INCENTIVES AND DEMILITARIZATION:
THE RELATIONSHIP BETWEEN FOREIGN AID AND MILITARY EXPENDITURE IN DEVELOPING COUNTRIES

JICA

INCENTIVES AND DEMILITARIZATION

Dr. SAADET DEGER (SIPRI)

FOREWORD

With the recent drastic change of the world situation, the issue of development and democratization has gained increasing international recognition. The Insitute for International Cooperation (IFIC) has been holding a series of informal study sessions, in order to incorporate this issue to the JICA's current aid programmes. As part of these activites, IFIC held the Seminar on 2 March 1992, inviting Dr. Saadet Deger from Sweden. This report summarizes this seminar, under the title "Incentives and Demilitarization: The Relationship between Foreign Aid and Military Expenditure in Developing Countries".

Dr. Saadet Deger is a Senior Researcher at the Stockholm International Peace Research Institute (SIPRI). She is the Project Leader of the SIPRI World Military Expenditure proiect. She is an economist who received her Ph.D from the University of London. She is a member of the United Nations Institute of Disarmament Research Working Group of Experts for the Economics of Disarmament. She has been an expert adviser to the United Nations, a Consultant to the World Bank and a Consultant to the United Nations Children's Fund (UNICEF). She is the author of Military Expenditure in Third World Countries: The Economic Effects (1986), a co-editor of Defence, Security and Development (1987), and co-author of Military Expenditure: The Political Economy of International Security (1990). She has published many articles for international journals on the development effects of military expenditure, the economics of security, disarmament and development, and the arms trade.

I hope that this report will prove useful and informative for those who are involved in development assistance.

Lastly but not least, I would like to express my sincere gratitude to Dr. Deger and the participants of the seminar for sharing their valuable experiences and opinions at this occasion.

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SECTION I

Introduction

The end of the cold war allows us an unique possibility to reduce global military expenditure and spending on arms import and divert resources towards the many unmet socio-economic needs in the world. The rise in defence spending and arms trade during the last two decades has been fuelled by a competitive arms race whereby the major powers and their surrogates in the Third World have increased the acquisition of weapons and armed forces. This action-reaction mechanism, whereby military spending to increase national security by one participant in the arms race has increased the insecurity of the other participant(s), has culminated in a global defence spending of around 950 billion dollars per year in 1990 - 1991. World-wide defence expenditure at the beginning of the 1990s was about 70 per cent greater than what it was about twenty-five years ago. In 1966 aggregate military spending for the world was $568 billion.

Major weapons procurement expenditure indicates how much governments are spending on means of mass destruction. In 1989, before the cutbacks in the USA and the former USSR began, world procurement spending on major weapons was about $ 257 billion. The figures are dominated by the United States and the then Soviet Union. But even the EC countries spent almost 34 billion dollars on major weapons acquisition in 1989. Ultra sophistication of available technology, and unprecedented technological requirements by the military, contributed to ever escalating costs. Parallel to the quantitative arms race, mirrored in the rise of military expenditure, there has also occurred a qualitative arms race during the last two or more decades. This is demonstrated by the rapid rise in military R&D spending which in 1990 was about 100 billion dollars (according to my estimates) and accounted for over 11 per cent of world defence spending and possibly 20 to 25 per cent of global expenditure on all research and development (including those in the civilian sectors).

From the early 1970s Third World defence spending rose continuously until about 1984 - 85. Since the middle of the 1980s Third World military expenditure has been consistently falling, at least until 1990. Almost all regions have participated in this decline with the possible exception of the Asia-Pacific region.

The data should be treated with caution since the information on military expenditure and arms cost of war countries are difficult to evaluate. During the 1980s there were a number of wars, particularly the long drawn out

conflict between Iran and Iraq, and this can distort the data. It is possible that the turning point in the graph (the date at which defence spending peaked for the aggregate Third World) should be 1985 and not 1984 as shown. However, the basic feature remains intact i.e. defence expenditure is declining. SIPRI puts in a lot of effort in estimating military expenditure data and we are quite certain about the trends. See **Figures 1, 2, 3** for military expenditure trends of industrial countries and regional trends for the Third World.

This sustained fall is principally due to economic and structural reasons. The 1980s has been a lost decade in terms of growth and development for many countries in the Third World particularly in Africa and Latin America. The new orthodoxy calls for government expenditure cuts which have also affected the defence sector. Thus, defence spending has fallen not because of major arms control initiatives but simply because countries could not afford to spend huge amounts of resources on the military sector. However, economics is not a good arms controller. If growth is resumed and economic development occurs, then it is possible that defence spending may rise again. The Asia-Pacific region is a good example where high growth has allowed relatively large military sectors to exist.

In 1990, Third World defence spending was about 150 billion dollars. In 1991, almost all regional defence expenditures fell slightly except for the Middle East where the Iraq war has lead to a significant expansion. Our preliminary estimate shows that in 1991 Third World defence spending was about 160 billion dollars and this amounted to 17 per cent of the world total.

Third World arms imports also increased rapidly at least until 1987. Starting at around 12 billion dollars (in 1985 prices) for 1971, it rapidly increased to over 27 billion (in 1985 dollars) by 1987. After that, there has been a rapid fall and in 1990 it was again around 12 billion dollars. The causes again relate to the economic crisis of developing countries, the end of major wars like that between Iran and Iraq, and the decline of the Soviet Union as a major exporter.

