POLICYMIC

Military Spending Cuts Mean More Money for Other Programs

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Yesterday, Cato released a new video pointing out that the military spending cuts specified under the 2011 Budget Control Act's sequestration provision are not large relative to total spending, and would still have the U.S. government spending nearly $5.2 trillion on the Pentagon's base budget over the next ten years. Under sequestration, the average annual total, $472 billion in constant, 2012 dollars, is well above the level spent during the 1990s (average $422 billion), and comparable even to what the U.S. spent during much of the Cold War. The video (building on my and Ben Friedman's earlier writing, especially here) spells out the strategic rationale for even deeper cuts.

In a new paper released today, economist Benjamin Zycher outlines some of the economic rationales for such cuts. He shows that cuts on the order of $100 billion per year over ten years can be reasonably expected to reduce economic costs by $135 billion — provided that the funds are redirected to the private sector and not simply plowed into other government spending. Zycher concedes that the demand for U.S. military spending has declined, and its value (measured in what we actually spend) should also decline. At a minimum, he concludes, "These potential savings in real resources are sufficiently large to justify a detailed analysis of U.S. national security needs and the outlays required to defend them."

Zycher's findings should help to set the record straight on some of the more outrageous statements pertaining to sequestration, particularly the claims of massive job losses and economic devastation. The study that has attracted the most attention, by George Mason University Professor Stephen Fuller, alleged that a reduction of just $45 billion in procurement spending would result in a decline of about $86.5 billion in GDP in 2013, and the loss of over one million full-time equivalent jobs (1,006,315, to be precise). Fuller updated his findings last month and now concludes that the automatic cuts under sequestration, both defense and non-defense, will reduce the nation's GDP by $215 billion, and cost 2.14 million jobs.

There are at least two major problems with Fuller's research (and others like it), one methodological, the other conceptual. Zycher scrutinizes them both.

The primary methodological flaw is Fuller's grossly inflated assumptions about the multiplier effects of defense spending, in particular, and government spending generally. The supposed economic effects above imply a multiplier of 1.92%, whereas the recent peer-reviewed economics literature shows multipliers of between 0.6% and 0.8%. Zycher observes: a multiplier effect of less than 1% "suggests strongly that increases in defense spending (and government spending more generally) have effects on GDP that are offset by reductions in other economic activity."

The conceptual problem of proclaiming that defense spending is good for the economy, and cuts are bad, flows logically from the different assumptions about the multiplier. Fuller and others focus narrowly on the particular industries affected by cuts. But these cuts should free up resources elsewhere. To be sure, there are likely to be temporary dislocations for some workers and businesses. These will be difficult for the individuals and firms affected, but the economy as a whole will benefit as skills and resources are redirected to more productive activities.

These conclusions shouldn't really surprise, and they should be common sense for Republicans who are generally skeptical of Keynesian arguments for using government spending to stimulate the economy. After all, every dollar spent by the government — federal, state or local — is extracted from the private sector. Advocates for higher taxes and more government spending claim that individuals in Congress, state capitols and city halls are wise enough to know where these resources should be spent. Conservatives and libertarians point out that this attempt to pick winners and losers will fail more often than it succeeds, and the net result is a less productive economy. The principle applies equally when the money is spent by government agency A (e.g. the Department of Agriculture) vs. government agency B (e.g. the Department of Defense).

In fact, it costs more than a dollar to send a dollar to the government because of the excess burden of taxation, a process documented by a number of economists, including Harvard's Martin Feldstein. The tax system imposes costs on the economy by discouraging economic activity, including both work and investment, that would otherwise occur in the absence of those taxes. Feldstein finds that higher marginal tax rates generate an excess burden on the economy of $0.76 for every additional dollar of revenue. Because "the taxes needed to fund existing spending impose an excess burden smaller than the taxes needed to fund increased spending," Zycher conservatively estimates an excess burden of 35 percent for current military expenditures. Accordingly, he concludes, "a reduction in annual defense outlays of $100 billion can be predicted with high confidence to increase the size of the private sector by at least $135 billion per year."

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