trade, in which marketing and generous sales terms play an increasing role. At the same time, increased internationalization means reduced possibilities for national governments to implement national arms export regulations, since companies can choose to export their products from a business unit in another country with more liberal export regulations. For this reason, national export laws are becoming increasingly irrelevant. This points to the need for common or international export rules.

However, globalization may render also international control more difficult. The globalization of technology in general, and in the context of a gradual closing of the

gap between military and civil technology, will make it increasingly difficult to control the international transfer of militarily relevant technologies in the future. The challenge is to achieve international limitations in the transfer of military technology without resorting to controls which will inhibit international transfers of all types of advanced technology, that is, also civil technologies which would benefit economic growth in the recipient countries.

A relatively new development is the impact of globalization on armed conflict and the financing of these. The fragmentation and decentralization of the state has produced a new type of wars and with it increasingly financing of wars outside traditional government defence budgets. As described by Mary Kaldor,²² these new wars take place in the context of extreme globalization, under which territorially-based production has more or less collapsed and production continues only of a few valuable commodities (diamonds, emeralds, drugs), which provide a source of income for whoever can provide 'protection'. These wars are fought by various types of fighting units, public and private, state and non-state, including regular armed forces or remnants thereof, paramilitary groups, self-defence units, foreign mercenaries, and regular foreign troops, usually under international auspices. During these conditions governments, like privatized military groups, need alternative sources of funding for their military activities, many of which involve criminal activities. These fall into the following categories: 1) 'Asset transfer', i.e. the redistribution of existing assets to benefit the fighting units (such as loot, robbery, hostage-taking, and deriving profits from control over market prices); 2) 'war taxes' or 'protection' money from the production of primary commodities and various forms of illegal trading; and 3) external assistance, in particular for imports, such as (a) remittances from abroad to individual families, b) direct assistance from the Diaspora living abroad; (c) assistance from foreign governments; and 4) humanitarian assistance diverted by governments and warring factions for their own use. For countries involved in such new wars, data on government military expenditure are irrelevant for measuring military expenditure. What is more important is that the set of social relationships which are formed by these systems for financing wars constitute strongly resisting factors for the ending of war.

Privatization of security is an increasing trend also in countries which are not involved in regular armed conflict but where there is a demand for more security services than the government can offer. There is an emerging group of private security companies whose main task is the provision of security in many Third World countries, especially in Africa.²³ The demand for private security services has emerged from a combination of factors, including from western governments seeking to reduce defence budgets, African governments in search of security,

²² Kaldor, M., *New & Old Wars: Organized Violence in a Global Era* (Polity Press, Cambridge, 1999).

²³ Musah, Abdel-Fatau Musah and Fayemi, J. Kayode (eds), *Mercenaries: An African Security Dilemma* (Pluto Press:London, 2000); and Cilliers, J. and Mason, P. (eds), *Peace, Profit or Plunder?: The Privatisation of Security in War-Torn African Societies* (Institute of Security Studies: Pretoria, 1999); and A Consultation on The *Privatization of Security in Africa*, Summary report, Overseas Development Council, Washington DC, 12 March 1999.

international mining corporations and rebel movements. They provide a variety of services, ranging from guarding installations, protecting convoys, supporting humanitarian assistance operations to performing reconnaissance and intelligence services, providing logistical and transport support, military training, strategic planning, and engaging in combat. These companies have developed to fill the need for security in the current context of conflict in Africa, in weak states with limited government legitimacy and with limited economic resources, and in which the international community is increasingly reluctant to intervene.

V. Economic aspects of military expenditure and arms transfers

The experiences in many countries, which have cut their armed forces, arms production and military expenditures, are that these cuts have had adverse economic effects, in terms of economic decline, especially on a local and regional level, and in terms of unemployment. Such negative economic consequences constitute obstacles to reductions in military expenditure even if there is scope for cuts from a security perspective.

