

RESEARCH SUMMARY

The Overlooked Costs of the Permanent War Economy: A Market Process Approach

The United States is responsible for almost half of all world military spending. The national defense budget has steadily risen since World War II, and in 2010, the United States government spent \$738.8 billion on national defense, trumping the \$572 billion spent at the height of the Cold War in 1986. After World War II, President Dwight Eisenhower warned of the growing military-industrial complex that would work to grow discretionary defense resources and create a permanent war economy. But while budget tables can help us understand the *accounting costs* of military spending, the *opportunity costs* are not adequately captured in these figures. That is to say, the official figures understate the full cost of military spending because they do not account for the alternative uses to which those resources could be put.

In “[The Overlooked Costs of the Permanent War Economy: A Market Process Approach](#),” Christopher Coyne and Thomas Duncan examine the full economic costs associated with a growing permanent war economy in the United States. Though economic costs, by their very nature, are difficult to measure, the authors argue that the difference in the accounting cost and the full economic cost of engaging in continuous military spending is vast. Previous research on the cost of permanent militarization underestimates the actual cost of resource misallocation, and both private-sector and public-sector distortions in the economy arise as a result of a permanent war economy.

KEY INSIGHTS ON THE PERMANENT WAR ECONOMY

Official Figures Understate the Full Cost of Militarization

A permanent war economy redirects resources from nonmilitary to military sectors in both the public and private spheres.

- Within the public sphere, the US military comprises more than 1.5 million men and women deployed on active duty and more than 850,000 reservists. Not only is it expensive to employ them, but these people also forgo opportunities elsewhere in the economy.
- Both spending and employment in private defense activities have risen since 9/11. As the Pentagon base budget, funding for nuclear weapons research, Homeland Security, and atomic energy defense budgets grew, so did the amount of resources the US government spent on private defense contracts. Without the discipline of profit and loss, the government allocates contracts based on nonprice criteria. This directs the efforts of millions of individuals in the country toward national defense instead of other innovative efforts in the private sphere.

Entrepreneurship in the United States Suffers

Resources dedicated to defense activities cannot be used for other potentially productive activities. Individuals and firms seek profitable opportunities, and if the defense sector provides an increasing number of those opportunities, then entrepreneurial activity will take place there instead of in other areas. This is problematic because, to the extent that entrepreneurial activities build on one another, then entrepreneurship in the military sector will beget further entrepreneurship in that sector. Further, rather than developing technology for private efforts, defense contractors will become entrepreneurial in securing political favor to maintain contracts.

Defense Spending Creates a Resource Misallocation Problem

Defense spending in the United States is done through a central government mechanism rather than a market mechanism, which means it cannot attain the allocative efficiency that the private sector can. There are two reasons for this relative inefficiency:

- Market activities are disciplined by a profit-and-loss feedback mechanism. If an entrepreneurial endeavor is not desirable to consumers, the entrepreneur will receive that feedback through a loss. Government activities lack this feedback mechanism.
- The US government has a monopoly on defense spending. This has two implications. One, once programs are started, they become very difficult to cancel—or even scale back. Two, because contracts are allocated largely for political reasons, vested interests emerge to compete for those contracts.

CONCLUSION

The accounting cost often cited in the defense budget is an underestimation of the true economic cost of militarization. The war economy stifles entrepreneurship and innovation in the private sector because it creates incentives for individuals and firms to secure lucrative government contracts instead of operating in the market. Because the war economy is permanent, these distortions in incentives only build upon each other. The result is a self-perpetuating military-industrial complex that undermines the innovation and entrepreneurship so closely associated with growing prosperity in the United States.