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## CHAPTER 4

### War-Related and Defense Expenditures

IT is clear that the aggregate statistics of government expenditure change over time in a fashion that cannot be explained by the permanent influences affecting expenditures. When such factors have been removed, the relation between the growth of government expenditure and the growth of GNP is still not constant or regular. More particularly, a chart of real expenditures per head of population has peaks during the two major wars, separating plateaus at ascending levels. The association of this displacement in the level of expenditures (and in the proportion of national output devoted to government use) with war periods invites examination of the possibility that the rising plateaus are the direct consequence of the wars themselves. In this chapter, therefore, we shall examine the possibility that not only the time process of expenditure growth, but also the growth itself, is the direct result of war and not of the deliberate wishes of the citizens or the government. This means that we shall have to discuss war-related expenditures in two distinct contexts. In this chapter we are interested in the direct importance of the expenditures actually made for such reasons, as an explanation of the phenomenon of displacement. In the next chapter, where we break down total government expenditure into what we believe to be significant categories in order to examine the development of different kinds of government activity, we shall be concerned with the relative changes in expenditures for war-related purposes compared with changes in government expenditures of other kinds.

#### *National Debt Interest and Other War-Related Expenditures*

The notion that the growth in British government expenditure is the consequence of war is of course not new. Indeed, throughout British fiscal history writers have attributed rising government expenditures to war-related causes, and especially to the growth of interest payments on the national debt. The last chapter of *The Wealth of Nations* treats war as a major and direct cause of changes in the level of government expenditure,<sup>1</sup>

<sup>1</sup> See Adam Smith, *The Wealth of Nations*, Vol. II, Book V, Chapter 3, "Of Public Debts" (Cannan edition), London, 1904.

Smith says, for example (p. 418), "That the public revenue of Great Britain can ever be completely liberated, [i.e., from the burden of debt] or even that any considerable progress can ever be made towards that liberation, while the surplus of that revenue, or what is over and above defraying the annual expence of the peace establishment, is so very small, it seems altogether vain to expect." What Smith had in mind is that government expenditure must remain higher after wars because, given current views of the tolerable burden of taxation, sufficient revenues cannot be raised to repay the debt incurred in wartime, so that the debt interest charges become a permanent addition to government expenditure.

It will be recalled by the American reader that the peacetime burden of public debt interest was a major reason why Smith supported taxation of the American colonies—but taxation *with* representation!

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and a similar attitude pervades much subsequent writing, at least up to the time of the Colwyn Committee in 1927.<sup>2</sup> Such a view was encouraged by the fact that the conventional form of budget statement, on which these authorities had to rely, exaggerated the importance of government debt and debt interest. In particular, they included payments of debt interest by one government agency to others, and such intragovernmental payments were not inconsiderable. Moreover, the budget statements were only concerned with the expenditure of the central government and not with total government expenditure, and excluded the accounts of the various social insurance schemes. We should expect the significance of debt in the growth of total expenditures to become less marked when these matters were taken into account.

Even if we accept the inflated official figures of debt expenditures, we find that while debt expenditures never became negligible in absolute size, they declined in importance relative to expenditures of other types from the end of the Napoleonic Wars onwards. This confirms, for Britain, the argument of Wagner and other Continental writers whose researches covered a number of countries, that war debt alone could not serve as a general explanation of government expenditure growth, at least during this earlier period.

In Britain during our own period, debt interest payments have become of smaller relative importance than ever before, although just after World War I they rose again for a time to almost 30 per cent of total government expenditure. The evolution can be seen from Tables 3 and 4, but the place of debt interest payments in total government expenditure is perhaps most easily understood from Charts 8, 9 and 10, which show what happens to the curve of government expenditure, and its relation to national income, when national debt interest and other war-related expenditures are omitted.<sup>3</sup> The curve of government expenditure less debt interest shows a displacement at the same periods as total expenditures, whether we use statistics of total money expenditures or of real expenditures per head. Thus, this residual curve starts at a much higher "real" level after 1918 (Chart 9), declines at a faster rate than the total expenditure curve up to 1923, and thereafter follows a more quickly rising trend than total expenditure up to 1939. This is the result of the

