



ECAAR NewsNetwork

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Primakov Reforms: They Should Do the Trick

Stanislav Menshikov, Co-Chair, ECAAR-Russia

Prime Minister Yevgeny Primakov is much respected as a statesman and consensus builder. But some, mainly former ministers appointed then dismissed by President Boris Yeltsin, have criticized him for "stopping reform" and "doing nothing" in the economic sphere. These criticisms are far from true.

Since his appointment in mid-September, Primakov and his economic team have initiated two major economic reforms that previous cabinets have avoided or failed to implement. They are in the process of simplifying and reducing taxes as well as restructuring or realigning Russia's banking system in accordance with the principles of modern market economies. In the initial stages of development, it is far too early to expect results from these reform efforts. In the context of an extremely precarious economic and financial situation together with default and devaluation inherited from the Kiriyenko cabinet, it also seems unfair to criticize Primakov for stalling.

Tax reform has proved most controversial. Stanley Fischer from the International Monetary Fund (IMF) and our domestic opponents have called the proposed tax reductions untimely, even disastrous. To lower taxes, they argue, would further reduce government revenues and lead to an enormous deficit financed largely by printing more money, the result of which would lead to hyperinflation. But the Primakov team disagrees, believing tax reductions would encourage firms to pay taxes in full and induce enterprises to produce more goods thus increasing the real tax base.

Theoretically, Primakov's critics would be correct if the supply side was unchangeable and not positively affected by tax reductions. They claim similar tax relaxation efforts in the past have not resulted in larger output. Such reductions in recent years have been coupled with drastic cuts in federal expenditures, leading to falling aggregate demand. When aggregate demand falls, real GDP is not supposed to rise. Tax reductions lead to worse tax collection.

Mindful of the highly unstable financial situation, the Primakov Government in 1999 is planning to increase federal expenditures, albeit cautiously when

measured in real terms. Increases in aggregate demand are limited to the regular payment on time of pensions and wages of federal employees, both civilian and in the army as well as to financing crucial investment projects that will result in fast increases in output. The positive effect of these stimuli combined with tax reductions is expected to bring about general economic recovery by the second half of 1999—in time to influence voters on the eve of the December 1999 parliamentary elections and the presidential elections that would normally be held in June 2000.

Whether these plans materialize depends on the ability of the Government and the Central Bank to restrain inflation and keep the ruble exchange rate from undue devaluation. The Government's target for 1999 is a maximum consumer price inflation of 30 percent. This would be a definite improvement over the 73 percent upsurge in prices between December 1997 and December 1998. Apart from maintaining relative balance between aggregate supply and demand through fiscal policies, it would also necessitate keeping money supply in check. There are many factors feeding into the Russian money supply equation, and printing money to finance part of the budget deficit is only one element in the overall picture. In an economy that is striving to eliminate barter by restructuring its

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A New Military Buildup?

Richard F. Kaufman

For the first time since before the end of the Cold War, the U.S. defense budget has been substantially increased.

Congress passed its regular defense appropriations bill at the end of September but last minute gyrations in an omnibus spending bill later resulted in an \$8.3 billion boost for defense. The boost brings the total defense budget for Fiscal Year (FY) 1999 to \$278.8 billion. Adjusted for inflation, this represents an 0.8 percent increase over last year's defense budget.

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"The Pentagon's goal is to increase the procurement portion of the budget from about \$48 billion to \$60 billion . . . Historically, such rapid growth in arms purchases have occurred in periods immediately preceding an overall military buildup or during the early part of a buildup."

Richard Kaufman
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Russia Teetering at the Brink

Michael D. Intriligator

Despite what some policy makers and opinion leaders say, the future of Russia poses a far greater threat to global security than other concerns such as nuclear proliferation, regional conflicts and terrorism.

The dangers stemming from Russia are amplified by its precarious economic situation. As a result of the desperate moves taken by the Russian government on August 17, 1998 that included devaluation of the ruble, default on foreign debt, and freezing of bank accounts, the situation has gone from one of crisis to one of catastrophe.

The subsequent replacement of Prime Minister Sergei Kiriyenko by Yevgeny Primakov possibly signals the beginning of a new set of policies that will reverse the economic collapse. Such a reversal will be very difficult, but the new economic team deserves support from the West as Primakov's government may represent Russia's last chance of democracy.