One major and crucially important reason for looking carefully at military expenditure reductions is because it is a large reservoir of resources which can be used for international development. With the entry of East and Central European countries in the market for resource transfers it will be increasingly difficult, at least in the transitional period, for LDCs to acquire foreign aid and investment unless new sources of resources are brought into use. Traditional surplus countries, like the former FRG, are now burdened with domestic transfers. The long drawn out recession in the European Community, which shows no signs of abatement as of early 1991, also spells difficulty for LDCs. Soviet aid, at least for the less developed members of COMECON, has effectively been terminated from the beginning of 1991 with the formation of

Figuer 1: Trends in military expenditure for industrialized countries, 1981 — 1990
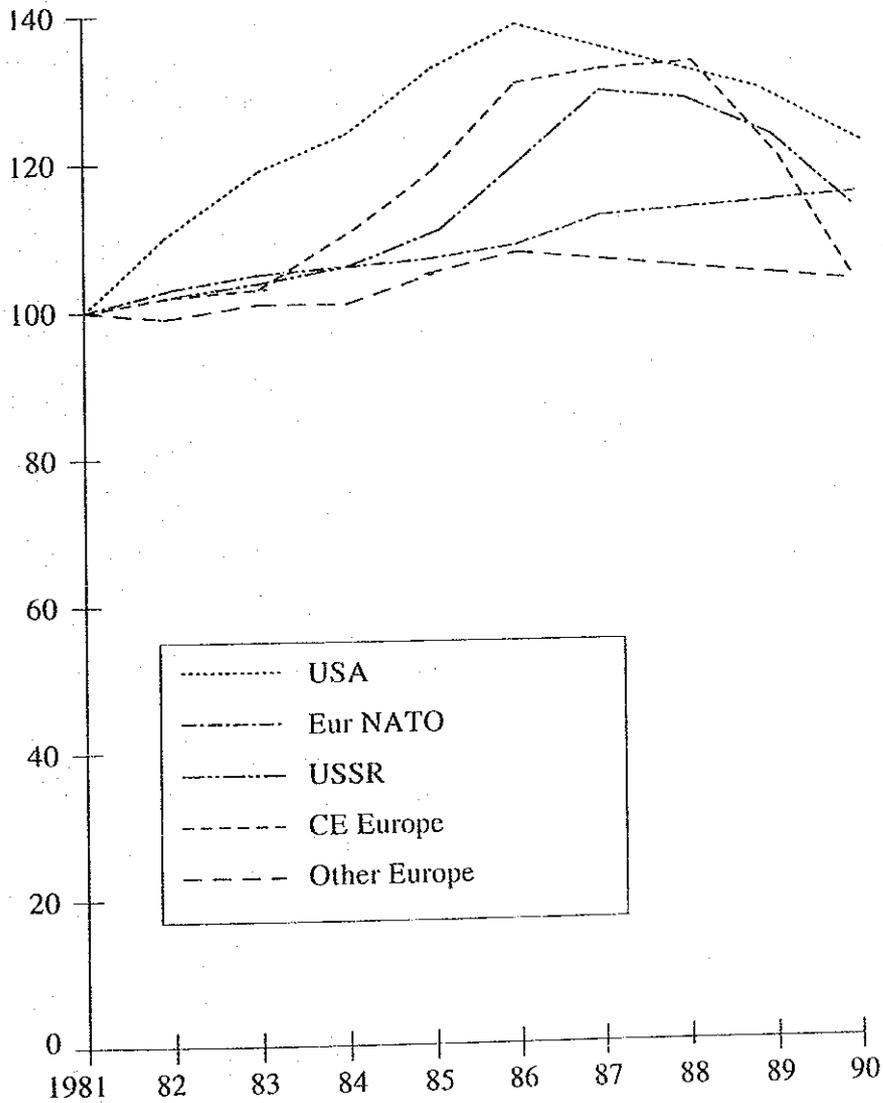
Figure 2: Trends in regional military expenditure for the Third World, 1981 – 1990
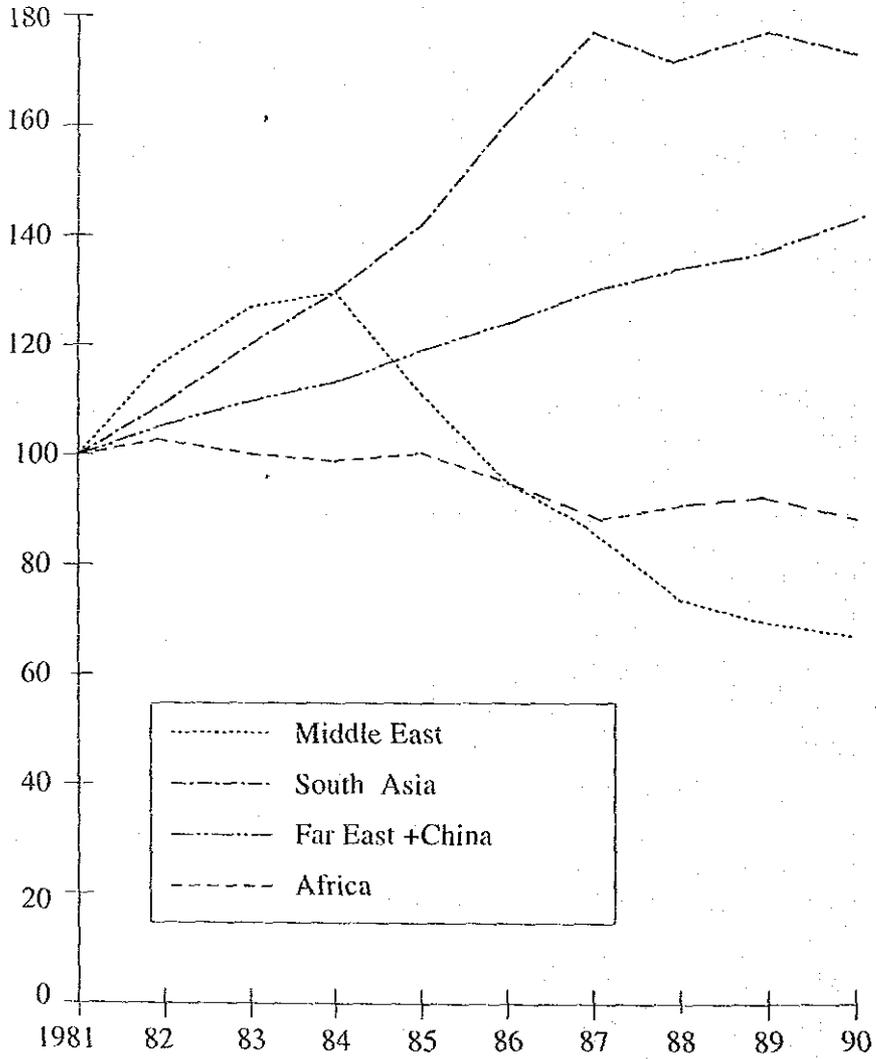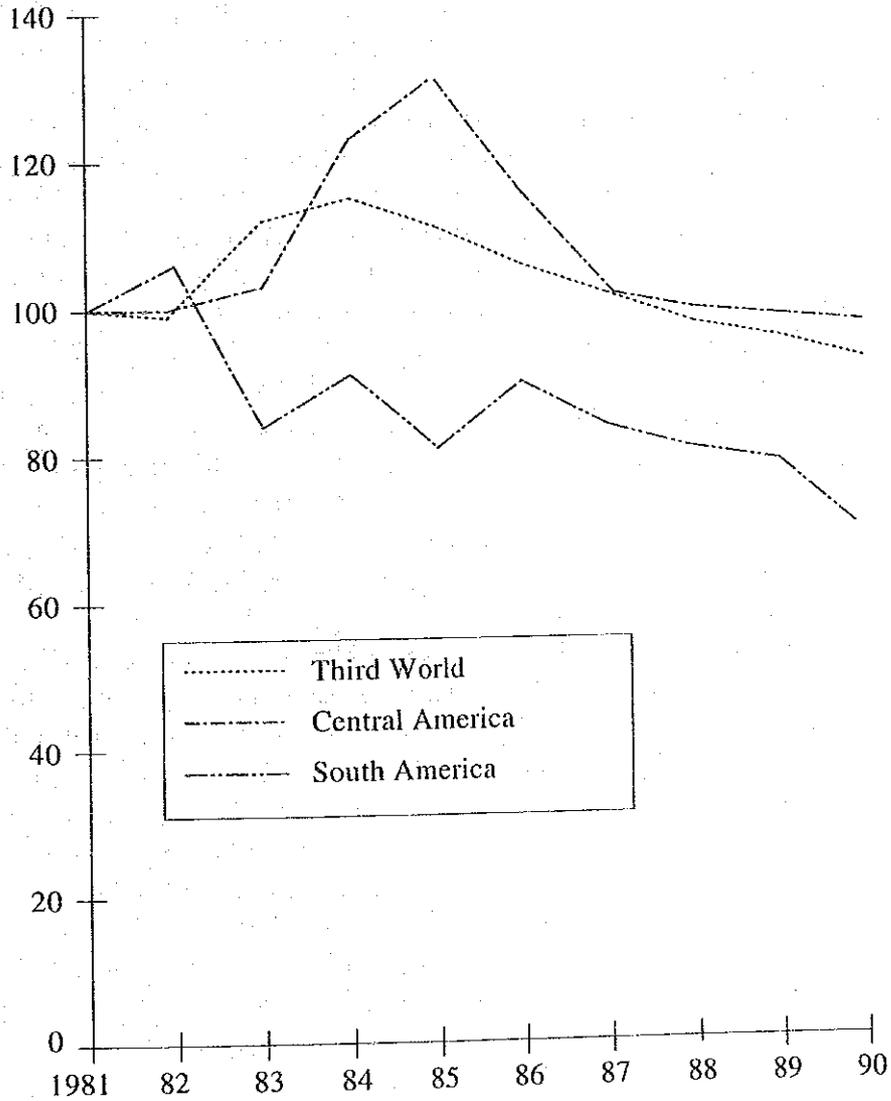
Figure 3: Trends in regional military expenditure for the Third World, 1981 – 1990