<sup>2</sup> See, for example, C. F. Bastable, *Public Finance*, 3rd ed., London, 1903, pp. 70-72; J. Stuart Mill, *Principles of Public Economy* (Ashley edition), London, 1909, Book 5, Chapter 7, pp. 788-880; and the *Colwyn Committee Report on National Debt and Taxation*, H.M.S.O., Command Paper 2800, 1927. For an interesting review of that committee's views on debt burdens, see also J. M. Keynes, *Economic Journal*, June 1927, pp. 208-212.

<sup>3</sup> It will be noted that only the total government expenditure curve is complete for the war years; the peaks are omitted in the residual curves because no very satisfactory breakdown of the wartime expenditure statistics is possible (see Appendix, "Central Government," p. 162). However, this does not preclude using the charts for information about the plateaus.

### CHART 8

Total Government Expenditure and Its War-Related and Defense Components, in Relation to Gross National Product, at Current Prices, 1890-1955

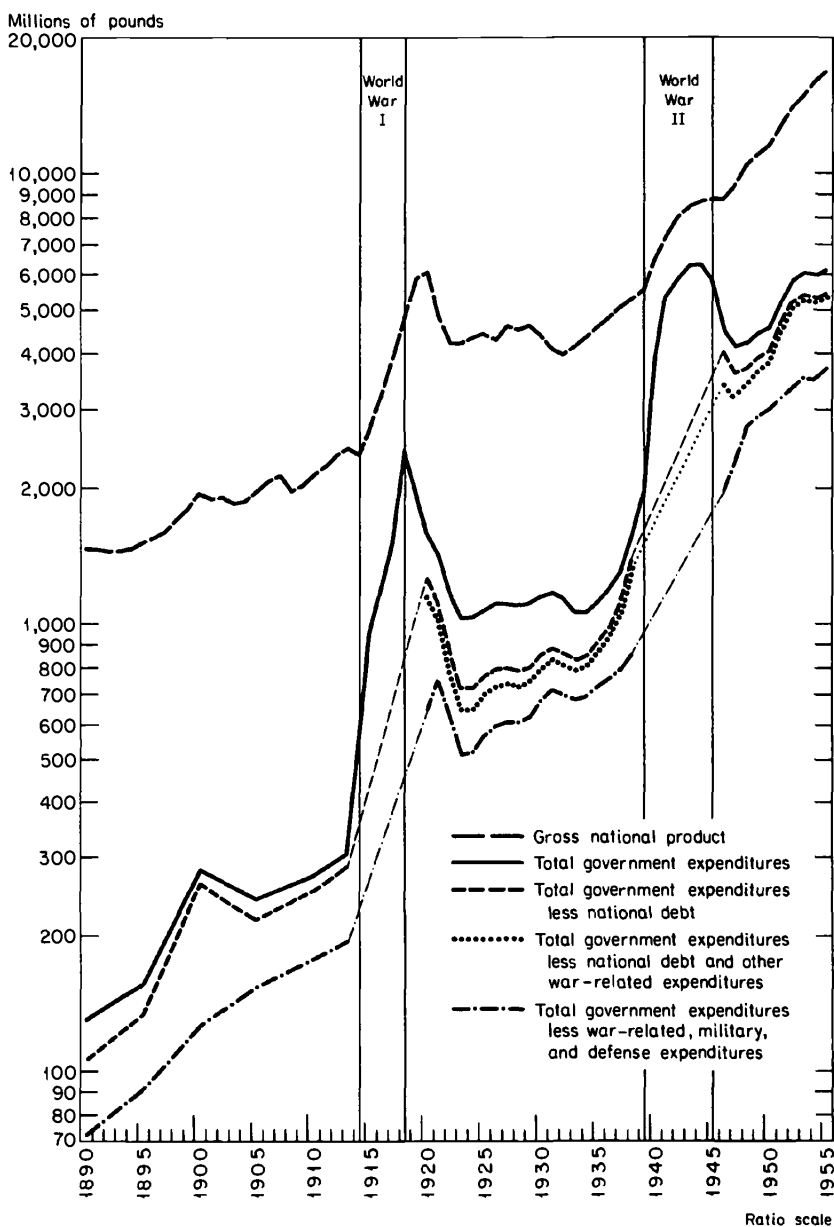


