
DEFENCE SPENDING IN STAGNATING ECONOMIES

Victor Halberstadt

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INTRODUCTION

It is a privilege for a largely academic professor of economics from a small northern country to be invited — notwithstanding my lack of experience in defence issues — to speak here. And particularly to do so before this distinguished audience which represents an important group of Portuguese democracy.

Frank as I can be with this expert group, I hasten to add that defence is not a very popular field of study among fellow economists outside the United States. Actually, I have not been able to find even one in-depth article published on this subject in the past decades by economists in my own country. This may very well change in the near future. Not because of academic considerations but because foreign policy and defence policy are becoming more intertwined with economics than has ever been the case before.

Soon, economists interested in actual economic policy and its constraints will have to conclude that foreign policy in the traditional sense, like defence policy, is increasingly irrelevant in discussing nations' relations with each other. The rights and wrongs of the debate, of which there must be plenty on both sides, are less important than the sort of world they reflect. That world is that foreign policy, defence policy and international economic policy are now equally important components of security policy. E. g., the traditional ideological and strategic orientation of foreign policy has already given way before economic interests. In recent years, farmers in the United States desperately want to increase trade with the Soviets. European farmers say the same. And, international banks, multinational companies and global traders now effectively create their own foreign policies. All this in turn will have an, as yet immeasurable, impact on defence policies and defence

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budgets. Economists will surely be intrigued by that, at least that is what I would hope for the quality of the debates on security policies in democratic nations.

Mr. Chairman, let me indicate briefly which three questions I plan to discuss here.

First, some general remarks about the interrelationship of economics and national security. Second, I'll discuss the Three Per Cent Solution and burden-sharing. Third and last, I'll address some aspects of the consequences of the present recession for defence.

ECONOMICS AND NATIONAL SECURITY

In almost any debate about foreign and defence policies, there is one element upon which protagonists can usually agree: that economic considerations play a major rôle in shaping the substance of those policies. However, it is worthwhile to point out that some of the currently popular views about the interconnections between economics and national security are either misleading or wrong.

An example: military strength — measured in physical outputs — does not depend, to any significant degree, on the rate of growth in our economies, at least within the range of variations which is likely to occur in the foreseeable future. Conversely, the level and the rate of growth of national income and employment are in no fundamental way dependent on the maintenance of heavy military spending.

It seems to me that the national security of democracies far more than ever before in history depends upon the way in which we conduct our economic relationships with other nations. In turn, the state of our domestic economics strongly influences how those relationships are handled. And it is through this chain of influence that economic and security policies are strongly linked.

Does the national security of democracies depend on maintaining a healthy rate of growth in our economy — is it solely dependent on our economic strength? Surprisingly, perhaps, my answer to that question is negative.

Obviously, it would be impossible for industrialized democracies to keep our military strength if we had the GNP of developing countries. But within the range of likely possibilities for economic development over the next ten

years, our economic strength will not really make much difference in our capability to sustain the military spending which is now foreseen, unless we put far more emphasis on non-nuclear defence spending.

At the present time, the United States spends almost 6 per cent of its gross national product on defence while collectively the NATO allies average about 3.5 per cent and Japan only 1 per cent. In the Soviet Union the build-up of military power takes a heavier toll of the stagnating economy. Figures published by the American Defense Intelligence Agency suggest that defence is now eating up 14-16 per cent of Soviet GNP, up from 12-14 per cent in the 1970s.

The faster GNP grows, the smaller will be the fraction of it consumed by a given defence budget. In a slowly growing economy a larger proportion of our national income would have to be taken in taxes, or other government revenues or be financed through a higher budget deficit to support the defence budget. And this is certainly so in a stagnating economy. But these differences are surely not critical. At present we can clearly afford the appropriate defence burden at lower levels of GNP growth than experienced in the 1960s or 1970s.

However, of course securing national economic prosperity and a return to healthy growth are exceedingly important objectives in their own right. A return to economic growth ought to be pursued for many reasons, but also because prosperity is a direct determinant of our political and financial ability to support defence budgets.

But, also in a more subtle way, there are connections between economic strength and national security. Rapid technological advance, a sizeable population of research-oriented scientists and engineers, and large numbers of technologically advanced business firms help to generate rapid economic growth and at the same time provide the research capability essential for defence in the modern world. But it is the research and technology rather than the economic growth itself which contributes to military capability.