the Commonwealth of Independent States (CIS). The volume of the disarmament dividend and its allocation is the obvious source of new resources that can be tapped. It is important therefore to see how global military expenditures can be re-allocated.

Military aid alone has absorbed huge amounts of international resources in the past specifically for the superpowers. Aggregate military aid in that year was almost 10 billion dollars, split about equally between these two countries. If this sum had been diverted to economic aid, aggregate official development assistance (ODA) could have risen by almost 20 per cent in that year alone.

The purpose of this paper is to investigate the relationships between the effects and causes of military expenditure, as well as to specify how foreign aid can be used effectively as an incentive mechanism to help Third World countries to de-militarize in the post cold war period. A number of dilemmas arise in the process since the objectives of security and development occasionally are in contradiction with each other. The next section analyses the impact of defence on development and shows it is generally negative. Yet, the needs of military security propel countries to spend on this unproductive category of government expenditure. The central dilemma domestically arises because security needs (which are growth reducing) and development problems (which needs a stable security environment) can be in conflict with each other. Section III discusses the international dimensions of the problem and shows that foreign aid can be utilized as an incentive mechanism to further disarmament and peace. Yet, inappropriate incentive oriented aid policies can cause security problems and could be also detrimental to the original objectives. This is the international version of the central dilemma mentioned above. Section IV sets out briefly what Japan can do in this new world order and a post cold war security environment. Section V concludes briefly.

SECTION II

Military expenditure and economic development

There is a belief that in developing countries military expenditure could have some economic benefits. The earlier writings of Emile Benoit claimed that military expenditure in Third World countries could have positive effects on economic growth. This is because of spin-offs such as infrastructural investment, education, training, discipline and other such intangible effects which are essential for development could be provided by the military. In addition, it was also thought that military regimes were more effective in promoting economic growth since they provided a stable, albeit authoritarian, environment within which economic development could prosper. Defence spending provided security and this in turn allowed economic activities to proceed smoothly within a stable society. It was of course, clearly recognized that wars were extremely destructive and had high economic costs. But even in this field, opinion was divided and a school of thought believed that national integration needed to be preserved even at the cost of conflict.

The more recent literature, initiated by Saadet Deger and Somnath Sen, is much more clear about the negative impact of defence expenditure on economic growth and development. The general consensus is that, except for certain specific countries such as those with large resources (like oil) and small populations, military spending is highly detrimental to economic growth even though some spin-offs do exist. Military spending reduces investible resources which could be used to promote growth. It lowers the domestic rate of savings as people increase consumption to pay for public goods which are crowded out by defence allocations. It increases imports and therefore squanders foreign resources which could be used to purchase intermediate imported inputs to promote growth. There are also large distortions implicit in having a large military sector: through the impact on the labour market; or through domestic defence industrialization which reduces absorptive capacity; or through arms imports which compete with productive imports such as machinery; or through social expenditure trade-offs within the government budget which increases poverty; or through budget deficits and balance of payments disequilibrium which causes macroeconomic stabilization problems; or through inflationary effects as scarce resources such as skilled labour and investible funds are in high demand. The consensus is that defence expenditure is highly and significantly detrimental to economic growth.

The question then arises as to why Third World countries increased their defence expenditure so much (for fifteen years between the 1970s and until the middle of the 1980s). There is little doubt that these countries had

genuine security problems partly inherited from colonialism and partly imposed by superpower rivalry. The international ideological conflict, whether between colonialism and nationalism or between capitalism and communism, had a spill-over effect on many developing nations.

The growth and rise in regional defence spending in the Third World, similar to those of the superpowers and the two Alliances NATO and the previous WTO, has often been accelerated by regional arms races. The common belief is that defence spending produces national security which is considered to be a public good. However, this view does not take into account the high externalities that such weapons acquisition can cause for other countries in the region whose national security goes down in the process. Thus there exists a motivation for an arms competition or race which in turn has feedback effects on the country which initiated this process in the first place. Clearly, therefore, from a global point of view, increasing aggregate military expenditure is welfare reducing even though there is some justification from each individual country's point of view. The gains from co-operation are therefore much higher than the costs. The process of military spending, in regional arms races, are very similar to a prisoners' dilemma game whereby each participant loses through non-cooperation. The reasons for not cooperating, such as mutual distrust, the difficulties of communication, the lack of an institutional framework, the high degree of uncertainty and risk involved in not protecting national security, asymmetric information sets and so forth, are also similar in a regional arms race as in the prisoners' dilemma game. The major powers have encouraged this process in the past and created a situation of distrust which acted as a catalyst to the inherent national security problems of LDCs. As mentioned earlier, the changing international political environment forces LDCs to re-consider their security doctrines and their defence spending mechanisms.

This was then the security dilemma. On the one hand, legitimate security needs often justified an increase in military expenditure by one country. This had a negative impact on development which in turn created more conflict arising out of developmental failures. Such developmental problems often gave rise to repressive authoritarian regimes who were thought to be better in promoting growth. But lack of popular participation meant that long term development was not sustainable. Rather, security expenditure, broadly defined to include policing and paramilitary forces' upkeep, increased to maintain dictatorial regimes. On the other hand, neighbouring countries felt insecure at the initial spurt in defence spending and counteracted in like fashion. **Thus the security coflict and the poverty trap created the development dilemma.**

SECTION III

The international demensions

Over the last forty years and more the industrial nations of the world have been divided into two ideological groups which have competed to influence each other and to gain the support and allegiance of the Third World. International security, defined in the broadest possible terms to include political, economic and military factors, required the capitalist and socialist systems to co-ordinate policies within each bloc and compete elsewhere. The parameters of burden sharing were defined in terms of how much each country spent on defence expenditure (military security) and how much each country spent on Official Development Assistance, ODA (international economic security).

In the western or capitalist sphere there were countries like the USA and the UK which spent relatively large amounts on the military and relatively small amounts on ODA. On the other hand were countries like Japan and Canada which spent large amounts on ODA and small amounts on the military. It should be clearly specified that these so called large and small amounts are relative terms. In **Table 1** we show some indicators of burden sharing between military and economic security. The first column gives the standard measure of ODA/GNP. The third column gives the relationship between economic and military security obligations. In Canada and Japan the ratio of ODA relative to defence is quite high, showing the importance they place on economic security obligations towards the Third World compared to their military requirements. In contrast the ratio is quite low in the UK and the USA.

