

The Economics of War and Peace: Opportunities in the Post-Cold War World

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In my lecture today I want to consider an area of economics which gets relatively little attention in this country, Defence and Peace economics -or the economics of military spending. My focus will be on how economics can contribute to understanding the opportunities and problems presented by the end of the Cold War and how it can assist in developing policies to convert from military to civil production.

During the Cold War there was considerable debate over the economic effects of military spending. There was work showing that there was a peace dividend, as the benefits from reduced military spending were called, and vehement opposition, from the vested interests -often well funded. With the end of the Cold War there was a sudden shift as the economic realities and pressures on budgets led to cuts and their justification was the peace dividend. The problem was that the most noticeable impacts -or most publicised- were job losses and economic problems. This led to arguments about the existence of a peace penalty and calls to stop defence expenditure cuts.

Why did this happen? Well it is clearly politics rather than economics, but I would argue it was also a failure to read the literature fully. The studies of the peace dividend were concerned with the fact that military spending was an economic burden, but that cuts in military spending could have short run adjustment problems. These would need to be dealt with through policies.

There is still an argument to be won and I hope to convince you that a peace dividend is possible.

The Context

First to give some idea of the importance of the Cold War in World Military Spending stood at \$1069 billion (current prices) with World Armed Forces numbering 28,580 th. This meant that the share of military spending in GNP (the military burden) was 4.6% and the share of military spending in total government spending was 17.2%. There were 5.5 members of the armed forces per 1000 people in the world. By any standards this was a huge diversion of resources towards the military.

A word of caution is required in referring to the Cold War. The so called “Cold War” saw some 30-40 million people die as a result of about 150 conflicts. The implications that this was in some way a cold rather than a hot war does seem to be pushing it.

Given the resources devoted to the means of violence it is rather ironic that the United Nations Development Program (UNDP) estimated that in Developing countries the chance of dying from social neglect (malnutrition, preventable disease...) are 33 times greater than from a war started by external aggression.

The end of the Cold War has seen a marked decline in military spending in most parts of the world. As figure 1 shows military spending has declined markedly in real terms in the developed and developing world. There is, however, some regional variation, with South Asia still showing growth in military spending as shown in Figure 2, but this would seem to be the result of economic growth rather than a regional arms race, as shares of military spending in GDP have remained stable. Military spending as a share of GNP, the military burden, has declined for both developed and developing countries, quite markedly since the mid-1980s, as shown in Figure 3.

The world is still a dangerous place but the changed strategic environment presents the possibility of further cuts. The reduced superpower involvement in regional disputes has reduced tension and scale of conflicts, while there are increased economic pressures on many countries internally as well as externally. The World Bank and the IMF both focus on reducing military burdens in debtor countries.

It is important to note that Military burdens in advanced economies are still high by historical standards e.g. US and UK. This is particularly marked for the US, as Figure 4 shows, and less so for the UK as figure 5 shows. As regards the UK it is important to remember that for most of the period was involved in running a huge empire and so one would expect a higher burden. That role for the military has gone so one would expect a lower burden. What is clear from figures 4 and 5 is that the failure to disarm at the end of WW2 was unprecedented and led to an unprecedented “peace time” build up.

So there is clearly potential for further cuts but what of the economic arguments?

Economic Effects of Military Spending

So how do economists try to analyse the relation between military spending and the economy? It depends on the School of thought. The Neoclassical perspective has a basic model which sees the state reflecting national interests (through aggregated preferences or some voting rule) in providing security. There is a clear trade off between spending money on military spending. Defence is considered as a pure public good, non excludable and so having clear free-rider problems. It can only be supplied by the government as if left to individuals they would all want to be defended but would try to free ride on others spending on defence. There have been a number of developments in this approach. Arms

race models have been developed which started with Richardson's action-reaction model (an innovation in the Cold War in showing that once an initial increase in spending had occurred it was likely to lead to escalation implying that one side could not really blame the other) and developed using game theory following the initial Brito and Intrilligator model. There have also been models of military alliances, which have analysed the burden sharing and free riding. Nato has often been the focus. In addition, more general theories of conflict have been developed where the emphasis is still on market exchange, which is s-operative, but this is seen to take place in the shadow of conflict.

This has produced a varied body of literature which not surprisingly has not provided a consensus of the likely economic impact of military spending. That has to be an empirical question and the neoclassical approach provides models which are valuable in developing consistent models and analysing processes and so for developing applied work. It does, however, have limitations. It is a partial analysis - which is useful when focusing on particular issues but not when looking for a general understanding of the role of military spending in the economy. It is also ahistoric, assuming given endowments but never seeing where they could have come from and does not fit the institutional reality.