Our economies do not need a large defence budget in order to promote and maintain prosperity. In the post-1945 decades, full employment and prosperity have not depended upon large budget outlays for defence. Nor will this be the case in the future. There is no law of nature or economics which says that men and women producing arms must produce those arms and nothing else. Of course, if defence procurement is reduced, the demand for other goods and services — public and private — must be correspondingly

increased to provide civilian employment for those formerly producing weapons.

People are employed only if there is a market for the goods and services they produce. But we have — under normal, lowinflation circumstances — at our disposal monetary and fiscal instruments which can stimulate demand for nondefence goods, thereby increasing the demand for labour in an amount sufficient to absorb those laid off in defence establishments. Necessarily there would be transition problems. But, cutbacks in defence procurements or low growth of defence spending are no excuse for an overall increase in unemployment.

We can have a decent degree of employment — once the world economy gets back on a track of sustained moderate economic growth — with any size defence budget. Making and buying weapons is not essential to the potential prosperity of market-economies. The size of the defence budget can and should be determined on the basis of defence needs, not as a job-supporting program for putting people to work or keeping companies alive. How rapidly we change the defence budgets, up or down, does, of course, affect the character of the problem in devising adequate economic policies. But in the final analysis, we should see the problem precisely as an economic policy problem which requires advance planning and not as a rationalisation for proposing excessively large defence budgets.

Leaving aside in this lecture the very important problem of the dependency on the steady supply of a number of vital raw materials, which is of a different nature and size for the US as compared to most other democracies, I would for a moment want to focus on the relevance of defence policy for the conduct of our economic relationships with other nations. Particularly the economic relationships between Western Europe, the United States, Canada and Japan seem to me an essential element of any national security policy. Now, of course, the concept of national security does not lend itself to neat and precise formulation, certainly not by an economist. It deals, as I understand it, with a wide variety of risks about whose probabilities we have little knowledge and of contingencies whose nature we can only dimly perceive. Yet, in dealing with the question of how domestic and international economic relationships affect national security, it is impossible to avoid at least some discussion of what we mean by the term itself.

Clearly, to many people at least, national security does not consist simply in providing the military forces needed to deter or to defeat a direct threat to the territorial integrity of their own country only and to preserve it against physical domination by another power. A calculation of the armed forces directly needed to meet this objective would reveal the possibility of slashing the defence budget very sharply indeed in the United States, while it would reveal also that Western Europe and Japan would need very large increases in their defence budgets.

Again clearly, there still seems to be wide consensus among people in the Alliance and Japan — with increasing and deplorable differences on specifics — that in some way or the other our countries have basic national security interests which extend beyond the guarantee of our own territorial integrity. Unfortunately, from the standpoint of precision and simplicity in public decision making those interests revolve principally around intangibles, uncertainties and probabilities rather than around sufficiently concrete threats readily foreseeable and easily grasped.

Several facts about the postwar world — and more particularly the world as it can be projected over the next ten years — themselves suggest the nature of our countries, broader and interdependent national security concerns. First, the ability to manufacture nuclear weapons and vehicles to deliver them across national boundaries is well in the grasp of an increasing number of nations. That should make democracies stick close together. Second, contrary to the first postwar decades, now not only the United States but also Japan, Western Europe, China and the Soviet Union each possess a major industrial base, though partly in stagnation at present. Those interdependent industrial bases provide the raw material from which both war and peace can be made; another reason for the industrial democracies to stick together. Third, most of history teaches that there is nothing inherently stable in the relationships among world powers. Given the awesome potential for mutual destruction, coordination of as many as possible countries, national security concerns seems logical.

The core of US policy, accepted even by most of its most vigorous critics in the democratic world, rests on the concept of the United States as a guarantor of the security of Western Europe and Japan. The two chief rationales for that policy are, as I see them: (1) domination of either Japan or Western Europe by a hostile power would threaten US security, and (2) without the US guarantee, competitive arms would be set off and

the world would become a much more dangerous place, with the risk of major wars substantially increased.

Acceptance of these two propositions implies some important consequences about how the United States, Canada, Western Europe and Japan must conduct their international economic policies. The arrangements whereby the position of the United States on security matters is first among equals will endure only so long as its allies trust the US to use power wisely. At the same time, rapid economic growth among the industrial nations has made them almost equals to the United States in the area of world trade and monetary affairs. In the normal course of events, disputes and tensions about economic matters arise, many of which have major domestic political implications in the nations involved — energy supplies, agricultural prices, tariffs quotas, jobs and the like. How these disputes are handled inevitably has an impact on the underlying trust and confidence which countries have in each other's behaviour.