The question at stake is whether cuts in military expenditure lead to the release of economic resources for other competing demands? Is there a so-called *peace dividend*? This question can be perceived in two parts, the more long-term and the short-term. First, are there economic gains in the long term from reductions in military expenditure? This question can be analysed by looking at the economic impact of current military expenditure. If the overall impact is negative, there should be something to gain by reducing them. Second, what are the nature and costs of the adjustment process involved in transferring economic resources from military use to non-military use?

From a purely theoretical perspective, there is no consensus on the economic effects of military spending: the two main existing schools (neo-classical and Keynesian) provide different answers.²⁴ Applied empirical studies show that in advanced economies military expenditure has a negative effect on economic growth through its effect on investment.²⁵ Empirical studies for developing countries suggest that there is no evidence of a positive effect of military expenditure on economic growth and that a negative impact is likely.²⁶ In general, these conclusions refer to a *ceteris paribus* comparison, when nothing else is changed. They do not assume a policy of conversion to redirect the saved money from reduced military expenditure into alternative uses, such as non-military government expenditure or investment.

²⁴ Dunne, P.J., 'The Economics of War and Peace: Opportunities in the Post-Cold War World, An Inaugural lecture at Middlesex University Business School, Hendon, London, 6 Feb. 1997.

²⁵ Smith, R., 'Military Expenditure and Investment in OECD Countries, 1954-73', *Journal of Comparative Economics*, vol. 4, no. 1, March, pp. 19-32.

²⁶ Dunne, J.P. 'Economic Effects of Military Expenditure in Developing Countries: A Survey', in Gleditsch et al (eds.), *The Peace Dividend* (Elsevier: Amsterdam, 1996), chapter 23.

Since military expenditure has no positive effect on the economy, it follows that there should be no negative impact on the economy of cuts in military expenditure in the long term, that is, after the completion of cuts. In this sense there is a *peace dividend* (an economic gain) to realise from cuts in military expenditure. This has also been demonstrated in a series of case studies using input-output simulations of military expenditure reductions.²⁷ However, this does not mean that reductions in military expenditure are without negative economic consequences. During the period of adjustment to a situation with a lower level of military spending, a multitude of adverse economic consequences are likely to be confronted, on the macroeconomic, regional and local levels, on the company level and on the labour market. Such short-term economic adjustment problems have led many analysts to conclude that there is no peace dividend to be achieved from reduced military expenditure, while the proper conclusion to draw is that such reductions have not been associated with the proper policy, a policy directed at facilitating the conversion of military resources to civil purposes, that is, an active conversion policy.

Conversion policies can address anything from the demobilization of soldiers, base closures, diversification of arms-producing companies, transfer of military technology to civilian purposes. Such activities, which are annually documented by the Bonn International Center for Conversion (BICC) had given extensive results by the late 1990s. In its most recent survey of disarmament and conversion the achievements through 1998 were summarized as follows:

‘... while a reversal of the disarmament and conversion process in some countries or regions cannot be excluded, it must be emphasized that behind the noisy headlines of the many conflicts, there exists a string of positive, often silent achievements. Clearly, in total the 1990s balance sheet of disarmament and conversion is positive. Global disarmament continued even in 1997 and 1998, although at a slower pace, and so did conversion. Despite the difficulties of implementing disarmament, numerous practical conversion projects are underway or have already been completed.’²⁸

While efforts at the micro level to convert military bases, retrain former soldiers and diversify arms-producing companies are important contributions to the adjustment involved in reallocating military expenditure to sustainable non-military use, these efforts alone are not sufficient. This can be clearly seen from the Russian experience, where the ambitious conversion plans of the early 1990s faltered primarily because of the lack of two basic elements: investment capital and a functioning market for civil goods and for labour. Diversification of production requires a significant amount of investment, both for the conversion of production facilities and labour through reconstruction and retraining, which seldom occurs, and even more so for the expansion of civil production by new investment and new

²⁷ Gleditsch, N.P. et al. (eds.), *The Peace Dividend* (Elsevier: Amsterdam, 1996).

