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PART I

*National Security*

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# 1 *The Political Economy of Defence*

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## Introduction

The political economy of defence can be defined in numerous ways, but at the heart of the concept is the notion of governmental ownership and control in the defence of the state. In his seminal work *The Wealth of Nations* (1776), Adam Smith crystallised thinking on the profound role that government plays in all aspects of defence decision making, when he stated that ‘in a system of natural liberty ... the first duty of a sovereign is that of protecting the society from the violence and invasion of other independent societies’.<sup>1</sup> Smith was clear that the provisioning of defence is the government’s responsibility, not least because it is a public good:

It is produced for the community, and differs from private goods in that it is consumed by all citizens equally whereas private goods are consumed individually and exclusively by those who purchase them: once a public good such as defense is produced it does not matter whether an individual has paid taxes or not, his consumption of defense cannot be exclusive and at the expense of fellow citizens, nor can it be limited by the consumption of other citizens.<sup>2</sup>

Smith argued that it was incumbent on the state to ensure adequate resourcing of defence, especially as the cost of war was increasing with the invention of weapons. ‘The cannon and mortar are not only much dearer, but much heavier machines than the ballista or catapulta; and require greater expense, not only to prepare them for the field but to carry them to it’.<sup>3</sup> In Smith’s view, it was evident that defence was for the common good and it was reasonable, therefore, that the expenses of defence should be met by the whole of society, with ‘all the different members contributing as nearly as possible in proportion to their respective abilities’.<sup>4</sup> How was this to be done, though? David

Ricardo, reflecting on the economic impact of Britain's pursuit of victory in the Napoleonic wars, claimed that government-imposed taxes were the preferable method to finance war. Taxes would ensure that the economic burden of war was imposed on the present society, and, importantly, tax adjustments would require parliamentary approval, making ministers accountable for engaging in expensive contests, unless in the national interest. Conversely, he believed that if there was ease in the creation of public debt, then the associated lack of restraint by government would increase the risk of war for frivolous reasons, or wicked ambition, or, worse, financial gain.<sup>5</sup> Moreover, the use of loans would be without restraint, shifting the burden of repayment onto future generations.

As the powers of the sovereign have waned, it is government that has assumed the responsibility of providing national security and protecting society from invasion. An important part of government's role in this regard was the need to secure defence industrial sovereignty. Security of supply for cannon, munitions and warships was essential for strategic rather than for politico-economic reasons, but the latter was nevertheless a linked consideration. In the eighteenth century, the international political economy comprised of 'independent' nation states that pursued trade for 'mercantilist' national benefit, harbouring no inhibitions of going to war over the bounties from colonisation. The passage of time has not dulled the appetite of nations for self-sufficiency. However, since the 1930s, defence has come to be viewed not only as a political institution but additionally as an instrument of macroeconomic management. This was symbolised by Keynes' advocacy that government should use defence as a pump-primer to revitalise a stagnating United Kingdom (UK) economy.

Today, the principal politico-strategic goal remains national security, but defence-industrial autarky has become challenging. The contextual conditions of defence have changed since the 1970s, undermining the means for securing defence-industrial sovereignty. There were firstly tectonic shifts in the geoeconomic and strategic landscape, such as the international recessionary crises of the early 1970s and 1980s, followed by the implosion of the Soviet Union, the collapse of communism, the Gulf Wars, and, finally, the 9/11 terrorist attack on New York's Twin Towers. The age of uncertainty had arrived. Moreover, in the strategic domain, the dismemberment of the erstwhile USSR, and the loss of certainty that came with the bipolar great-power stand-off, had altered

the political, diplomatic and military calculus. The Cold War era had disappeared, but benign international relations remained elusive, pock-marked by numerous hot wars, insurgencies, asymmetrical conflicts, endemic violence and even genocide.