The third column is the appropriate index of burden sharing as well as the commitment of the country concerned with international economic security (requiring ODA) and military security (requiring defence expenditure). But these ratios reflect reality in a world of high threats and conflicts between the major powers. Today, the situation has changed in terms of threat and security. But the levels of ODA also need to be changed to reflect the 'peace dividend'. This has not happened as yet. The second column of Table 1 gives information on 'optimal' levels of aid that are calculated by the Nobel Prize winner Jan Tinbergen. These ratios are based on a global model with alternative assumptions about international security. Under a more benign political climate, the ratio of aid to GNP could rise to the levels shown in column 2 of Table 1 if some parts of reduced defence spending was diverted to ODA.

It is clear that the level of ODA is insufficient to meet the developmental needs of Third World countries. What is not so clear is how low foreign aid is compared to certain types of 'unproductive' expenditures that

Table 1: Ratio of Official Development Assistance (ODA) to GNP, actual (for 1989) and 'optitnal'; ratio of ODA to military expenditure (1989)(Figures are percentages).

Country	ODA/GNP		ODA/Military expenditure
	Actual	'Optimal'	
Canada	0.44	0.78	22.0
France	0.54	0.69	15.4
Germanay	0.41	0.72	14.6
Italy	0.42	0.53	17.5
Japan	0.32	0.57	32.0
UK	0.31	0.62	7.4
USA	0.15	0.82	2.5
USSR	0.24	N.A.	2.2

Source: OECD (1990), Authors' estimates, SIPRI database. Soviet figures are subject to high degree of uncertainty. The 'optimal' values are defined in the text as derived from Tinbergen (1990).

Table 2: Third World net transfers from long term debt, ODA received and arms imports, 1985 - 89 (US $ billion)

	1985	1987	1989
ODA	29.4	41.6	46.7
Arms imports	32.5	43.8	39.3
Net transfer	− 19.7	− 34.2	− 42.9

Source: OECD (1990), World Bank (1990), ACDA (1990) and authors' estimate.

LDCs have to incur. During the 1980s the debt crisis has forced developing countries to pay more and more to service their debt. By the late 1980s there was a negative transfer whereby new money received in the debt account was less than the amount paid for debt servicing. The poor were subsidizing the rich. At the same time arms imports of the South which comes predominantly from the North remained stubbornly high. Please see **Table 2**. By 1989, as the Table shows, negative net transfer and arms imports accounted for almost double the level of foreign aid. In other words, the South was paying to the North about twice the amount of money compared to what the South was receiving. Again the poor were subsidizing the rich.

Tables **3** and **4** show data on economic and military assistance of the two superpowers. Soviet data should be treated with caution since the rouble dollar exchange rates are not used and separate purchasing power parities are utilized to convert ruble estimates into dollars. Both sets of figures come from the United States since Soviet data is non-existent. The tables indicate how important military aid has been for the superpowers. For the United States military aid is about one-third of total aid. For the USSR, military aid is about two-thirds of total aid. Thus there are large amounts of resources available from military aid since the cold war is over and the disarmament dividend needs to be found.

Table 5 gives a somewhat different perspective. It shows how developing countries have been burdened with defence spending (as mentioned in the previous section) and also with external debt servicing. The two together have taken away much of central government revenue and left very little for all the economic and social expenditures that are essential for development and survival. We take these spending as a proportion of government income (or revenue) because this is where the constraint is felt most acutely. Aggregate expenditure can be increased through more borrowing but revenue is relatively inelastic. Countries like Pakistan or Columbia spend almost two-thirds of their government revenue on these two items of unproductive expenditure, leaving precious little for all the other expenditure categories that the government is responsible for – health, education, infrastructure, development and so forth.

One major problem with monitoring foreign aid and verify that is being used for appropriate purposes is that aid is fungible. If it is given for general budgetary support or for balance of payments support, it can be used for military purchases and expenditures even though it was not intended to be so. Even if it is sector specific, and tied to economic activities, it can release resources which can be used for defence purposes.

Any form of aid – economic or military, tied or untied, project or policy reform orientated – will involve some leakages from the original purpose for which it was provided, and will also allow, directly or indirectly, fungible

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Table 3 : US military and economic assistance, 1986 – 89
        (US $ billion)

	1986	1987	1988	1989
Total (military)	5.84	5.10	4.83	4.83
Loans	1.98	0.95	0.76	0.41
Grants	3.86	4.15	4.07	4.42
Total (economic)	10.79	9.39	8.98	9.86
Loans	1.22	1.14	0.85	0.69
Grants	9.57	8.25	8.11	9.17

Source: US Overseas Loans and Grants, 1990

**Table 4 : Estimates of total Soviet military deliveries, military grant aid,
         hard currency earnings from arms, and debt creation from arms
         transfers**
         (US $ billion)

	1982	1984	1986	1988
Total Military deliveries	16.03	16.3	15.48	19.1
Military grant aid	6.23	6.05	6.0	7.8
Hard currency arms earnings (includes oil)	4.3	3.8	2.8	3.3
Residual (debt)	5.5	6.45	6.68	8.0