The Keynesian analysis of military spending simply sees it as one component of government spending which will give a positive boost to the economy by providing effective demand through income multiplier effects. This would imply an unambiguous positive economic effect, but focuses only on the demand side.

The Institutional approach is predicated on existence of a Military Industrial Complex (first considered by Eisenhower - a Republican, though much of the developments have come from those on the left) made up of interest groups dependent of military spending in the state and industry and other parts of society in addition to the military. Their activities lead to internal pressure for increases independent of any threat. It also creates inefficiencies in the economy, pushing resources into military industry, and through the impact of the military industry -with its lack of market discipline on other parts of industry (working and management practices etc.). This approach sees an unambiguous negative effect on the economy. It has been criticised as being a middle range theory.

Militarism has played an important role in Marxist thinking, although Marx had little to say about it. He seems to have been influenced by Clausewitz's view of war as politics by other means and in Anti-During Engels sees only the negative impact of military spending. Later Marxists have held a variety of views with the idea of an MIC being used but one constrained by the laws of motion of capitalism. Luxemburg saw positive effect for military spending if paid for by taxes on workers in her scheme of expanded reproduction. Bukharin took a less deterministic approach focusing on the contingencies and specificity of the concrete forms to argue for a negative impact. By the Second World War the Stalinist orthodoxy was that military spending was necessary for capitalism as it was needed to maintain demand and prevent underconsumption crises-that capitalism could not support a peace economy. Other developments were Kidron's 'permanent arms economy' and Mandel's argument that military spending would have a negative impact through its effect on the rate of profit.

This approach provides a variety of different possible impacts of military spending on the economy. It also influenced the final approach the Underconsumptionist, linking the Keynesian and the Marxist and based on the Monopoly Capital arguments of Baran and Sweezy. In this approach military spending is seen to allow the absorption of surplus without increasing wages so maintaining profits. It has an unambiguous positive impact and only military spending can play this role.

With this brief overview of the theoretical perspectives, it is clear that there is no theoretical consensus of the economic effects of military spending. But I would see no reason to believe there should be an unambiguous impact in general. Why not see it as historically specific, contingent rather than deterministic, and a contradictory/dialectical process. This would suggest that military spending could have a positive impact in some cases and a negative one in others. It would also allow for the process which create the positive impact to contain their own contradictions and finally become a negative effect. This is in effect the sort of approach Paul Kennedy took in his book on the rise and fall of the Great Powers. Military might can facilitate economic development but at some point the military burden may start to act as a fetter on economic growth.

For our specific concern need to move to a more focused empirical analyses of the economic effects of military spending.

Applied work

I will not try to do justice to what has become a large and varied literature but will attempt to give the flavour of the work. We can categorise the types of studies undertaken:

Ad Hoc studies: The work of Benoit's which found a positive relation between military spending and growth in developing countries was conducted on the basis of simple correlations between military spending and growth. It was responded to by a number of studies some of which used the same approach, others which developed more formal models.

Estimating Formal models: This approach allows account to be taken of the different channels and feedbacks and provides consistent framework. The models have taken the form of neoclassical or Keynesian or some mixture of the two. Structuralist.

When models have been estimated using econometric techniques they have taken a number of forms. There are the single equation or reduced form models which have had different underlying theoretical bases, the simultaneous equation systems which have allowed explicitly for exogeneity and indirect effects, and there are the macroeconomic modelling methods which have introduced military spending into macroeconomic models. This has been done either explicitly or implicitly (treating only total expenditure). World models have also been used to analyse scenarios.

Overall, the empirical studies have shown little support for Benoit's finding, have found a negative effect of military spending on economic growth for advanced economies (through its effect on investment) and either insignificant or negative impact for developing economies.

The implications of this is that military spending has a negative or at best no effect on the economy. Further implying that reducing it should not cause economic problems. There should be a peace dividend. However, this is a long run argument in the short run there may be problems of adjustment which could be acute.

The next question to ask is how we can deal with such problems. In so doing I will focus on conversion policy. This is really only relevant for countries with defence industries. But as we will discuss later it is really of more general importance, having a DIB can lead to a push for its survival and subsidising. This can lead to a push for exports to counter the reduction in domestic procurement. Government provides assistance and even link aid to arms sales and the result is the moving of weapons to areas of conflict.