TABLE 3  
TOTAL GOVERNMENT EXPENDITURE, AND EXPENDITURE FOR WAR-RELATED AND DEFENSE  
PURPOSES, AT CURRENT PRICES, SELECTED YEARS, 1890-1955  
(millions of pounds)

Expenditures	1890	1900	1910	1920	1928	1933	1938	1950	1952	1955
1. Total government	130.6	280.8	272.0	1,592.1	1,094.7	1,066.0	1,587.0	4,539	5,777	6,143
2. National debt	23.8	19.6	20.2	324.8	305.1	228.4	212.5	507	609	707
3. (1) minus (2)	106.8	261.2	251.8	1,267.3	789.6	837.6	1,374.5	4,032	5,168	5,436
4. Other war-related	—	—	—	104.7	57.5	45.5	39.4	194	154	119
5. (3) minus (4)	106.8	261.2	251.8	1,162.6	732.1	792.1	1,335.1	3,838	5,014	5,317
6. Defense	34.9	134.9	74.3	519.7	125.1	112.4	469.0	836	1,641	1,606
7. (5) minus (6)	71.9	126.3	177.5	642.9	607.0	679.7	866.1	3,002	3,373	3,711

Source: Appendix Tables A-7 and A-9.

TABLE 4

TOTAL GOVERNMENT EXPENDITURE, AND EXPENDITURE FOR WAR-RELATED AND DEFENSE PURPOSES,  
PER HEAD OF POPULATION, AT 1900 PRICES, SELECTED YEARS, 1890-1955  
(pounds per head. Index, 1900 = 100)

