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Summary of
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"Economic Consequences of Lower Military Spending:
Some Simulation Results" by Tamim Bayoumi,
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Recent changes in international politics offer the possibility of general reductions in military expenditures, the so-called "peace dividend." This paper reports the results from simulations designed to estimate the economic and financial impact of a 20 percent decrease in worldwide military expenditures. No attempt is made to measure the impact on security of lower military expenditures or to estimate its associated welfare impact.

The initial impact of lowering military spending is a modest reduction in the growth of GDP, with those countries whose military expenditures (in proportion to their GDP) are above the world average experiencing greater losses. At the same time, lower government spending reduces interest rates and allows governments to lower taxes, which raises private sector consumption and investment. In the medium and long run, GDP rises significantly above baseline values. Hence, in the short run military spending creates jobs and stimulates the economy, but in the long run it lowers economic growth by crowding out investment.

Tracing the movements of GDP provides insight into changes in total output and employment, but GDP is not an appropriate measure of economic welfare in the present case. The correct measure of economic welfare is the gain in current and future nonmilitary consumption. A 20 percent cut in military spending is estimated to produce long-run increases in both private consumption and investment in industrial countries. Economic welfare is estimated to rise by 48 percent of 1992 GDP, with those countries that implement the largest cuts having proportionally higher benefits. Less developed countries could experience gains in economic welfare that are significantly larger than those of industrial countries (79 percent of 1992 GDP).

Since most of the gains in economic welfare come in the longer run, these results are relatively insensitive to short-term factors, such as the timing of tax cuts associated with lower government expenditures and the speed of the spending cuts. They are affected, however, by the size of the government spending multipliers and the percentage of military spending that is assumed to represent productive investment. Nonetheless, in all cases, the simulations indicate a substantial gain to economic welfare.

Another result that emerges from the simulations is that a positive international economic externality is found to exist. The economic benefits to all countries are found to be greater when a coordinated reduction in military expenditures is carried out than when a nation undertakes a unilateral decrease in military expenditures. This externality results from lower world interest rates and increased volumes of international trade. The external benefits to developing countries appear to be particularly pronounced. This externality implies that there are economic, as well as security, reasons for coordinating expenditure cutbacks.

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