²⁸ Bonn International Conversion Centre, BICC, *Conversion Survey 1999: Global Disarmament, Demilitarization and Demobilization* (Nomos Verlagsgesellschaft: Baden-Baden, 1999), pp. 13-18.

recruitment, which is the more feasible strategy. Therefore, the adjustment from military to civil use of economic resources, in addition to practical conversion measures, 'requires a more general policy which sees conversion as an integral part of a policy of industrial restructuring and regeneration'.²⁹ Conversion must be seen as an investment process.

This conclusion applies in particular to the arms-producing industrial countries. However, it is also of relevance for developing, although in a somewhat modified form, since most of these have no arms production, and since the large part of their military expenditure is spent on military personnel. 'Thus, their adjustment problems will involve either releasing military personnel on to the labour market, or, in the case of conscription, not recruiting labour. In the short run, the result is likely to add to the substantial employment problems of developing economies. there are also likely to be implications for accommodation and for the provision of social services previously supplied by the armed forces.'³⁰ Therefore, abrupt declines in military expenditures, 'when combined with conditions of economic decline stemming from low prices of exports, reduced foreign assistance and poor macroeconomic policies would lead to high costs, a long transition period, low benefits, and thus a low (or even negative) return from disarmament., This may be the case in several such countries today, unless countered by international technical and financial assistance and informed national macroeconomic, trade and defence economic policies. In the developing countries, through, the prospects of achieving a peace dividend might be improved because they probably have smaller stocks of military capital and relatively greater flows of resources into and out of the military sector.'³¹

Few studies have been made on the actual reallocation of public expenditure from civil to military purposes. However, a recent survey by the International Monetary Fund showed that reductions in military spending in some countries have been accompanied by increased public expenditure on health and education. In 61 countries for which health and education data were available for the period 1993–97, the share of these expenditures increased during the period, both as a share of GDP and of total government expenditures, while the shares of military expenditures declined.³² The tabular data provided indicate that the increased shares of health and education were the result of the fact that expenditure on health and education did not decline as much as military expenditures.

VI. Key challenges

Our current world is one in which military activities annually absorb an amount of economic resources corresponding to the annual income of half of the world

²⁹ Dunne (1997) (note 24);

³⁰ UNIDIR, *Economic Aspects of Disarmament: Disarmament as an Investment Process*, United Nations, New York, 1993, p. 63.

³¹ UNIDIR, *ibid.*, pp. 71-72.

³² 'Military spending continues to stabilize; some countries increase social spending', *IMF Survey*, 7 June 1999, pp. 186-188.

population, while at the same time there is an enormous need for these resources to stave off poverty, hunger and preventable diseases. Furthermore, in spite of the amount of resources spent ultimately for security purposes, the actual security of states and human beings in many regions is extremely low. The overall challenge lies in how to reduce military expenditure and international arms transfers and channel the released resources into economically and socially more beneficial uses, while at the same time not reducing, but rather enhancing the security of the world population. An insurmountable challenge it appears, but it still has to be addressed.

Any policy aimed at the reduction of military expenditure and international arms transfers, on a world-wide scale, or regionally or locally, would clearly have to address a whole range of factors which contribute to sustain current levels of military expenditure and arms transfers. This would involve at least six different levels: (i) the root causes of the need for military forces; (ii) a whole set of security-related factors behind military expenditures; (iii) the organization of the military sector itself; (iv) vested economic and political interests to sustain military expenditure; (v) arms control and disarmament agreements and activities; and (vi) the planned transfer of released resources to productive or social use. A condition for being able to address most of these challenges, is an open and democratic political decision-making process for issues related to these. Therefore, the challenge of increased transparency in the military sector is discussed in some detail.