If one of the major partners involved and committed in the arrangements for our interdependent national security system uses its economic power on a unilateral basis to extract short-term economic gains, why should other nations not begin to believe that this will also be done in the political and military arena. A major nation can, if it wishes, throw its weight around through unilateral actions and often gain some immediate trading advantages. For any nation, this is a dangerous game in a relatively normal period of economic growth; its success depends on the good sense and restraint of the trading partners. In a period of slump, as we are now experiencing, it is very dangerous. Once retaliation starts, the whole world trading system is in jeopardy. Unfortunately we do, right now, continue to face the grave risk of a breakdown of the world's economic system. However, this is not the right place to address that issue. I would only want to remark that all democratic countries carry a heavy responsibility here in the trade-games we are playing. But, for the United States and the EEC it is a doubly dangerous game. It is after all a risk to the trust which other nations place in the rôle of the United States in the political and military arena and of the EEC in the economic field, which in turn is critical to national security arrangements of all democracies.

This then brings me to a specific set of issues, best described as the Three Per Cent Solution and Burden-Sharing.

THE THREE PER CENT SOLUTION AND BURDEN-SHARING

In the late 1970s, as in the early 1950s, early 1960s, and early 1970s, the United States began pushing its European allies to increase their defence spending in order to enhance NATO's conventional capabilities. The design to achieve this was the 15-year Long Term Defence Plan (LTDP). The catchword was «three per cent real growth» in each member's defence budget each year. This policy was and is intended to deal with an admittedly significant increase in Russia's qualitative and quantitative improvement of her forces deployed along the central front. Almost as an addendum to this massive effort, a Task Force was set up to look at the state of NATO's tactical nuclear forces. When I, relatively an outsider, first encountered this bit of recent history I was rather surprised. It turns out that the Carter Administration did so in order to avoid raising Europe's fears about the degradation of the nuclear deterrent that usually arises when they push for a conventional build-up. As I understand it, this Task Force, number 10, was a political afterthought as much as anything else. But part of its efforts evolved into the High Level Group (the HLG), which developed the rationale for the modernization of NATO's long range theater nuclear forces. If I read current history right it is then important to note here that the Americans' intent from the outset was to build up NATO's conventional forces, not her nuclear ones. The latter decision came reluctantly from the United States only after Europeans pushed hard for some type of American response to the SS-20. The familiar pattern was repeated: America pushed for conventional defences; Europe countered with a nuclear request. Whether the latter would have occurred without the presence of the SS-20 and solely because of the former is anyone's guess. But if the past be any guide to the present, surely the two are not unrelated.

In assessing the current dispute over the conventional build-up, many questions should be asked. Among them are both the questions of the degree of conventional disparity between NATO and Warsaw Pact Forces and the question about Soviet intentions. I am not qualified to answer these two questions and will focus solely on a related and very important issue: what issues are involved in the relative sharing of the burden between the United States and her NATO partners?

With merit, one could argue that the weakening in NATO's conventional forces was due to American, not European action. Various unclassified data

support this view. America gutted her NATO-based forces in order to help fight the Vietnam War. She drew down her troupes in Europe by over 100.000 and removed valuable noncommissioned officers and material. It is interesting to note that in roughly the same period the larger members of the Alliance — especially France and the Federal Republic of Germany — increased their real defence expenditures throughout the years 1971-1978 by nearly three per cent. The available data on defence expenditure also show that the British, French, Dutch and West Germans have been doing reasonably well since NATO formally adopted the LTDP in 1977. Surely, overall not as well as the United States would like, but not badly, especially if one keeps in mind that the Europeans in general throughout the 1970s increased their defence in real terms whereas the United States did not.

It is, I would suggest, the trend over the last ten years, not departures from a fixed goal in any one year or two, that counts.

Europe's share of NATO's combined defence expenditures has increased from around 23 per cent to almost 42 per cent over a ten-year period. Over this period from 1969-1979 Europe's defence expenditures have remained constant as a percentage of GDP, throughout this period, while America's defence expenditures declined.

A word of caution should be introduced here. Europe has been doing more relative to the United States, but the United States still bears, by gross dollar figures and by the percentages derived therefrom, the lion's share of NATO defence expenditures. However, a little bit more refined analysis shows that the United States from 1969-1979 decreased its contribution to NATO measured by defence dollars as a percentage of GDP devoted to NATO and also when measured by the total US defence dollars devoted to NATO as a percentage of total NATO defence spending.