Russia is now in a catastrophic economic and political situation that poses long-term dangers to it and the world at large. The economy continues its decline, with general overall losses in production much greater than those experienced in the United States during the Great Depression of the 1930s. The country has also suffered an inflation that has wiped out the middle class and that now takes a repressed form as enormous arrears in wages and payments by firms to suppliers. The economy is also riddled with crime. As a result of the failure to introduce market institutions, such as property rights, commercial and investment banks, and other institutions, the transition has been not to a market economy but rather to a criminalized economy, with mafias controlling huge economic sectors.

No one can precisely predict Russia's future, but there are scenarios that could dramatically alter its relations with the rest of the world. One such scenario would be the advent of a new authoritarian regime, in effect, a contemporary version of Joseph Stalin. This could come about through the democratic election of an extremist president who would take advantage of the 1993 Constitution that grants sweeping powers to

its highest elected public official. Another scenario could be through a putsch, like that of August 1991, or a coup that would repeat earlier Russian history. The result would be, as happened in Russia in 1917 and more recently in Iran in 1979, a brief period of democracy between two authoritarian regimes.

Another scenario would be the continued collapse of legal authority, leading to chaos and anarchy with criminal gangs taking over whole regions of the country. There are other scenarios, but few if any bode well for global security. Virtually all involve potential dangers in Europe, Asia and other regions of the world. Several involve possibly another Cold War. Indeed, the present situation is remarkably like the situation between World War I and World War II. Now may be a comparable lull between Cold War I and Cold War II. The use of weapons of mass destruction by intent or by accident could be yet another scenario.

Winston Churchill, in his book, *While England Slept*, published in 1938, criticized Britain for ignoring the threat from Nazi Germany that erupted in war the next year. There are striking similarities between Russia today and the Weimar Republic that preceded Hitler's coming to power in 1933: loss of empire and status, depression, hyperinflation and destruction of the middle class. The question has often been raised as to how the German people, a highly civilized and educated people, could have democratically installed Hitler with a clear plan for war and genocide. Of the various answers that have been proposed, perhaps the best is the simplest: desperate people will do desperate things. The same could happen in Russia, with comparably disastrous consequences. While England was "sleeping" in the 1930s, America may similarly be "sleeping" today.

Michael D. Intriligator, an ECAAR vice chairman, is a professor of economics, political science and policy studies at UCLA.

Primakov Reforms *(Continued from page 1)*

barter by restructuring its banking system, the process of remonetization would lead to a steep rise in money supply that would not necessarily be inflationary but would in fact help increase tax revenues.

Another important factor is the issue of government indebtedness. The pyramid of short-term treasury bills has ceased to be a decisive factor in the budget picture after the August, 1998 default. But the much larger sovereign debt of the former Soviet Union remains a problem as well as the new debt to the IMF that appeared in recent years. These have become major destabilizing factors. In the current situation, Russia is

not in a position to honor all these debts that have to be rescheduled. Because the IMF is partly responsible for the misguided policies of the previous Russian cabinets, it should take a more realistic attitude toward these matters. Admitting past errors would not be pleasant, but it would be better than continuing to err.

On the whole, the chances that the Primakov reforms will work are fairly high. But more understanding is needed from the international community. Supporting the present Russian Government today means insuring against the risk of dictatorship and militarization if its efforts fail. Such dangers are real.

ECAAR and the Russian Economy

Planning Meetings in Waltham

Urgent needs of the Russian economy identified during a late October meeting with leaders of ECAAR-Russia include:

- emergency food and fuel aid, especially in northern regions;
- measures to move toward a monetary, taxable basis;
- action to deal with Russia's external debt;
- reform of the military-industrial complex;
- reform of the legal system to foster competition;
- re-establishment of agriculture.

The ECAAR planning meetings were possible because leading officers of ECAAR-Russia and ECAAR-U.S. — Oleg Bogomolov, Alexander Nekipelov, Stanislav Menshikov and Michael Intriligator — were in Waltham, Massachusetts, for a Gorbachev Foundation conference.