The basic challenge is how to address the root causes of military forces, and in particular the more ominous ones. Again, these are multifold and not comprehensively explored. Among the more important factors today, at least in large parts of the developing world, is the existence of armed conflict. Thus, one of the basic challenges is how to address the root causes of armed conflict. Existing theories and empirical studies attribute armed conflict to a complex of economic, political, social, environmental, religious and other cultural factors.³³ Causation is difficult to establish in social sciences and causes are working on different levels. On the systemic level it has been shown that there is a clear relationship between political system (as measured by human rights abuse) and armed conflict and between economic development (and the distribution of economic resources) and armed conflict but a less clear relationship between ethnic diversity and armed conflict.

A second challenge is how, given the need for military forces, to develop policies and measures which improve security regimes and security in all its aspects: international, regional, national and human, and in particular, to develop new non-military policies and measures of providing security. These are factors traditionally belonging to the domains of national and international security, but increasingly also other domains, with the current transformation of the security concept to a broader scope, including not only military security of the state but also economic, social, and environmental security for both states and people. In particular there is a need to

³³ Smith, D., 'Towards understanding the causes of war', in Volden, K. and Smith, D. (eds.), *Causes of Conflict in the Third World* (North/South Coalition and International Peace Research Institute, Oslo (PRIO): Oslo, 1997), pp. 9-22.

develop non-military methods of peace enforcement and to avoid the use of military means to prevent the outbreak of armed conflict or stop its continuation. The new phenomenon of using private security groups or forces for the provision of military security, particularly in Africa, deserves special attention. These security groups are primarily private companies providing security services to foreigners for profit. The main tasks of these companies is to fill the void created by inefficient armed forces. Many of them have been involved in one way or the other in the region's many conflicts, supporting either government or the rebels. However, since they are profit oriented there are doubts about their sincerity in bringing about an enduring peace where they operate. How to regulate their activities is a source of concern for the international community.

A third challenge is to ensure that there is a proper match between existing security requirements and the size of the military establishment and to reduce waste and inefficiencies which is common in the military sector and often made possible by the fact that military establishments are shrouded in secrecy and often politically and economically protected.³⁴

A fourth challenge is how to remove obstacles to reductions in military expenditures, which stem from domestic and personal, economic and political rather than international security-related factors. These refer to the vested interests not only of the military establishment itself, but also of the ruling regimes in many countries, of the companies and countries involved in the production and sales of military goods and services, and of the politicians with electorate constituencies in regions depending on military contracts. Vested interests in war, as described by Kaldor is an increasing challenge, primarily for the prospects of conflict resolution and successful peace settlements. Both these challenges can be met only by studying the causes and mechanisms of vested interests and devise measures addressed at the causes, not their effects.

The fifth challenge is to cement any progress reached into international agreements on arms control and disarmament, primarily because this creates some resistance against any reversal of progress. In particular there is a need to develop new forms of arms control measures that are relevant in the new post cold war environment. While traditional arms control that developed during the cold war, was designed to manage arms competition among antagonistic states, what is needed today are arms control measures which can be applied in the context of internal armed conflict fought by substate or nonstate actors, in particular to maintain peace and resolve conflict in countries where civil wars have been settled by peace agreements. Although much remains to be done in this area, some experience have been gained and analysed. A study by the Lessons Learned Unit of the UN Department of Peacekeeping Operations on the Disarmament, Demobilisation and Reintegration³⁵

³⁴ This challenge is illustrated in several case studies in Singh, R.P. (ed.), *Arms Procurement Decision-Making*, vol. I (SIPRI and OUP, 1998).

³⁵ Kapungu, L. T., Lessons Learned Unit, Department of Peacekeeping Operations (UN), 'Arms control and peace settlements and the challenges of substate activities', Paper prepared

has developed a number of recommendations which also include the need to address the new channels of financing war and the conversion of military forces through their reintegration and rehabilitation. These are measures which requires significant assistance from the international community, both in terms of sanctions and financial assistance. Another summary has identified several categories of arms control mechanisms that are particularly well suited to post conflict environments: disengagement, demilitarization, disarmament, and confidence-building measures.³⁶

A sixth challenge, finally, and related to the above, is to find policies to redirect economic resources that have been released from cuts in military expenditure into uses which are beneficial to economic and social development in the long run. The transfer of resources from military to non-military uses requires a conversion policy for its implementation. It also requires financial capital for investment in alternative economic activities. Many countries in the developing world would require development aid to assist in the conversion process.

