IMF sees limited wins from defence boom

Spending sprees store up fiscal problems, warns fund in call for joint procurement

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Defence spending booms tend to stoke inflation and store up fiscal problems without delivering a lasting boost to economies, the IMF warned yesterday, as it urged European governments to develop joint military procurement programmes.

Around half the countries in the world have increased military budgets in the past five years, the fund said in analysis published ahead of its annual meetings in Washington next week, adding to existing fiscal pressures such as ageing populations.

Experience after the second world war shows that when countries step up rearmament, the boom typically lasts around three years, with defence spending rising by 2.7 percentage points of GDP — mostly financed by extra borrowing.

The IMF said evidence from 164 countries showed deficits worsened by about 2.6 per cent of GDP as a result of higher defence spending, with public debt rising by 7 percentage points within three years.

This meant governments faced “a crucial question about trade-offs”, the fund’s staff said in a blog, as the longterm effects of higher military spending on the economy would “vary widely depending on how outlays are sustained, financed and allocated”, as well as on how much equipment was imported rather than produced by domestic manufacturers.

The findings temper the claims many European politicians have made about the potential for higher defence spending to revitalise the bloc’s industrial base and spur productivity growth.

Last year, most European members of Nato agreed to raise annual spending on defence and strategic infrastructure to 5 per cent of GDP by 2035, from the alliance’s current 2 per cent target.

Germany in particular is hoping to recover from years of stagnation through a debt-fuelled spending spree on defence and infrastructure.

The IMF’s modelling shows that if EU countries raise their defence spending by 1.3 per cent of GDP by 2030, funding it through borrowing, the stimulus would boost GDP by 0.9 percentage points by 2028. This assumes a fifth of new spending goes towards importintensive investment.

Inflation and interest rates would also be permanently higher, however, and the exchange rate stronger — worsening the current account deficit.

In an alternative scenario, both the stimulus to growth and the inflationary effect would be stronger if monetary policymakers did not raise interest rates in response. The effect would be more muted if rearmament was funded by raising taxes or cutting other budgets.

A better course for European governments, said the fund, would be to pursue projects for public investment in joint procurement that could lower financing costs and cut reliance on imported equipment. This could generate a bigger short-term boost to GDP and greater longer-term gains, it said.