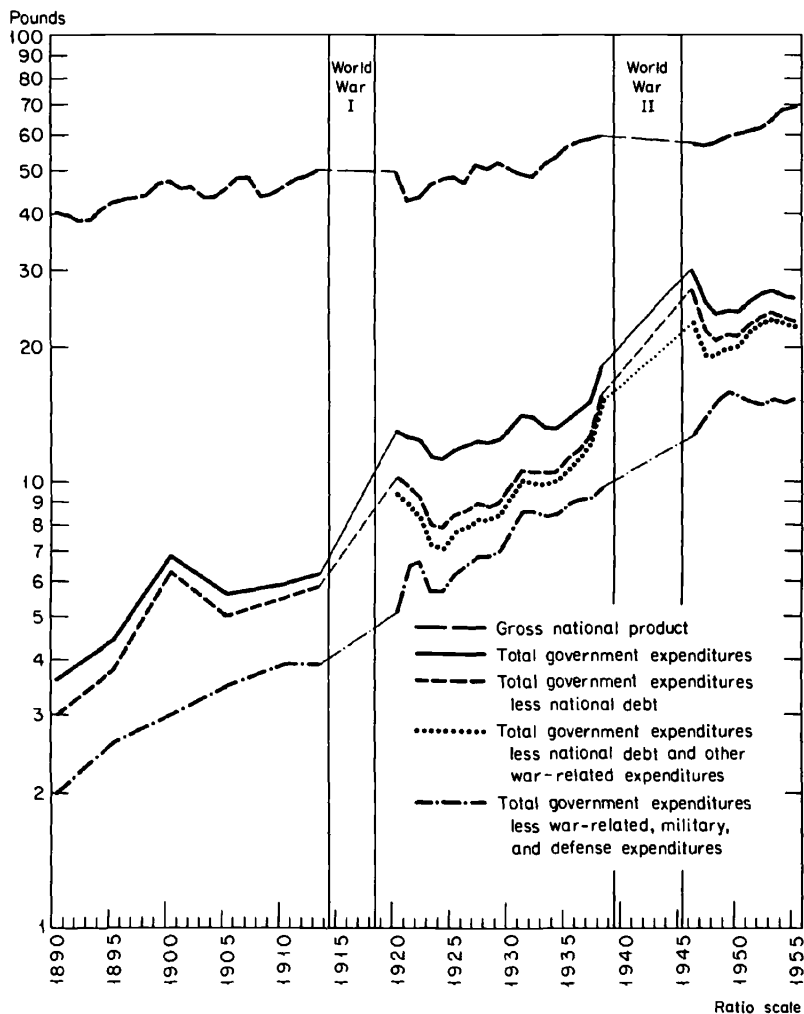
Expenditures	1890	1900	1910	1920	1928	1933	1938	1950	1952	1955
1. Total government	3.6	6.8	5.9	12.9	12.2	13.2	17.9	23.8	26.0	25.7
At 1900 prices	53	100	87	190	179	194	263	350	382	378
Index										
2. National debt	0.6	0.5	0.4	2.7	3.4	2.8	2.4	2.7	2.8	3.0
At 1900 prices	120	100	80	540	680	560	480	540	560	600
Index										
3. (1) minus (2)	3.0	6.3	5.5	10.2	8.8	10.4	15.5	21.1	23.2	22.7
At 1900 prices	48	100	87	162	140	165	246	335	368	360
Index										
4. Other war-related	—	—	—	0.8	0.6	0.6	0.5	1.1	0.8	0.5
At 1900 prices	—	—	—	—	—	—	—	—	—	—
Index										
5. (3) minus (4)	3.0	6.3	5.5	9.4	8.2	9.8	15.0	20.0	22.4	22.2
At 1900 prices	48	100	87	149	130	156	238	317	356	352
Index										
6. Defense	1.0	3.3	1.6	4.3	1.4	1.4	5.3	4.5	7.6	6.9
At 1900 prices	30	100	48	130	42	42	161	136	230	209
Index										
7. (5) minus (6)	2.0	3.0	3.9	5.1	6.8	8.4	9.7	15.5	14.8	15.3
At 1900 prices	67	100	130	170	227	280	323	517	493	510
Index										
<i>Gross National Product</i>										
8. Index	85	100	97	105	106	108	126	128	132	146

Source: Appendix Tables A-8 and A-10.

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CHART 9

Total Government Expenditure and Its War-Related and Defense Components, in Relation to Gross National Product, per Head of Population, at 1900 Prices, 1890-1955