There are no easy solutions to this broad range of challenges. The identification of such solutions is also beyond the scope of this paper. However, an important condition for their solution is increased transparency in the military sector in order to promote democratic and participatory decision-making in setting the priorities between military and non-military expenditure in the allocation of central government expenditure. In addition, increased information and knowledge about the characteristics and functioning of the military sector and about the relationship between military expenditure, conflicts, and economic developments are essential for any future change, whether in the short or medium term. Thirdly, the nature of these challenges, and the state of the economies in the most seriously affected countries, are such that any progress in addressing these require the involvement of the international community. Such involvement includes many different types of activities. The most difficult to achieve is probably the commitment of economic resources for the various ends outlined above. Perhaps the most immediate task is to make a convincing argument for such financial commitments: one of the main pro-arguments is that the long run cost of not addressing these challenges is likely to exceed by far the short run costs of addressing them today.

Another overall challenge is a reconsideration of the relationship between security and economic development. These two issue areas have been and are still to a great extent treated as entirely separate fields, they are dealt with by different organizations, both nationally and internationally, and also within the UN system, and by different types of policies and measures. In practice, however, they are increasingly intertwined. Military expenditure constitutes a significant economic burden in many developing countries, which inhibits economic and social development. Lack of security inhibits economic activities and armed conflict exerts a disastrous negative impact on economic development. The conflict prevention

for the 1999 Nobel Symposium: A Future Arms Control Agenda', Stockholm, 30 Sept. - 2 Oct. 1999.

³⁶ Ball, N., Overseas Development Council (Wash DC), 'Arms control as a conflict-management tool', Paper prepared for the 1999 Nobel Symposium: A Future Arms Control Agenda', Stockholm, 30 Sept. - 2 Oct. 1999.

perspective is now being integrated into national development policy and co-operation in many countries. The World Bank has created a Post-Conflict Unit to facilitate assistance in reconstruction activities after the cessation of hostilities. Security can no longer be understood mainly as military security. An expanded security policy should integrate also development policy in terms of a global security policy which covers economic, social, ecological and political relationships in other regions of the world. It is possible that the UN could have a role to play to promote the needed fundamental change in security policy which is already emerging.

The need for increased transparency in military matters

Openness and democratic participation in the formation of defence and security policies, in arms procurement decision-making, and budgeting processes constitutes an overall challenge. Transparency in defence budgeting and the activities financed by defence budgets is important for two major reasons:

1. For establishing national priorities between military and non-military sectors in the allocation of public expenditures.
2. For building confidence and security between neighbour states.

Domestic transparency in military matters facilitates the identification of excessive military spending and can in itself lead to reductions in military expenditure in cases where other than security-related factors determine the amounts of money allocated to defence.

This facilitates the identification of excessive military expenditure and the establishing of priorities in the allocation of public resources between military and non-military purposes that are in line with the interests of the population. In many countries there is extremely little information available about the military sector, not only for the tax-payers and the electorate, but also for the members of parliament with the task to approve or reject government proposals on military matters.

Information exchanges with neighbour states can also lead to reduced levels of military expenditure by reducing threat perceptions and preparing the ground for arms control and disarmament agreements.

While increased transparency on the national and sub-regional level is the most important, international initiatives may reinforce demands for national transparency and also contribute to the provision of data. Here, the international community and the United Nations have a role to play in promoting the concept of transparency and setting the standards. Existing initiatives include those of the United Nations for reporting military expenditure and international arms transfers. While the response rate to the latter is relatively high, the reporting of military expenditure has a much lower turn-out and this measures is currently therefore under review by member governments.