In parallel, dramatic changes were occurring in technological innovation. Computerisation, information technologies, space-based telecommunications and digitisation had begun to impact the commercial and military landscape. The United States was at the helm of this 'systems of systems' transformation; indeed, its economic, technological and military dominance was fundamental to winning the arms race and the associated ideological struggle against the 'bankrupt' Soviet communist system. Capitalism provided the spur for innovation, and in the military space this found resonance through what came to be known as the Revolution in Military Affairs (RMA). Ironically, it was a Russian, Marshall Organov, who first coined the term when describing US technological prowess in the development of revolutionary weapon systems.<sup>6</sup> Some observers believe that these smart, stand-off, laser-guided and often autonomous munitions represented a 'step-change' in warfare.<sup>7</sup> Others rejected this thesis, arguing that instead of revolutionary, discontinuous change, enhanced defence technology capability reflected more evolutionary, continuous, innovational development.<sup>8</sup> The debate was perhaps an intellectual distraction, because whether change was revolutionary or evolutionary the practical reality was that profound changes to weapon systems and doctrine were happening, and rapidly. The first Gulf War demonstrated the United States' military technology superiority through the dramatic destruction of Saddam Hussein's Soviet-supplied tanks and artillery, prompting a wake-up call for Moscow and its client state, China.

Yet, the RMA came with an economic cost. The smart new weapon systems demanded intensive research and development (R&D), and this led to dramatic acceleration of procurement costs. Inflated cost structures, in turn, fuelled a decline in orders, and the subsequent loss of scale further increased unit costs, exacerbating the deterioration in market conditions. The result was 'structural disarmament', reflected via a 'Starship Enterprise' mindset, whereby affordability constraints would ultimately lead to just one galactic military system being responsible for the protection of Smith's 'independent society'.<sup>9</sup> These RMA-induced changes ensured that defence economics had firmly entered

into the military's vocabulary. Affordability, the principal defence economic issue, was now forcing a rethink over defence-industrial sovereignty. Although technology multipliers associated with the RMA were an undeniable attraction to military planners, due to the benefits of precision targeting, reduced attrition of military personnel and the Cable News Network (CNN) benefits of limited collateral damage, the trade-off was a dramatic steepening in acquisition costs to the point where attainment of comprehensive defence-industrial capability was no longer financially feasible.

Notwithstanding the panoply of commercialisation initiatives designed to reduce defence costs, government remains the dominant player. It has the authority, for instance, to promote the defence and aerospace sectors as strategic industries. These sectors can then be protected and subsidised to ensure industrial vitality and sustainability. Defence is different, and its critical role in the pursuit of national security has been recognised through international norms, such as, for instance, its exclusion from the rules of the World Trade Organisation (WTO). Government and supranational interventionist policies are central to the political economy of defence. Government determines how much will be spent, and invariably influences the final decision as to the sources of military procurement. However, irrespective of whether the defence business case (based on cost effectiveness) leans towards procuring local or foreign defence systems, costly procurement programmes will always face stringent political scrutiny, with final decisions based not so much on the military capability of those systems but rather on the politics of saving jobs in marginal constituencies. In the process, the moral, ethical and even strategic justification of continued arms acquisition may also play second fiddle to the political dimension. Ministries of Defence (MoD), along with senior members of the armed forces and defence industry (the so-called iron triangle) allegedly engage in deliberate exaggeration of international threats as a means of maintaining or even increasing defence expenditures when faced with a benign strategic environment.<sup>10</sup>

Given the contextual backdrop of political, economic, financial and strategic uncertainty, this volume on the political economy of defence not only offers a relevant and timely contribution to knowledge, but may also offer policymakers, analysts and interested observers useful insights into the process and structure of defence. It is intended that the

chapter topics will provide a ‘holistic’ sense of the structural linkages and influences that act to strengthen or weaken national security.