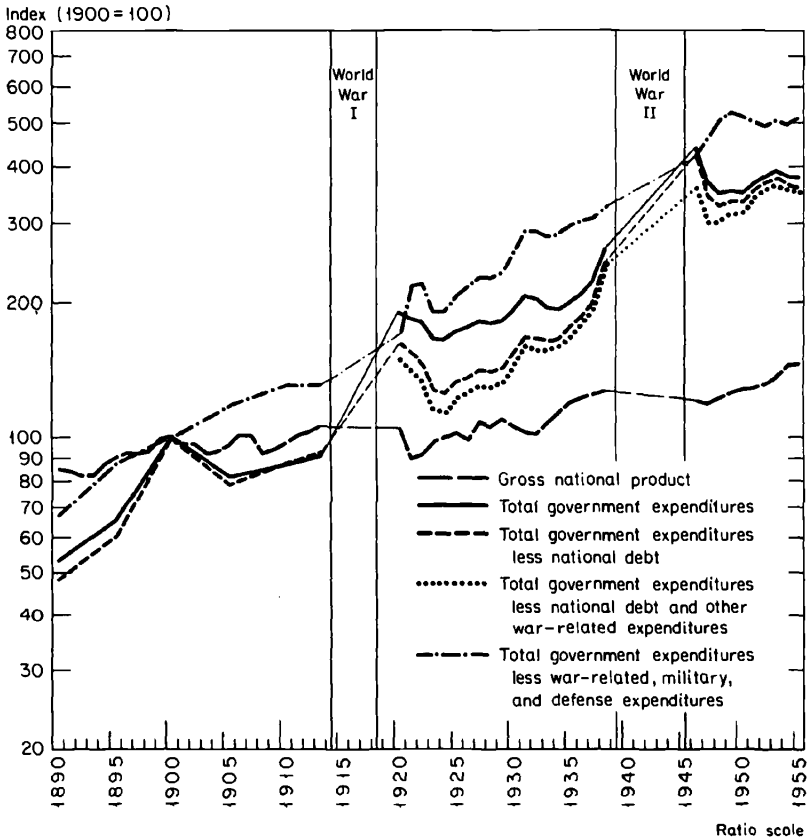


heavy burden of debt interest after 1918 resulting from the debt policies of World War I, the significance of debt being greatest around 1924, then reducing gradually up to around 1934, and more rapidly thereafter as a result of the debt conversion operations of 1932 and 1934 (see Tables 3 and 4 and A-7 to A-10). While, therefore, the curve fluctuates somewhat

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more than that for total expenditures, the residual expenditures never approach their earlier level after 1918, and describe a rough plateau at the new higher level over the period of the interwar years.

CHART 10  
Indexes of Total Government Expenditure and Its War-Related and Defense Components, in Relation to Gross National Product, per Head of Population, at 1900 Prices, 1890-1955



The upward shift in the plateau is even more striking after 1945, and the sympathetic movement of the total expenditure curve and the curve of expenditures excluding debt interest is much more marked. This must be attributed first to wartime debt policy, which led to a much smaller increase (in real terms) in the size of debt during World War II than during World War I, second to the postwar "Dalton era" of cheap money which kept interest rates and debt service charges low, and third to



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the postwar inflation which has reduced the real significance of payments fixed in money terms. In relation to national income, the removal of debt interest must of course reduce the share of expenditures in total income, but the trend of that share is still an increasing one, as the residual grows much faster over the period than does GNP. The respective rates of growth can be seen from Table 4, by comparing the changes in GNP index and the "residual" indexes, and (perhaps more easily) from Chart 10, which plots indexes (1900 = 100) of GNP, government expenditure, and so on, per head at 1900 prices on a log scale. The increasing share of government expenditure less national debt is clearly shown by the rises in the relevant curve as compared with the curve of GNP per head, and the association of change with war is demonstrated by the fact that it is after the wars that the distance between the two curves widens.<sup>4</sup>

However, national debt interest is not the only type of war-related expenditure. Governments also incur obligations through war for such items as war pensions and war damage compensation. Could not the aggregation of these three items account for the time pattern that we are trying to explain? The magnitude of these other war-related expenditures can be seen from the tables, and their influence upon the displacement effect is brought out by the charts, which include a curve of total government expenditure excluding war pensions and war damage compensation as well as debt interest payments.<sup>5</sup> In fact, these additional items are relatively insignificant; the curve of expenditures excluding them differs little from the curve excluding debt interest only. All the conclusions reached by examination of the latter curve thus continue to hold; specifically, the displacement effect still appears in the new residual curve.

### *Defense Expenditure*

There remains a further problem. The expenditures discussed so far are in a direct fashion the consequences of war. They take no account of expenditure upon war itself, or of peacetime military expenditures for the defense of the realm. It is very difficult to distinguish military and other types of government expenditures in wartime, and even more difficult to distinguish, even conceptually, between military spending

<sup>4</sup> The relation between the index of GNP and the indexes of government expenditure in the period before 1914 may perhaps require elucidation. The base year, 1900, is in the period of the South African War, so that some decline in government expenditures is to be expected in the following years of peace. Also, as explained earlier, the statistics for this period are at five-year intervals only; the divergencies between the curves would probably be smaller if annual data were available.