Source: Joint Economic Committee (JEC), 1990

**Table 5: Military expenditure and external public debt service as shares
of current government revenue, 1988 (figures are persentages).**

| Country | Percentage of Current Government Revenues | | |
	Ext. debt service	Military Expenditure	Ext. Debt service plus military Expenditure
Argentina	22.3	15.2	37.5
Columbia	54.3	16.7	71.0
Chile	19.6	24.6	44.2
Egypt	10.8	18.1	28.9
Indonesia	51.6	12.0	63.6
Jordan	67.1	51.4	118.5
Morocco	26.2	20.5	46.7
Pakistan	20.6	41.8	62.4
Philippines	49.0	9.1	58.1
Sri Lanka	24.7	16.8	41.5
Zimbabwe	22.8	18.1	40.9

Sources: World Development Report 1990 ; SIPRI data base; author's
calculations.

resources to be transferred to other purposes. Net foreign transfers create the
potential for fungible resources, however small or large, that can be used at
will. However, the form and extent of fungibility varies from case to case and
also depends on the strictness with which the transfer is contracted,
implemented and monitored. Further, there will be an important difference as to
whether the resources released are predominantly in the form of foreign
exchange or in terms of domestic resources. If the former, then arms imports
could rise after economic aid is provided. If the latter, then the costs of
personnel may increase. If foreign aid is also to help de-militarization, then
fungibility should be reduced in an optimum aid policy. The incentive would be
that more and better quality aid will be provided if countries do not divert
resources saved through economic assistance towards military use.

Imposing political or defence conditionality on foreign aid is a good
method of stopping the effect of fungibility i.e. economic aid to be used for
military purposes. In the same way, domestic resources released by foreign aid
will be less likely to reach the military sector if there are stricter conditions

imposed on defence spending and arms imports. But there are a number of problems.

First, the terms of the defence conditionality will have to be wide ranging as well as country specific. Otherwise, some countries will suffer relatively more through no fault of theirs. The next section, which deals with Japan, spells out these problems in more detail.

Second, there will be an incentive to cheat and transfer military related spending to other accounts. Then police expenditure, para-military spending, imports of small arms which are not verifiable, military pensions transferred into civil accounts – could all rise but reported defence expenditure remains the same or becomes lower.

Third, if countries do not accept such defence conditionality, then their foreign aid will be reduced. The impact would fall on social and economic expenditure rather than on the military. There is evidence that military expenditure exhibits 'resilience' i.e. it is cut less when total government expenditure falls rapidly and therefore its share in the total rises. If this is so, cutting foreign aid will not reduce defence spending proportionately but also may do more harm than good. Social and economic expenditure may bear the brunt of expenditure reductions followed by foreign aid cuts.

Fourth, if there is only a threat to cut aid when defence is high, then it might be relatively unacceptable to the recipients. What is also needed is a positive incentive which includes promises of more foreign aid. If aid levels remain depressed, or LDCs are crowded out by aid supply to Eastern Europe, then developing countries will not find it easy to comply with stringent defence conditionality. Incentives (to get more foreign aid from current levels if de-militarization occurs) and disincentives (to reduce foreign aid from current levels) must go hand in hand.

Finally, the process of de-militarization can be reversed when economic conditions improve and foreign aid is no longer necessary. Countries in the Asia Pacific region have some of the highest growth rates of military expenditure and such incentives that we are discussing will not work because their need for foreign aid is low. Therefore, aid as an incentive must be broadly defined as an incentive towards regional political co-operation. Thus military and political confidence building measures must be encouraged at the same time as defence spending and arms imports are sought to be cut. These pressures and encouragements may not be open and publicly stated. But it must remain in the background discussion and influence the process by which aid donors transfer resources.

This is therefore another dilemma. Appropriate incentive policies, linking foreign aid to de-militarization, is extremely helpful. But if it is not done carefully, then the final effects would be unproductive. The central point

is that defence conditionality will make the terms and conditions for foreign aid more difficult. Put in another way, it will raise the 'price' of foreign aid. If now the resources available are not increased to compensate, then the welfare of the recipients will decline. The impact on other parts of government expenditure may also not be favourable because the state may try to protect the military. The final outcome is undesirable. The only effective way by which foreign aid can help true de-militarization is to combine greater defence conditionality and higher foreign aid levels. These two elements must go together.

It is therefore essential to discuss fully how foreign aid is to be increased and how LDCs are to be compensated for the loss of resources due to the change in the international political climate. In a resource constrained world the disarmament dividend (money saved from military expenditure reductions) is probably the only way to get more aid to the Third World as well as to raise their own domestic savings ratios. How much would economic aid rise if a 10 per cent reduction in industrial country military expenditure was transferred as foreign aid. For countries like Japan and Sweden the increase is modest because they already provide large aid amounts. For the United States, a modest 10 per cent cut in defence spending (about 30 billion dollars) and given as aid would raise ODA by three times (currently US ODA is about 10 billion dollars). An alternative set of calculations would involve hypothesized resource transfer from the previous conflict in Europe. I have estimated that in the late 1980s the total defence expenditure for the conflict in Europe, by all the powers involved, was about 510 billion dollars. This calculation takes into account European military costs of the United States, that of the USSR, as well as all the European NATO, WTO and neutral countries. Total ODA in 1988 was about 56 billion dollars. Thus, a 10 per cent reduction of defence spending and transfers to the Third World would raise world ODA by 91 per cent. Thus, such transfers would almost double foreign economic aid. The potential for the disarmament dividend is high. Unfortunately, the political will is absent.

SECTION IV

What can Japan do?