Kennedy School of Government Hosts Lecture

On October 26, the John F. Kennedy School of Government hosted a seminar entitled, "The Economic and Political Crisis in Russia: Implications for Global Security." Richard Parker of the Kennedy School and ECAAR-U.S. organized the event, which was chaired by ECAAR friend and Board member Professor John Kenneth Galbraith.

Stanislav Menshikov, Co-Chair of ECAAR-Russia, was the principal speaker. His analysis (see article on page one) was followed by a second incisive commentary on the situation in Russia by Marshall Goldman of Wellesley College and the Davis Center for Russian Studies at Harvard.

Over 30 experts, writers and scholars concerned with international policy issues participated in the seminar. The event would not have been the same without Prof. Galbraith, who at age 90 remains as clear-headed and pithy as ever.

ECAAR-Russia, ECAAR-U.S. Visit World Bank

On October 27, ECAAR helped to organize a seminar on Russia at the World Bank, hosted by chief economist Joseph Stiglitz. Academician Oleg Bogomolov and Prof. Stanislav Menshikov from ECAAR-Russia participated, while Kenneth J. Arrow and Michael Intriligator spoke for ECAAR-U.S. United States Deputy Treasury Secretary Lawrence Summers also spoke during the event as did Joseph Stiglitz, who also chaired the seminar. World Bank and the International Monetary Fund staff attended and contributed to a lively discussion.

Nekipelov and Menshikov at Reception Seminar

Patti and Jeffrey Kenner hosted a seminar at their home in Park Avenue, New York, for some 45 opinion leaders and bankers (see photographs). Stanislav Menshikov and Alexander

One of the benefits of the end of the Cold War has been a sharp decline in the value of the international arms trade. But with the removal of Cold War competition as a driving force behind arms sales, economic rationales have assumed greater importance.

The Clinton Administration in 1995 issued a Presidential Directive (PDD-34), stating that maintenance of the domestic defense industrial base was an objective of arms exports. In addition, the Administration instructed the Commerce and State Departments to assist the Pentagon and private firms in these efforts. This was the most explicit statement by any U.S. administration of the economic importance of arms sales. According to Arms Control and Disarmament Agency reports, the global arms trade dropped from a peak of \$82.4 billion in 1987 (in constant, 1995 U.S. dollars) to \$26.7 billion in 1994, before rising in 1995 to \$31.9 billion, fuelled by post-Gulf War arms purchases.

Economic Gains Appear to be Overstated

Arguments positing substantial economic gains from arms sales focused on macroeconomic benefits in terms of positive balance-of-payments effects and domestic job and income creation, and microeconomic benefits in terms of expanding markets and allowing firms to achieve more efficient levels of production. In both cases, however, the net gains appear to be overstated, largely because the economic costs and benefits of the arms trade tend to flow to different sets of decision makers.

The positive macroeconomic effects of arms sales have been undermined by the growth of offsets. The United States exports far more military goods and services than it imports — \$15.6 billion as opposed to \$1 billion in 1995. Over the last several decades, and especially in the 1990s as massive excess supply has turned the arms trade into a buyer's market, purchasing nations have increasingly demanded substantial offsets as a condition for undertaking an arms purchase.

Offsets are of two types: direct offsets require the selling firm to

A New Military Buildup? *(Continued from page 1)*

Until this year, the Clinton Administration regularly proposed and achieved modest annual cuts in defense. Congress at first dutifully complied with the budget proposals, but some legislators later complained that the reductions had gone too far.

In 1994 Clinton seemed to bow to the criticism by saying in his State of the Union address that "We must not cut defense further." The next year, Congress began a pattern of appropriating substantially more for defense than proposed by the Administration. Thus, Congress added a total of \$20 billion for military spending above the President's requests in fiscal years 1996, 1997, and 1998. The add-ons were not sufficient to arrest the downward trend and the budget continued to decline in real terms.

The balanced budget agreement negotiated in 1997 temporarily constrained congressional demands for greater military spending and a mere \$2.7 billion was added to the President's request for the next fiscal year.

However, a dangerous precedent was set when the Administration increased its own proposal that year with a supplemental request to cover the costs of the U.S. presence in Bosnia and the build-up in the Persian Gulf. To get out from under the cap on spending established by the balanced budget agreement, the supplemental request was designated an "emergency." This set a dangerous precedent.