<sup>5</sup> No statistics for these other war-related expenditures were computed for the period before 1914. There is no reason to believe, however, that they were any more significant then than in later years.

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concerned specifically with the prosecution of war and other kinds of defense spending which occur in both war and peace. Fortunately, our interest is in the influence of war upon peacetime government activities rather than in the detailed composition of actual government expenditures in wartime; for study of the displacement effect we can therefore concentrate our attention upon peacetime defense spending. Even so, the appropriate interpretation of defense expenditures in relation to the displacement effect is not easily decided. From one point of view, there are strong arguments for treating all defense spending as being exogenously determined in a sense that other government expenditures are not. The size of such expenditures clearly depends to an important extent upon world political conditions and upon the government's interpretation of its own security needs in the light of those conditions.<sup>6</sup> Consequently, it could be argued that influences (such as views about tolerable levels of taxation) that might be significant in determining the level of expenditures of other kinds would have much less direct effect on the level of defense spending. To the extent that this is so, any displacement effect of war on government expenditures in general would show more clearly if we eliminated both defense spending and more directly war-related expenditures from total spending, and studied the behavior of the residual.

On the other hand, peacetime defense expenditure clearly does not lie as completely outside the influences that affect expenditures of other types as do wartime military expenditure and other war-related expenditures. Politicians try to take account of the financial implications of proposals for defense policy, rather than simply accepting the views of military experts. In Peel's words: "If you adopt the opinion of military men, we are never safe."<sup>7</sup> Like all other expenditure, defense spending requires the raising of revenues, and the governments of many countries (including Britain) are answerable to the electorate for defense spending. Even if it is accepted that increases in defense expenditure are less easy to control in such ways than expenditures of other types, nevertheless, peacetime expenditure on defense constitutes a part of the total tax burden that the community is called on to bear. From this point of view defense expenditure is no different from any other expenditure; it is the total that is of prime importance to a government. Hence, acceptance of the need to spend more on defense in peacetime may result not (or not only) in changes in the total of government spending, but rather in

<sup>6</sup> This interpretation will itself not be independent of a country's economic development. The richer a country, the more it may become an object of envy and greed and the more liable it will be to attack if not adequately protected.

<sup>7</sup> Quoted in D. H. MacGregor, *Public Aspects of Finance*, Oxford, 1939, p. 34, in a discussion of these questions, pp. 33-35.

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reductions in expenditures of other types. Conversely, it can be argued that if in any peacetime period defense expenditures had been smaller, the likely result would have been increased spending of other kinds rather than (or as well as) reduced total spending, given existing notions as to the tolerable burden of taxation. It is probable, therefore, that in eliminating all defense expenditures we are eliminating altogether too much if we want the residual to reflect what government expenditures "would have been" in the absence of such spending.

Unlike the other war-related expenditures, defense expenditures are by no means negligible, as can be seen from Tables 3 and 4 and from the Appendix tables. In many years, indeed, defense spending has been larger than all other expenditures for war-related purposes, and for a number of years after World War II it was around twice the size of these other items. The charts show the results of eliminating defense expenditures as well as the other types of war-related spending from the global statistics of government expenditures. The new residual expenditures still show a displacement in periods of war (lowest curve, Charts 8 and 9), and the peacetime expenditure plateaus do not show any more marked fluctuations. Of course, the time pattern of those fluctuations is now different; there is no reason why defense spending and military expenditure of other types should change in any closely connected fashion in peacetime, and it is clear from the tables that they have not done so. It is also clear from the GNP and residual expenditure indexes in Chart 10 that the residual still takes an increasing share of GNP over our period as a whole, and that changes in this share are roughly associated with periods of war.

The cumulative evidence seems to justify the conclusion that the characteristic time pattern of government expenditures is not solely the accidental consequence of wars. Some further explanation is therefore needed, to be found by more detailed examination of the changes that have occurred in the nature of peacetime government expenditures, to which we now turn.