One way of estimating what the United States spend for NATO is extracting the defence dollars spent on American forces in the Far East. This exercise, which is debatable, was done by the US Defence Department in the Spring of 1981 (and later again, but those results are, as I understand them, not different). As I already said, this kind of exercise is debatable. But that is one of the points I would like to make here. Some may argue that defence of the Far East is defence of the West because security is indivisible. Others may argue that security is divisible because America has fought two wars in the Far East without one having broken out in Europe.

Others again will counter that no war broke out in Europe because America fought in the Far East. And still others will argue that the last war in the Far East was ill conceived and was funded in part by NATO. Measuring burden-sharing remains a mystery game.

At the level of macro figures, the debate on the relative sharing of the burden is inconclusive. It must be because there are various other measures than only defence outlays as a percentage of GDP, which must be considered in order to fairly evaluate allied contributions.

Secretary of Defence Weinberger mentioned these other burden-sharing measures two years ago in a report to the Congress. Examples are:

- (1) NATO allies maintain on active duty about 3 million men and women as compared with about 2 million for the US and 250,000 for Japan. Including the reserves with specific assignments after mobilization, the allied total is over 6 million compared with 3 million for the US.
- (2) The GDP of all the non-US NATO nations combined represents around 45 % of NATO and Japan total but non-US NATO account for over 60 % of total NATO and Japan ground combat capability and around 55 % of the tactical air force combat aircraft.
- (3) Most of the European nations obtain their manpower through conscription. If allied defence manpower costs reflected their true civil sector opportunity costs, the value of non-US NATO defence contributions would be larger than they appear with conscription costs.
- (4) Nonmilitary economic assistance to underdeveloped countries is not included in the NATO definition of defence spending. Nevertheless, it is considered by a number of European allies and Japan, less though by the United States, as an important share of their contribution to world security and stability. Norway and the Netherlands spend close to 1 per cent of GDP for Official Development Assistance while the US ranks much lower with only 2 per cent of GDP devoted to foreign economic assistance.

These factors temper the apparent inequity in the GDP percentage for defence comparison. With this problem in mind the US Department of Defense devised a number of indices of burden-sharing and an overall assessment. Secretary of Defense Weinberger reported to Congress in March 1981 that this approach can give a better perspective of burden-sharing than any

one individual indicator. And he added: «Using this formulation, the aggregated NATO allies appear to be shouldering their fair share of the total NATO and Japan defence burden.» This conclusion is, as I infer from remarks by some US politicians, not yet a common good shared by many in the United States with their present Secretary of Defense.

Back now to the Three Per Cent Solution. As Secretary Weinberger has already pointed out, we may be at a point where the burden-sharing pendulum is beginning to swing in the opposite direction. For example, US real increases for 1980 and 1981 have, if I looked at the right data, been on the order of 3 and 4 per cent compared with non-US NATO increases of, probably, on average around 3 per cent in 1980 and much lower in 1981. Without denying the relevance of these recent figures it must be stressed here that the Three Per Cent yardstick created misunderstandings due to dubious by-products of financial fixation. This was well understood by the defence ministers of the Eurogroup who in December 1980 emphasized that what mattered were «the results achieved in terms of improving manpower, equipment and overall readiness».

Three Per Cent yardstick exit then? No, this has not been the case because political capital has been invested in this pledge, especially, but not only it seems, in the United States. Defence establishments and politicians would, however, be well-advised if they got rid of a yardstick which does not address the basic burden-sharing questions. True, the Three Per Cent pledge may prevent free-riders from too little contribution to the common tasks. But if kept for too long it risks the treatment given by politicians to primitive supply-side economics: once taken serious it can do real damage.

This brings me to the last part of my remarks which deals with defence and recession.

DEFENCE AND RECESSION

As indicated before there is, as yet, no clear indication that current defence budgets have been seriously affected by the dangerous economic recession of the past few years. Surely different countries have reacted differently in both spending and in planning for defence budgets. But to the best of my knowledge, defence spending has in most democratic nations so far not really been slashed because of economic slack. Rather other considerations may slowly be affecting the basic positions, especially in-

vestment in hardware. These other considerations have everything to do with political values and the setting of national priorities. Such development is, I would suggest here, rather serious and requires careful analyses and discussion.

