

NOTES AND COMMUNICATIONS

DEFENCE EXPENDITURE AND NATIONAL ACCOUNTING*

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1. National accounting in the capitalist and semi-capitalist countries holds defence expenditure at par with other expenditures. National accounting in socialist countries does not. The reason is generally said to be that defence expenditure is "unproductive". I have not seen, however, a clear and conceptually rigorous exposition of the argument. It seems to be that any distinction between "productive" and "unproductive" expenditure, when the expenditure concerned is considered *necessary* by relevant decision-makers, has got to be arbitrary. Such a distinction cannot serve as a scientific basis of national accounting concepts. There exists, however, a difference between defence and other expenditures that is fundamental in character, and can serve as a scientific reason for making a distinction between the two. This difference arises from the fact that national defence, by its very definition, has an *international dimension*. This is of such a nature that the quantity of "defence goods" cannot conceptually be measured in the same way as the quantity of other goods. This is the main point in this note.

2. The index conventionally used to measure *real* national product is a "quantity index". This is derived either by valuing current outputs at "base-year" prices or by deflating aggregate national product at current prices by an aggregate price index. The two methods are two different ways of approximating the same basic notion, *viz.*, a measure of the aggregate *quantity* of goods and services produced in a given year. The measurement is essentially relative: the aggregate quantity produced in one year is measured in comparison to that in the base year. The measurement of real national product does not have any meaning except in such comparative sense. To put in another way, the index of real national product measures *change* in the aggregate quantity of the various goods and services produced in the given year from that produced in the base year.

3. For ordinary goods and services, changes in the quantity produced may be defined as changes in the physical amount(s) of the product(s) in question: e.g. in terms of number of machines of a given specification and size, number of hours put in by labour of given specification. *The concept of defence service as a commodity, i.e. security from external aggression, does not lend itself to such quantification.* Doubling of the strength of the armed forces and all other defence equipments, for example, does not necessarily constitute doubling the "quantity" of security a nation may enjoy from external aggression. In fact, in spite of such doubling of the physical components of defence service from one year to another, the amount of *security* enjoyed by a nation may actually be *smaller* in the latter than in the former. It all depends on changes in military strengths of potential aggressor countries. This is the inevitable *outcome* of the arms race: the amount of security produced by one nation depends by definition on the international balance of power. Thus an index of physical quantities of the components of a nation's defence efforts is no measure of the quantity of the final good (security) that these efforts seek to produce. And this divergence occurs not because of any "imperfection" in the market; if it did, one might be inclined to accept the former at least as a first approximation of the latter. The divergence occurs because of the very concept of the final good in question which has an international dimension as its very essence.

*A discussion with Dr. A. N. M. Mahmood on this question was very helpful.

4. It may be thought that to some extent the valuation of most other goods and services has an international aspect too. Changes in international tastes and consumption patterns influence the valuation of most commodities; and such changes are not reflected in a base-year-price-oriented quantity index anyway. Is the difference then between defence good and non-defence good brought out above a matter of degree and not of kind? This is not so, for the following reason.

5. The international aspect specific to defence goods is *definitional*, while that observed for other goods is a matter of subjective valuation (tastes). To be correct, the latter type of international dependence of values applies to the valuation of defence goods as well in the sense that the (marginal) utility attached by one nation to a given amount of *security* (as reflected by the relative priorities assigned to different amounts of security), may be influenced by valuations in the same area by other nations. But the measurement of the *quantity* of security itself, as distinct from (subjective) relative valuation of the *utility* of this quantity, has by definition an international dimension that is intrinsic and specific to this commodity.

6. For the above reason, the measurement of defence goods in the very *quantity-index* sense, as distinct from measurement in the sense of (subjective) social valuation or an index of social choice, cannot logically be done without reference to the state of international power balance at the given period(s) of time. The conventional method of measuring national product cannot therefore measure the quantity of defence goods produced by a nation at any given period. Hence, if the conventional measure is intended at all as a quantity-index of the bundle of *final* goods and services produced by a nation at any given period, then there seems to be a logical case for excluding defence expenditures from this measure in order not to mix up something that this measurement cannot stand for.

This is not to suggest that, for other purposes (e.g., a quantity-index of the flow of *resources*), inclusion of defence expenditure as part of the national product is not justified.

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