The budget increase achieved for the current year (FY 1999) was the result of decisions at both ends of Pennsylvania Avenue to enlarge the emergency loophole. When the regular defense appropriations bill was enacted, the Administration let it be known that it would make a supplemental request to improve combat readiness, among other things. This included \$1 billion dollars for readiness, another \$1 billion for the Pentagon's year 2000 computer problem, and nearly \$2 billion for military operations in Bosnia. In final negotiations, the Administration's supplemental was nearly doubled.

At the insistence of the congressional leaders another billion dollars was thrown into the mix for the anti-missile program, despite protests from the Pentagon that the extra money was not needed. Additional large sums were added for such things as intelligence, anti-terrorism, and drug interdiction. Again, because the supplemental sent the defense bill through the balanced budget cap, it was designated an emergency.

Readiness Squabble in Budget Debate Signals Increase

Of all the political maneuvering over defense this year, the most revealing episode concerns the squabble over combat readiness. This is usually defined as the quality of troops, their training, and the condition of their weapons and equipment. Allegations of readiness problems have been made before, sometimes employed as a scare tactic to induce larger budgets. Charges, which turned out to be inaccurate, that the Army was unready were made in 1994. Not much was heard of the subject for the next several years.

"To get out from under the cap on spending established by the balanced budget agreement, the supplemental request was designated an 'emergency.' This set a dangerous precedent."

But in August of this year Senate Majority Leader Trent Lott directed the Senate Armed Services Committee to conduct a hearing on reports of readiness problems. It was reported that Sen. Lott's action was intended to build a Republican consensus to tap the budget surplus for defense. The Senate Armed Services Committee held the hearing on September 29. There the Joint Chiefs of Staff complained that readiness was declining and that an extra \$20 billion for FY 2000 was needed to reverse the trend. The Chiefs said that similar increases needed to be made in future budgets.

Some of the senators seemed taken aback and criticized the Chiefs for not speaking out sooner. Significantly they did not take issue with the substance of the complaints. There can be little doubt that there will be a strong push from the Pentagon for a substantial increase in the readiness accounts in next year's defense budget.

There are other signs that arms spending will continue to rise. One is the recent hike in the procurement budget. For several years, the Pentagon has been urging an increase in spending for weapons and this year's budget provided for a real increase of seven percent over last year. That was the first time the Administration requested an increase in procurement since the end of the Cold War. Procurement had increased by three percent last year due to congressional add-ons.

Pentagon to increase procurement by \$12 billion

The Pentagon's goal is to increase the procurement portion of the budget from about \$48 billion to \$60 billion. That goal may be reached in a few years. Historically, such rapid growth in arms purchases have occurred in periods immediately preceding an overall military buildup or during the early part of a buildup.

Another indication of the impending buildup lies in the debate over what is termed the plans/funding mismatch. Those who favor larger budgets argue the military has been asked to carry out greater responsibilities—with respect to contingency planning for future wars and operations around the globe—with smaller budgets. If present trends continue, it is maintained, a financial crisis will ensue. Others respond that the Pentagon's plans are affordable if the arms modernization program is scaled down, if forces are restructured, and if savings are realized from additional base closings and reductions in the reserves.

Those are big "ifs," and one may reasonably be very skeptical as to whether any will materialize. Eventually, it will have to be decided whether to narrow the objectives, seek to achieve them in more cost effective ways, or request more funds. It has been apparent to some that, sooner or later, the solution of the budgetary problem will be perceived by top officials as a need for larger budgets.

Richard F. Kaufman, former General Counsel, Joint Economic Committee, U.S. Congress, is Director, Bethesda Research Institute.

Remembrance of Robert Eisner

Robert Eisner, ECAAR Board member, professor of economics, and former president of the American Economic Association, died on November 25, 1998.

A much respected scholar, Eisner was the William R. Kenan Emeritus Professor of Economics at Northwestern University where he joined the faculty in 1952 having previously taught at the University of Illinois at Champagne-Urbana.

Robert Eisner

From the outset, Eisner was one of ECAAR's most loyal and supportive trustees, early on advising founding trustee Robert Schwartz to recruit Nobel Laureates onto the organization's Board of Directors. He generously supported ECAAR and faithfully participated in its Board meetings. It was his firm belief that monies freed up from military spending could be used to expand educational services as well as university and corporate research and infrastructure improvement projects.

