POGO PROJECT ON GOVERNMENT OVERSIGHT

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CATO Study: Reshaping the Pentagon Budget Won't Negatively Impact on the Economy

A recent study by Benjamin Zycher from the libertarian think tank the CATO Institute reaffirms what we've been saying all along: Cutting Pentagon spending will *not* cause the economic nightmare or job loss catastrophe the defense industry wants us to fear.

In addition to CATO, other right-leaning analysts, advocates, and politicians have also been vocally challenging the narrative that defense spending must not be decreased. Grover Norquist, president of Americans for Tax Reform, recently pledged to fight any efforts to divert tax reform revenues toward an increase in Pentagon spending or avoiding across-the-board budget cuts, known as sequestration. Rep. Roscoe Bartlett (R-Md.), a senior Republican on the House Armed Services Committee, has called for a national dialogue on sequestration, recognizing that “the average American out there, by big percentages, wants to cut defense by twice the sequester amount.”

This debate isn’t about which side of the aisle you are on—we can all recognize that national security is rooted in economic security. And in fact, Zycher finds that a reduction in defense outlays could actually result in significant economic gains down the road.

According to Zycher, the long-term international threat environment has shifted and the perceived value of defense services has declined along with it. He argues that slashing the Pentagon budget to better reflect this waning threat level will not impact employment levels in the long run. This is because “the defense sector is too small a part of the economy for changes in defense spending to have large aggregate effects on GDP.”

What’s more, Zycher explains that redirecting resources (such as labor and capital) to more productive uses can yield long-term benefits for the economy as a whole:

The process of allowing market forces to redirect resource use increases aggregate output and wealth, thus making virtually all individuals better off over time on net. The movement of resources from less to more profitable sectors increases the aggregate productivity of the economy.

Zycher also demonstrates the gaping holes in a study funded by the Aerospace Industries Association (an industry group of top defense companies that also funds the “Second To None” influence-peddling campaign). The association's flawed study predicts that a reduction in procurement spending of $45 billion in 2013 would yield a loss of over one million jobs. In addition to identifying problems with study author Stephen S. Fuller’s methodology, Zycher states:

At a general level, the Fuller study fails to distinguish between economic costs—the consumption of valuable resources, including labor—and the dynamics of resource allocation shifts as a response to changes in relative prices… The use of labor (or any other resource) is a cost of economic activity, and the release of labor for more productive uses is a benefit for the economy as a whole.

Fuller starts out with incorrect guiding principles and consequently draws the wrong conclusion.

Furthermore, Zycher compares Fuller’s study with recent scholarly analysis on defense outlays and the economy. Most of the literature reported a GDP multiplier from changes in defense spending of approximately 0.6 to 0.8—in stark contrast with Fuller’s estimate of 1.92. The fact that most estimates of the multiplier effect are less than 1.0 strongly suggests that increases in defense spending “have effects on GDP that are offset by reductions in other economic activity.” Thus, it appears that Fuller is overblowing the impact of defense spending on GDP by almost twice as much as other estimates. The table in Zycher’s analysis (reproduced below) provides a visual representation demonstrating just how out of sync Fuller’s study is:

Table 2: **Estimated Multiplier Effects**

Author	Estimate	Notes
Fuller	1.92	defense procurement
Cogan et al.	0.65	large stimulus
Mountford and Uhlig	0.65	spending “shock”
Barro and Redlick	0.6–0.9	increases in defense spending
Ramey (2011)	0.6–0.8	defense spending after WW2
Hall	0.7–1.0	all government purchases
Parlow	0	defense spending
Ramey (2012)	0.5	all government spending

Other recent analysis has also cast doubt on the purported economic effects of increased defense spending. In a Project On Government Oversight special report, “Defense Contractor Time Machine: Less Spending, More Jobs, Analysis Reveals,” national security investigator Ben Freeman found that between 2006 and 2011 the top five defense contractors, collectively, were cutting jobs while being awarded more taxpayer dollars. Total employment at companies like Lockheed Martin and Boeing declined as they raked in more and more federal contract dollars over the five-year period.

All of this just goes to show that shelling out more money for the Pentagon budget does not necessarily mean more jobs. Don’t believe the hoopla. For more information, see this detailed POGO briefing paper.

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