Conversion Policy

Conversion vague concept often thought of as swords to ploughshares but this is only one aspect. Indeed, a 'hands-off' free market approach, where military spending is reduced and no action is taken is a conversion policy. Others imply various forms of planning at macro and micro level

Many of the studies of conversion have tended to focus on particular aspects of the problem

As we have seen macroeconomic studies using neoclassical and Keynesian reduced form models have considered how the economy would respond to a change in military spending. Given the findings of a negative relation military spending and growth one would expect that reducing military spending would have a positive effect. When large structural models are used the impact of policy changes can be estimated. With Keynesian macroeconometric the reduction in defence spending will have a deflationary effect but when the expenditure is reallocated that expenditure can lead to increased growth an employment. A peace dividend. In some models, particularly those used by the World Bank and the IMF see the reductions in government expenditure allowing reductions in the real interest rate which in turn leads to economic growth

All of these studies suggest a 'peace dividend' but fail to address the problems of adjustment, focusing on the macroeconomic adjustments and not considering those which have to take place and the level of individual factories, companies, regions and local communities. Of course the impact will depend on the level of dependence on military spending.

Plant based

Considering the impact at the level of the factory or plant and ways in which the existing plant an workforce can be used is what most people consider to be conversion, the 'swords into ploughshares' approach. This implies using available resources and technical solutions to the problem of moving from military to civil production. In the most famous example the Lucas Aerospace shop stewards set up alternative use ommittees, though in some instances one might expect management initiative

The problems with this approach are that it is usually a defensive response to closure rather tahn a proactive attempt to move to civil production while the future is bright. The management and workers lack civil expertise. The relation of production in the plant are the produt of a market which was specific and very different to the civil market. There is little expertise in marketing and other areas. All of this means there are high costs of adjusment and high barriers to exit from the defence industry.

An alternative approach is to converst the company. This is in fact the most common approach and is often called diversification. It can take place through merger and acquisition, overcoming some of the problems of pnt conversion as well as by internal change.

Problems with company conversion are that again it is often defensive response, that defence companies, lack of civil expertise and so there are high barriers to exit. Bae tried and failed to diversify, despite considerable help from the government and ended up focusing on their defence areas. As the Managing Director of what was then Matrin Marietta said "In defence unrelated diversification is unblemished by success"

An alternative which has had use in the US is community based conversion. Here community groups made up of representatives of workers management and officials

form a committee to consider their response to base closure, and sometimes to factory closure. While it has had some success and at least gets people thinking about the problem in advance it still shares the problems of the other approaches where companies and plants are involved. There is also the added problem that although local managers may be willing to undertake a policy of conversion, head office may simply overrule the decision and close the plants.

CONVERSION POLICY

In developing a conversion policy I would argue that we have to recognise that the partial approaches will not work alone and that a more general policy is required, one which sees conversion as an integral part of a policy of industrial restructuring and regeneration.

It is important to recognise the contingency of demand and supply, government can replace present demands with others and can influence supply responses (in the extreme could simply ask the companies to produce something that is useless but not dangerous). It is also important to recognise that defence is a declining industry and not one we should be planning to rely on. It is also obvious that a structural change will be easier in a growing economy.

It is also important to recognise the wider influences of military spending and militarism on society and technology. Society is affected by militarist ideology, while technology is influenced by the effort and resource put into military research (esp in UK where a high proportion of government funded researchers (almost half) are in military research). The DIB is also not a passive actor but part of the MIC. Its success has been based upon getting money out of government and it has become good at it, better than at surviving in civil markets. As a result governments pushing new programmes might find defence firms highjacking them and treating them in the same way they have treated military problems (overly high tech and expensive solution), they may create a Health IC for example)

As things stand the DIB is restructuring in ways which are a cause for concern: becoming less visible - dual use/civil inputs, with globalisation - lessening government control

Implications

The implications of all of this are

Disarmament must be seen as an investment process

Conversion of the economy is required not just the defence industry

Conversion an opportunity not a problem but requires political will

This is very different from the 'hands off' approach the government has tended to favour in UK

Conclusions

Military spending remains at historically high levels. Planned and actual reductions are only impressive by the standards of the Cold War. So there is considerable scope for further cuts.

Have to consider what we need for defence and peacekeeping. Unlikely to be the products of the Cold War.

Military spending is an economic burden and reducing military spending provides an economic opportunity

It is important to have a conversion policy as part of a more general economic policy for industrial regeneration

“A good plan today is better than a perfect plan tomorrow.” George Paton

Looking ahead

International arms market increasingly competitive as result of reduced domestic procurement.

Internationalisation and globalisation of defence industry is reducing government control and visibility.

Conflicts increasingly interstate and fuelled by exports of weapons from desperate defence companies

Important to develop

Increased visibility and accountability of weapons production and exports

Regulatory measures for the international arms industry

Debate over proactive policies of disarmament, demilitarisation, and conversion

Non-aggressive forms of defence and peacekeeping.

The opportunity exists to get rid of the hangover of the Cold War. The potential prize is peace and prosperity. But is there the political will?