Graduating from City College in 1940, he earned a masters degree in sociology from Columbia in 1942. After serving in the United States Army until August, 1946, Robert Eisner completed his doctoral degree in economics at Johns Hopkins University in 1951. He was a fellow of the American Academy of Arts and Sciences and of the Econometric Society, and was the 15th recipient of the John R. Commons Award of Omicron Delta Epsilon, the international honor society in economics.

An innovative thinker, Eisner contributed actively to the professional discussion on public economic policy. On issues

relating to employment, he was a leader in the debate on the question of whether there is a rate of unemployment below which inflation would accelerate so quickly that it would lead to hyperinflation. Most recently he was very pleased that actual unemployment was well below the posited danger level, while at the same time there was very little inflation. A central belief was that increasing aggregate demand by a range of means is the key to economic growth and full employment.

In an "Eisnerfest" paper from September 1993, James Tobin listed a number of ideas on which he and Robert Eisner agreed. He included the comment that, "It exasperates both me and Bob to hear again and again from financial wizards, talking heads, editorial writers, politicians, and some economists that although the economy may need stimulus, it can't be fiscal because deficits and debt are already so large and it can't be monetary because that would be inflationary. It exasperates us to read and hear that although spontaneous private demand stimulus would be safe and welcome, public stimulative policy would be inflation-unsafe and most unwelcome."

A frequent contributor on economic issues to the *Wall Street Journal*, *The New York Times*, *Chicago Tribune* and *Los Angeles Times*, Robert Eisner also published a number of books. His latest is a 20th Century Fund Report, "Social Security: More, Not Less." Other publications include: "The Misunderstood Economy: What Counts and How to Count It"; "The Great Deficit Scare: The Federal Budget, Trade and Social Security"; "Factors in Business Investment"; "How Real Is The Federal Deficit?"; and "The Total Incomes System of Accounts."

Robert Eisner, a man of great vision, was a proponent of government spending to achieve full employment, but opposed massive expenditures to finance the defense industry.

Reporting From South Africa

South Africa's \$5 billion decision to build warships, fighter aircraft and helicopters and to create 65,000 defense-related jobs is drawing increasing fire from a broad-based coalition of research and activist groups opposed to what it says is unnecessary military spending.

Terry Crawford-Browne, chairman of ECAAR-South Africa, reports that Archbishop Ndungane has taken the debate to the nation's airwaves and print media to convince policymakers and the public that the money could be more wisely spent feeding the country's poor. He notes that Patricia de Lille of the Pan Africanist Congress, Vanan Pillay, the director of the Industrial Participation Program at the Department of Trade and Industry and others, have joined Ndungane in the debate against what they call the misuse of public funds. Parliament is currently in recess, but leaders of the various social organizations plan to continue the debate when it reconvenes in late January.

In the meantime, some of these leaders plan to spend the next several weeks enlisting support for their position from the local business community. Crawford-Browne recently said he was involved in the production of a television documentary that highlighted "the contradictions of spending R29 billion [the

equivalent to \$5 billion in U.S. currency] on weapons with the crises of poverty in South Africa." He and others involved in the television production hope it will develop into a series relating to human security issues, including the proliferation of small arms and light weapons and domestic violence. "Yesterday," he said, "I was in Johannesburg to make a submission to a workshop organized by the National Union of Metalworkers (NUMSA) on the weapons procurement program and the lure of R110 billion in offsets and 65,000 jobs. I am hopeful that NUMSA's central committee will come out with us in opposing the deal. They also 'smell a rat' about all the promises of jobs."

He hopes members of the Association of West European Parliamentarians for Africa will help mobilize "European opinion" against the Government's \$5 billion defense and jobs creation plan. The Church of Sweden, he said, has threatened to sell its shareholdings in any Swedish company that supports or participates in the defense program. He also said, Saab, the Swedish auto and aircraft maker, has conceded that none of its "R48.3 billion in offsets for 23,195 jobs is in place. I am hoping that this will prove to be very far from a 'done deal,' and that the government ends up with considerable egg on its face."

