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Does Military Spending Matter for Long-Run Growth?

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The primary role of the state is widely regarded to be the “protection of its citizens” either from themselves (internal order) or military defence (external aggression).

History suggests and contemporary events affirm that the “better angels of our nature,” are too often subverted by the demons lurking inside. Nonetheless, for a moment in 1989, after the fall of the Berlin Wall, it seemed that war and conflict might be banished from the heartlands of Europe for good. Very obviously, such hopes were misplaced and in Churchill’s portentous words, “an Iron Curtain is, (once again), descending across the continent.”

In our world, that translates to a larger proportion of GDP being devoted to military rather than civil expenditure as the “new world order” gives way to the very much older world order of perennial conflict.

Away from the human tragedy and cost in blood and treasure, the question is whether such increases in military spending are good for the economy and investment in the longer run.

Despite its roots in the US “military-industrial complex” of the Eisenhower era, the RAND Corporation notes that the “large number of studies on the relationship between defense (sic) spending and economic growth have not provided agreement on whether the impact is positive, negative or near-zero” although they go on to note that “the best available evidence suggests that defense spending promotes growth, even if there are disagreements about how much.”

By contrast a paper by d’Agostino, Dunne and Pieroni of the universities of Rome, Cape Town, and Perugia (2017) presented evidence that increased military spending leads to “slower economic growth”: over a 20-year period they estimate that a 1% increase in military spending will decrease a country’s growth rate by 9%.

Interestingly this large negative economic impact was found to be much stronger in the rich world club of the OECD nations than in the typically (but not exclusively) poorer non-OECD nations in the rest of the world. Ironically, in these nations defence spending is often significantly higher than the OECD average: Lebanon, Saudi Arabia, Algeria, and South Sudan all spend between 6% and 9% of their respective GDP on the military.

At the height of the Cold War, developed world military expenditures were considerably higher than today.

In 1960, the US devoted 9% of its GDP to “defense” spending. In 2010 it was still a relatively high 4.9%, whereas today it is 3.5%. Much reduced but between 2 and 3 times more than the average EU member spend. Within Europe, only the UK and Poland meet their internationally agreed obligation of devoting 2% of GDP to the military whilst in Asia, Japan spends just 1% of annual production on its defence.

As geo-political risks, both East and West are rising sharply, it seems inevitable that military expenditure will rise across the world: Japan has recently amended its constitutional barrier to military spending and Germany recently announced that spending on defence could rise to 3.5% of GDP, double the current level, in the near-term.

Nonetheless, that is still a far cry from the 6% of GDP that Russia is spending and the staggering 37% of GDP that Ukraine is devoting to its defence from the Russian invasion.

As the academic literature makes clear, the consequences of raising military spending are unclear, but we think there will be two.

Firstly, rising expenditures will put public sector budgets under further strain and/or prevent the normalisation of government debt levels that are already pregnant with the consequences of Quantitative Easing.

Secondly, though military spending tends to support technical innovation in the short-term (after all, the iPhone and internet are the fruits of military research conducted in the 1970s), it will divert resources from the civilian domain, damaging longer-term productivity and infrastructure renewal. In effect, one key consequence of Vladimir Putin's attempt to reincarnate the ghosts of Ivan the Terrible, Catherine and Peter the Great is to lower living standards for us all unless our government can increase per capita (per person) growth meaningfully over the coming decade.

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