

Lecture 9: Arms Trade

International trade theories (Anderton)

Consider general trade theories:

- Absolute advantage and comparative advantage: Ricardo
- N-C Model: Volume of trade and relative price determined by tastes (allies strength; threats; reliability; plans) production technology; resource endowments. Trade will take place with countries that differ:
 - Heckscher-Ohlin: difference in factor endowments
 - Stolper Samuelson: factor intensity
 - Specific factors model: short run capital immobile across industries so earnings to capital can vary
 - General equilibrium: codetermination weapons/non weapons/ factors in countries. Interdependence affected by alliances and arms races
- Economies of scale and learning economies
 - Economies of scale give reason for export to lower cost
 - Would imply specialisation
 - Learning economies give benefit from exports
 - But DIB debate
- New trade theories
 - most countries that trade have similar endowments
 - economies of scale learning economies; intra industry trade of differentiated products imply imperfect competition
 - monopolistic competition/ oligopoly
 - weapons trading improves the scale/variety tradeoff for nations
- But do these help for the arms trade?

International arms trade -features

- Not that important relative to total trade –despite what hear
- Important for foreign policy –influence- and politics. National and international legislation.
- Controlled/influenced by governments –procurement needs/security supply/DIB
- Important for certain industries and companies –sometimes crucial if little civil
- Secrecy and definitional difficulties make analysis difficult

So not clear general trade theories help very much as market distorted by non economic concerns –but do provide useful framework D&S; GE effects

Nature of the Arms Trade

- It is useful to categorise the commodities of the arms trade in decreasing lethality or proximity to lethality as:
 - Weapons of mass destruction (nuclear, chemical, biological weapons and long-range missiles);
 - Major 'conventional' weapons (ships, aircraft, missiles, tanks etc.);
 - small arms (guns, ammunition, grenades etc.)
 - 'dual use' equipment (electronic communications equipment, computers, transport vehicles etc.);
 - spare parts, weapon training and maintenance;
 - torture and other such security, interrogation and anti-insurrection equipment; and
 - technology, chemicals and other raw materials and components used to manufacture weapons.
- All have different levels of national and international control.
- Different submarkets –level of development of exporter and importer

Arms trade

- SIPRI estimates major weapon systems are exports \$20bn a year in 1990 prices 200-4
 - US and Russia account for half
 - About 60% goes to developing countries
- Some historical context
 - Organised arms production on a large scale has a long history
 - Government restrictions on weapons sales common
 - Modern industry dates from mid 19th century
 - Before WW1 thriving market was largely unregulated and global
 - After WW2 shaped by Cold War and concern for comprehensive DIB
 - Restrictions on trade and technology to non allies and potential allies -COCOM
 - Later commercial interests became more important
 - With decreasing demand and increasing fixed costs exports needed
 - As shall becomes increasingly complex market and profitability questionable.

Global Weapons Market

- Theoretically might expect the market to be competitive –many buyers and sellers etc
- But it is far from it
 - Few companies are private entities in reality
 - National government's have direct influence on imports and exports
 - International regulation
- But small arms...
- Consider the nature of the market and its developments in terms of simple demand supply model: demand sides, supply side and price determination

Demand for arms

- As we have seen:
- World military expenditure and procurement trends in post Cold War world
- Domestic procurement –declines and rises
- Arms Exports –end of Cold War
- Nature of arms exports
 - Government to government
 - Firms to government
 - Informal market
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Supply of Arms

- Sources of supply: domestic vs imports; domestic plus exports?
- Economies of scale and high mes
- Push for exports –government support
- The world arms industry: globalisation
- Recognition of security issues

Price determination

- Domestic prices Government determined –imports as credible threats
- International prices not necessarily market determined
- Government influence/support
 - Export credit guarantees
 - Marketing and other support
- Often sell package of arms + services + spares etc so price obscured
 - Offset arrangements similar effect
- Aid budgets
- Commissions and bribes
- Technology transfer and licensing
- Prop of domestic components in exports

Effects of Restrictions

- Restrictions such as quotas, sanctions and export licensing and control can create deadweight loss in principle
- But not so simple as restricting exports may have security benefits –taking arms away from the bad guys
- Difficult to do:
 - components vs systems

– Informal market!

- Taxation of Arms trade?

National returns: a good investment?

- Have seen hidden costs
- Companies vs whole economy
- Benefits licence fees etc
- Benefit provision training, spares etc
- Stagnant market?
- Changing nature of industry
- Overall estimates suggest a relatively large subsidy –Dunne and Perlo Freeman; Chalmers et al for UK

Economic Effects –as with production

- Reduce costs of maintaining DIB but other costs:
- support jobs but diverts resources
- crowding out

- spin off vs spin in
- creates demand vs bottlenecks
- socio political effects
- role of MIC –vested interests

Economic Effects -trade

- Simple arguments of economic benefits are misleading
 - hidden costs of exports
 - link with aid and finance of exports
 - exports can destabilise
 - corrupting influence?
- So: few economic problems in reducing arms exports

Economic Effects –imports

- Cheaper than maintaining comprehensive DIB
- Security benefits -allies
- Security of supply; technology lag
- Foreign exchange/debt
- Use to develop capability- benefit from offsets?
- Other benefits from offsets?

Conclusions

- Arms trace is complex –different markets exist eg SALW, second hand
- Linked with restructuring of the industry and procurement
- Important role of national governments
- Not transparent and potential damaging
- Not obviously profitable to economies though is to indiv companies
- Need concern over lack of international control
- Arms Trade treaty being supported by NGOs and governments –going beyond UN Register
- Useful to keep economics in mind given way often used justify arms exports but clearly doesn't add up
- Arms controls unlikely to have any damaging economic effects
- Taxation of the arms trade? Brzoska
- Consider issue of offsets...

Arms Trade Offsets

- Introduction
 - Definition
 - In principle but practise?
 - Important but little substantive research
 - Brauer and Dunne (2004)
- Offsets
 - Magnitude
 - Country objectives and strategies
 - Characteristics
- The Mechanics
 - Offset mandates
 - Minimum values
 - Multipliers
- The Evidence
 - Cost reductions
 - Generalised economic development
 - New and sustainable work
 - Technology transfer
 - Arms Trade Offsets
- Conclusions
 - Offsets
 - do not result in arms acquisition cost reductions,
 - do not stimulate broad-based civilian economic development,
 - produce little substantial and sustained job creation
 - lead to limited technology transfer into the military sector

- technology that is transferred is quickly outpaced by advances in the main developed countries.
- Support for offsets tends to rely on pre-offset assertions, rather than post-offset evidence.
- Need better information but incentive not there to provide it