As I perceive the setting of priorities in some European countries today, the debate about future defence budgets stands out alone in not getting much public attention. This differs, of course, from country to country, but especially the smaller countries and one or two larger ones do experience in almost total political silence that the perplexing problems facing the Atlantic Alliance may carry a price for defence budgets.

However, at the same time within Western Europe dissent over present day security policies is being voiced as never before, most obviously with respect to the rôle of nuclear weapons. European questioning of some of the assumptions underlying aspects of current allied policy and posture may not be easily accommodated.

This also relates to the management of Western economies which is proving problematical. Mustering the resources to maintain Western defence efforts seems likely to get more rather than less difficult as time goes by. Indeed, it seems necessary to point out that the continued willingness of all European NATO members to find the money — and the manpower and material — to sustain the apparatus for deterrence and defence as at present conceived and organized must be in doubt. The partial fulfillment of the Three Per Cent pledge, so far at least, is usually and rightly considered a good sign, though it would be better if it were accompanied by an annual 3 per cent increase in efficiency.

It is, however, questionable whether, assuming continuing lack of economic growth, it can be expected that resources will continue to be allocated in line with the security needs of the Atlantic Alliance and Japan.

Talking to expert commentators in Europe, I have found that they probably agree that finding the money to keep NATO's order of battle up to strength and up to standard throughout the 1980s is a politically tough task. Many point out that the job will be harder if, to allay disquiet about the rôle assigned to nuclear weapons, governments feel, quite rationally, impelled to attempt some enhancement of capabilities for conventional warfare.

Essentially, the problem is twofold. In the first place, defence ministries face the prospect of getting less defence for their money year-by-year, because

of the rising real cost of military manpower and material. In the second place, the likelihood is that finance ministers will not be inclined to allocate more money for defence year after year. And certainly not sufficiently more to compensate for both general inflation and the tendency for the cost of military items to rise faster than the overall price level. In this connection it is worth noting here that, in practice, annual budget increments of even 5 per cent in real terms are what armed forces appear to need to maintain capabilities at existing levels; they do not buy actual improvements.

Now, any high-school student will remark new technologies ought, at least in theory, to offer relief from the «less defence for your money» predicament so far as expenditure on equipment is concerned. However, as I understand it, an important impulse in military circles is to exploit technology for the provision of more effective ways of doing whatever is being done at the moment and not to discover cheaper ways of achieving the current level of performance. Pay-offs from technical progress in the form of cost-reduction, such as are experienced in civil fields are not enjoyed to anything like the same extent in the defence field. All this means that, over time, for given or slowly rising real spending, we shall get less and less in terms of the usual indices of defence capabilities. Less defence for your money therefore.

And, worse, if the Soviet Union continues its huge increases in real defence spending, the conventional balance will not get better but rather worse. However, asking for more than a, say 2-3 per cent real annual increase across NATO-Europe does not, at present, seem realistic. Priorities are not with defence but rather with social programs, unemployment benefits, education, infrastructure, lame-duck companies, subsidizing agriculture and with reallocation of resources to get back on the path to sustained economic growth. In fact, it seems to me that trying to increase defence budgets at the expense of social and economic priorities may very well boomerang unless there is clear, televised evidence that the Americans are going and/or the Russians coming. That would be late.

[In passing, I would like to mention here that a great potential for employment and efficiency should be considered through a common European defence industry. Production could be spread around Europe. This does not require grand new design but a practical approach to a European share in allied arm purchasing.]

CONCLUSION

In May 1982, Henry Kissinger remarked in a speech in The Hague (Holland): «Existing trends may sometimes appear bleak, but let us not forget that they are the result of decisions by free societies and can therefore be reversed by free decisions.» This view certainly applies to the domestic consensus required for adequate defence spending even in periods of economic stagnation.

Unless we are willing to admit what the trouble is, we are not likely to find the solution. Part of that trouble is, in economists' jargon, exogenous to defence establishments, e. g., the world economy and the Soviet Union. Another part is endogeneous, e. g., defence management and ease-to-grasp basic policies, intellectually accessible to the electorate. To me, a non-expert in military matters, one conclusion then stands out: tensions and economic stagnation make alliances more rather than less necessary. This being so, democratic nations would serve their people by continuously acknowledging that in the face of recession a mutually costly and hazardous process of military spending is a favour to none of the countries in the world.

But, as a final word Mr. Chairman, probably the situation was always a bit like this: it is like looking down different ends of a telescope. Both distort reality. Things are not as bad as they seem now and they were not all that great before.

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