ECAAR at the 1999 AEA/ASSA Meetings

ECAAR and ECAAR leaders are scheduled to play an active role in the January 1999 Meetings of the American Economic Association and the Allied Social Science Association. Among the panels at which ECAAR members and supporters will speak are the following:

A panel on "Economic Inequality, Militarization and Democracy" will have the following papers: Lloyd J. Dumas on "Economic Inequality and Democracy: The Cross-Connections"; James K. Galbraith on "Militarization and Inequality Around the World: An Empirical Analysis"; Aedil Suarez on "The Economic and Social Implications of the Armed Forces in Chile"; and Alexei Izyumov on "The Economic and Social Implication of Defense Industry Transformation in Russia"; (on behalf of himself and Leonid Kosals and Rosalyn Ryvkina.) Dietrich Fischer and John Tepper Marlin are the discussants for this panel, which was organized by Lloyd J. Dumas.

"Investment and Structural Consequences of Military Spending" is the title of a panel organized by Ann Markusen to be chaired by Lawrence Klein with the following papers: Michael Oden on "Defense Burdens and Economic Performance: Is there a Growth Premium from Defense Reductions?"; David Saal on "A Reassessment of the Impact of Defense R & D and Procurement on Manufacturing Productivity Growth"; and Ken Flamm on "From Endgame to N-Game: Scale Economies vs. Competition in the Military Aircraft Industry." Discussants are Robert Coen, Frank Lichtenberg and Ann Markusen.

"Kindleberger's Challenge: International Public Goods" is the title of a panel organized and chaired by Jurgen Brauer with papers by John Garrett on "Disarmament as an International Public Good"; David Gold on "Does Military R&D Generate Public Goods?"; Ruben Mendez on "Peace and War as International Public Goods and Bads"; and Todd Sandler on "Global and Regional Public Goods: a Prognosis for Collective Action." Discussants are Martin McGuire and Jurgen Brauer.

In addition, ECAAR Vice Chair, Ann Markusen will present a paper on "American, European and Russian Post-Cold War Downsizing" in a session on conversion. Greg Bischak will

**ECAAR Annual Meeting in Hilton Room 520
4:45 to 5:45 Monday afternoon, January 4th**

A Remembrance of Robert Eisner

**6:00 p.m. Monday, January 4th
in Hilton Room 520**

brief statements will be made by:

James K. Galbraith

Richard Leone

Lawrence R. Klein

Kenneth J. Arrow

James Tobin

Rebecca M. Blank

Alan B. Krueger

Robert J. Schwartz

Mary Eisner Eccles

speak in the same session on U.S. defense conversion programs. Also, Manas Chatterji, Dietrich Fischer and Akira Hattori are members of a panel on "Coping with Ethnic Conflict: The Potential of Peace Economics."

A panel on the natural rate of unemployment or the nonaccelerating inflation rate of unemployment (NAIRU) had been organized with the active leadership of Robert Eisner. This panel, entitled, "The 'Natural Rate' and the NAIRU After Four Years of Low Inflation," is being chaired by James Tobin. One of the papers is being presented by ECAAR Treasurer, John Tepper Marlin and by Robert Coen of Northwestern, on "The NAIRU and Wages in Local Labor Markets." Discussants include James K. Galbraith as well as James Tobin.

Call for Papers for Boston 2000 AEA

February 1, 1999 is the deadline for proposals for panels and papers for the AEA segments of the next AEA/ASSA conference. For details, please look at the AEA website: www.vanderbilt.edu/AEA. For advice on the topic categories that are most likely to be accepted, you may wish to write Jurgen Brauer at <jbrauer@aug.edu>.

All proposals will be grouped by the bibliographic code of the NEW Journal of Economic Literature. At least one author of each paper must be an AEA member. The Association discourages multiple proposals from the same person, and one is not to submit a completed paper.

ECAAR-Israel to Establish Website

ECAAR-Israel is in the process of establishing a website dedicated to the study of the economics of military spending in the Middle East, conversion issues, and the political economy of defense issues. It will include a bibliography of relevant literature, links to relevant databases, links to research centers in Israel, lists of courses offered on the topic in Israel and a list of important events.

ECAAR's Global Website

The Global Website is still a work in progress, but there are plans to get it off the ground in the coming months.

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