Japanese foreign policy in general, and security policy in particular, has relied exclusively on peaceful means of settling disputes and a concentration on the non-military aspects of security. Japan ranks first or second (depending on measurement) among the world's major aid donors, and has fulfilled its international responsibilities through economic burden-sharing. In the late 1980s the Japanese share of total ODA, given by all member countries of the Organization of Economic Cooperation and Development (OECD), was about 17 per cent. Japan has now promised to double the absolute value of its ODA to Third World and East European countries. If this pledge is maintained, the Japanese share could rise to a staggering 30 per cent of the OECD total. In 1991 the government has signalled its intention to impose non-economic criterion in evaluating aid recipients. Four conditions are reported to be important (in addition to economic cost benefit calculations) in determining aggregate levels of aid for recipients. These are: (a) military expenditure as a share of GDP or as a share of total government expenditure or socio-economic spending; (b) arms imports; (c) human rights violation; (d) the quality of governance, which may determine the internal security of the country concerned. The use of 'defence conditionality', and other non-economic criterion is a way of imposing sanctions and incentives by which aid policy can promote de-militarization as well as promote international peace and security. This may be termed the 'carrot and stick' aid policy whereby incentives are provided for countries which have acceptable standards of international relations and are ready to help the cause of peaceful settlement of disputes – both external as well as internal.

However, as our previous discussion suggests, the 'carrot and stick' aid policy needs to be carefully utilized. First, legitimate security interests must be protected. It is no use penalizing a country in isolation for having, for example, a high military expenditure when it has been forced into an arms race by its neighbours or a major power. Smaller countries, in particular, are at risk from their larger regional neighbours. In the absence of cooperative security arrangements such as the CSCE (Cooperation and Security Conference in Europe) process it will be difficult to protect vulnerable countries.

Second, such aid conditionality will involve some form of political intervention in the domestic affairs of the countries concerned. This has to be carefully handled because intervention can be both benign (and productive) but also hostile (and counterproductive). Defining the parameters of intervention is not easy.

Third, there is the necessity of a case by case study of the factors involved in such defence conditionality. Each country will have to be looked at separately and its specific security needs analyzed. It is now argued that if a country has military expenditure which is over 2 per cent of GDP, economic aid should be curtailed. However, there is nothing magical about the 2 per cent level and large countries can still keep to the limit and yet intimidate their smaller neighbours. It is essential in formulating aid policy to look carefully at the specific country concerned within its own regional security environment. The actual analysis will be similar to that of country risk evaluation where objective measures are utilized to measure subjective possibilities (such as a chance of defaulting on a loan). Evaluation of recipient countries will overall have to be much more sophisticated.

Fourthly, the measurement of defence expenditure as a share of GDP becomes problematic if military aid is received. Should defence spending include foreign aid (which is free or subsidized) or should it only include domestic cost? The former is the true measure of military capability and hence has security connotations. The latter is a measure of domestic burden and is more important for economic calculations of the cost/benefit of the military system. Therefore, care should be taken to have these criterion properly evaluated and measured.

Fifthly, our earlier analysis of fungibility suggests that it is difficult to stop leakages from civilian aid to military use. If the foreign aid, however well intentioned, helps the recipient to divert domestic resources towards the military, the purpose of foreign aid is destroyed. This possibility, however, will be increased and strengthened under stricter defence conditionality. Since countries will be obliged to spend less on the military, they will have an incentive to 'cheat'. Worse, they may divert domestic resources to internal security and to the para-military which will be justified for internal security reasons which are often more justifiable compared to external threats.

Sixthly, cutting military spending and arms imports are not enough per se. The fundamental problems of underdevelopment and poverty often require more positive actions such as more spending on the socio-economic sectors. If defence cuts are absorbed into the budget surplus and other social and economic sectors do not benefit in the process, the vicious cycle of underdevelopment will continue for large masses of the poor in the Third World. Then, countries will feel that they have lower security since they do not have adequate arms. At the same time they will also feel economically deprived relative to expectations. A reduction of both security and welfare will create more difficulties for stability and peace compared to the present situation.

The conclusion is that although the current Japanese attempt to link

economic aid with de-militarization is an extremely praiseworthy one, it has to be carefully made operational. Otherwise the dilemma will be that the positive aid policy will create more difficulties than had existed before the policy was implemented. International burdensharing requires Japan, with the second most powerful economy in the world, to take a much more positive and activist role. This is certainly desirable. What is now required is careful operationalization and the design of optimal aid policies. In my paper to the Annual World Bank Conference on Development Economics I have suggested some practical procedures in this respect.

SECTION V

Concluding remarks

I have suggested that it is important to have a fresh look at Third World military expenditure in the light of recent international political developments such as the end of the cold war and the dissolution of the Soviet state. It is also essential to use foreign aid as a means and incentive to reduce wasteful spending on arms procurement. However, both domestically and internationally there exists some dilemmas in the defence-development-security nexus. These must be carefully analyzed and understood before major changes are undertaken. Otherwise, the situation might become even worse than before.