The UN Reporting Instrument on Military Expenditure

The UN call on its member states to report annually the size and structure of their military expenditure³⁷ - which originally was established as a first step to reduction of military budgets - is currently a rather lame measure. The response rate is low, averaging around 30 countries out of a total of 187 UN member states and these are to a great extent those which already are most transparent in military matters. Some improvement is required and the reporting instrument is therefore currently under review.³⁸ The most important changes required are:

- a) A more active approach by the UN Secretariat to encourage member states to report;
- b) Some political momentum behind the initiative.

Today the UN Secretariat is not authorized to do much more than passively receive and file the reports. The much greater response rate by other organizations, including SIPRI, shows that a more active approach could give rather prompt results. However for broad participation in the UN reporting system, this would not suffice. Incentives to report require a political context.

Information exchanges on a regional basis for confidence building, modelled after the OSCE system could provide one such context. Broader proposals to reduce military expenditure by specific percentages, as was the original intention with the UN system and as are still kept alive in the academic community, may be too crude and general to be feasible. However, it could be possible to develop similar proposals on a regional basis and including measures which are tailored to the security environment of a particular region. Another useful initiative would be to set up some kind of transparency institutes with the task to compile and provide information on military matters, and provide support to parliamentarians, civil society for an informed debate on budget priorities, arms procurement, arms imports, economic impacts, etc. Today the most basic information for an open debate on these issues is lacking in many countries.

The UN Register on Conventional Arms

The response rate to the UN Register on Conventional Arms (initiated in 1991)³⁹ is higher: 97 member states reported in 1998. The report for 1999, which was released in August 1999, included responses from 64 countries with some additional

³⁷ Report of the Secretary-General, *Objective information on military matters, including transparency of military expenditures*, United Nations General Assembly, UN Doc. A/54/298, 22 Sept. 1999 (URL: <http://www.un.org/Depts/dda/CAB/rep542981.pdf>).

³⁸ See for example, Draft Resolution of the First Committee, *Objective information on military matters, including transparency of military expenditures*, United Nations, UN Doc. A/C.1/54/L.27, 22 Oct. 1999 (URL: <http://www.un.org/Depts/dda/CAB/res54127e.pdf>).

³⁹ UN, *General and Complete Disarmament: Transparency in Armaments*, Report on the Register of Conventional Arms, Report of the Secretary-General, UN Document A/47/342, 14 Aug. 1992.

replies expected later.⁴⁰ Much remains to be improved, however. Transparency in the international arms trade is still very limited. The UN Register provides little detail on the items which are reported. Small arms and weapons of mass destruction are not included at all, neither are technology transfers for the manufacture of weapons. Reporting on procurement from national production and on military holdings which have been included in the reporting to the UN Register since 1998 is still unsatisfactory. The Group of Government Experts with the task to review the Register will convene again in year 2000 and it is hoped that the gradual improvement of the Register will continue.

Transparency in arms production

The area in which there is the least transparency is arms production. This is so basically for commercial reasons. Arms producing companies release little information on their arms sales and governments are reluctant or unable to put pressure on them. With the internationalization of arms production, this becomes even more difficult on the national level. Still, arms producing companies are powerful actors and will probably have significantly increased leverage in the evolving international system for arms production and exports. With arms sales ranging up to 15-20 billion dollars per year and with an increasingly oligopolistic industrial structure, the power balance between state and industry is shifting to the detriment of the former. There is a need therefore, for policy proposals to introduce some transparency in the activities of the arms industry, with the long term view towards some type of regulatory measure of their activities, preferably on an international basis.

⁴⁰ Report of the Secretary-General, *The United Nations Register of Conventional Arms*, United Nations General Assembly, UN Doc. A/54/226, 13 Aug. 1999 (URL: <http://www.un.org/Depts/dda/CAB/rep542261.pdf>).