What we have here is a case of policy coordination in the broadest sense of the term. Foreign aid has been the domain of economic policy. Economic aid has been the domain of security and political policy. The time has now come to link them up. In a sense there is a need to do this not only in terms of the narrow dimensions of ODA but also in a much broader setting. I would like to propose that Japan should canvass and urge for the setting up of an United Nations Economic Security Council which would look at problems of developmental failure which have security implications. Poverty and famines are also weapons of mass destruction and their eradication is as much important as the elimination of war fighting capabilities. Many of todays conflicts are a direct and indirect product of economic deprivation. Tomorrow's conflicts, such as those related to environmental degradation and fights over scarce water resources, will also be related to under development. It will be the duty of the United Nations Economic Security Council to respond to such crises in a way that the current UN Security Council can never do. It will also coordinate the many successful UN economic activities with the work of the present Security Council deliberations. Its permanent members could be the United States, the European Community as a whole, the Russian Federation, Japan and one or two Third World countries chosen in rotation to represent the South. Such a Council would be a perfect channel for policy coordination where politics and economics meet such as in our discussion on foreign aid and military expenditure. In the brave new world Japan has a crucial role to play. I am sure it will accept its position with imagination and courage.

ANNEX

Value and rankings of military expenditure in Third World countries as share of GDP (military burden), 1981–1989 and 1972–88 averages (all values in percentages).

	1981 – 1989		1972 – 1988	
Country	Mil. burden	Ranks	Mil. burden	Ranks
Iraq	21.0	1	16.4	6
Angola	20.8	2	17.2	3
Saudi Arabia	20.0	3	17.0	4
Yemen PDR	18.7	4	16.3	7
Israel	16.8	5	19.6	2
Syria	14.5	6	14.3	9
Jordan	13.7	7	16.8	5
Nicaragua	13.4	8	9.5	13
Libya	12.5	9	10.3	11
Mozambique	11.7	10	7.6	17
Mongolia	10.9	11	n.a	
Korea, North	10.7	12	11.5	10
Yemen Arab R	10.0	13	9.6	12
Cuba	10.0	14	7.9	16
Ethiopia	9.8	15	7.1	18
Oman	8.9	16	23.2	1
Lebanon	8.3	17	5.2	28
Guyana	8.2	18	6.0	21
Chile	7.8	19	7.1	19
United Arab E	6.8	20	4.6	33
Pakistan	6.8	21	6.5	20
Kuwait	6.7	22	5.7	25
Zimbabwe	6.4	23	5.7	26
Brunei	6.4	24	5.0	31
Mauritania	6.3	25	8.2	15
Taiwan	6.3	26	6.4	22
Malaysia	6.0	27	6.2	24
Egypt	6.0	28	14.8	8

Country	1981 — 1989		1972 — 1988	
	Mil. burden	Ranks	Mil. burden	Ranks
Singapore	5.5	29	5.5	27
Bahrain	5.2	30	4.5	36
Tunisia	5.2	31	3.5	44
Honduras	5.2	32	3.1	50
Chad	4.9	33	4.6	35
Peru	4.9	34	5.2	29
Korea, South	4.9	35	5.1	30
Tanzania	4.4	36	4.3	37
Thailand	4.4	37	4.2	38
El Salvador	4.2	38	2.9	51
Argentina	4.2	39	4.6	34
China	4.0	40	9.1	14
Morocco	3.9	41	4.9	32
South Africa	3.8	42	3.6	43
Uganda	3.7	43	2.8	53
Bolivia	3.6	44	3.4	47
India	3.4	45	3.1	49
Zambia	3.4	46	3.8	41
Myanmar	3.4	47	3.8	42
Gabon	3.1	48	2.2	63
Iran	3.0	49	6.3	23
Kenya	3.0	50	2.9	52
Burundi	3.0	51	2.7	55
Indonesia	3.0	52	3.8	40
Burkina Faso	2.9	53	2.6	59
Liberia	2.9	54	2.0	69
Sri Lanka	2.8	55	1.9	73
Somalia	2.8	56	3.5	45
Botswana	2.7	57	3.4	48
Mali	2.7	58	4.0	39
Senegal	2.7	59	2.6	58

Country	1981 — 1989		1972 — 1988	
	Mil. burden	Ranks	Mil. burden	Ranks
Guatemala	2.7	60	1.9	72
Trinidad & T.	2.7	61	1.7	77
Uruguay	2.7	62	2.6	60
Congo	2.6	63	3.6	46
Togo	2.5	64	2.2	64
Madagascar	2.3	65	2.2	65
Sudan	2.3	66	2.6	57
Venezuela	2.3	67	2.3	62
Colombia	2.2	68	1.6	80
Cameroon	2.0	69	1.8	74
Central Africa	2.0	70	2.1	66
Swaziland	2.0	71	2.1	67
Benin	1.9	72	1.8	75
Malawi	1.9	73	2.0	70
Panama	1.9	74	1.4	84
Algeria	1.8	75	2.0	68
Rwanda	1.8	76	1.7	78
Bangladesh	1.7	77	1.4	82
Ecuador	1.7	78	1.9	71
Philippines	1.7	79	2.2	61
Nepal	1.5	80	1.1	86
Zaire	1.5	81	2.8	54
Nigeria	1.4	82	2.6	56
Dominican Re	1.4	83	1.6	79
Cyprus	1.3	84	1.7	76
Haiti	1.3	85	1.4	81
Brazil	1.2	86	1.3	85
Paraguay	1.2	87	1.4	83
Côte d'Ivoire	1.1	88	1.1	87
Jamaica	1.1	89	1.0	89
Sierra Leone	0.8	90	0.9	90

Country	1981 — 1989		1972 — 1988	
	Mil. burden	Ranks	Mil. burden	Ranks
Ghana	0.7	91	1.0	88
Niger	0.7	92	0.7	91
Hong Kong	0.6	93	0.6	92
Costa Rica	0.5	94	0.6	94
Mexico	0.5	95	0.6	93
Mauritius	0.2	96	0.2	95