1.1 Conceptualising the Politico-Economic Defence Framework

As a means of addressing the principal contemporary politico-economic fields of policy concern, a schema has been developed, as shown in Figure 1.1. The intention is to examine the role of government in the provision of defence, cognisant of its wider social, economic and diplomatic responsibilities. National security in its various guises is the principal goal of defence and security endeavours. Yet, the achievement of ‘security’ depends on a complex amalgam of policy, management, resource and global environmental variables. Threats are a major driver of the level of defence spending, but in peacetime they compete with other domestic economic and political pressures. As a public good, defence imposes opportunity costs on other government spending, such as

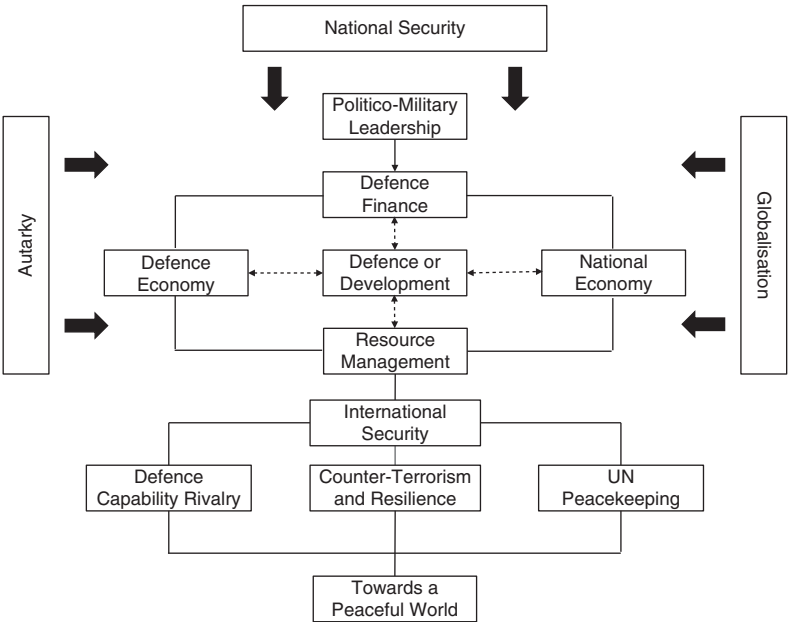


Figure 1.1: The politico-economic defence framework  
Source: author

welfare, education and health spending that has a more immediate impact on public opinion, especially in relation to political polls. Thus, in a democracy, government must always be prepared to balance critical quality of life objectives with its responsibility to defend the nation state. This is a tricky trade-off, and it is understandable that politicians will respond to the short-term social needs of its citizens rather than the long-term strategic consequences of inferior military capability. In search of affordability, there is an obvious expectation that constrained defence resources will be managed efficiently, but to reduce costs there is a temptation for the defence authorities to favour lower-cost overseas and collaborative procurement options. This will inevitably impact on security of supply, the vitality of the domestic defence economy and thus sovereignty, but on the plus side globalisation will reduce costs, assist affordability and contribute in a qualified way to national security.

The structure of the book addresses themes identified in the Figure 1.1 schema, as follows:

### *1.1.1 National Security*

National security is an awkward and ill-defined concept. It used to be interpreted solely with regard to territorial boundaries, international defence agreements and broader (defence) security interests of the state. It was grounded in military defence, and rationalised and expressed through defence policy. The contemporary interpretation of national security has changed, however. It now reflects a broader constituency of interests, including human, economic, environmental, energy, climate, as well as military security. This broader security canvas has been articulated through high-level documents, such as the UK (2015) and the US (2017) National Security Strategy documents.<sup>11</sup> Government has played a prominent role in ensuring that the seemingly disconnected strands of national security integrate into a coordinated and coherent strategic approach. For instance, the ‘greening’ of the military is consistent with the positive consequential benefits of managing climate change, including, for example, energy reduction through autonomously harvested vehicular energy, reducing the need for strategically vulnerable oil convoys in operational zones. Similarly, governments, at least Western ones, have also been actively pursuing a ‘prosperity’ agenda by promoting the economic benefits of defence through encouragement of their exports, technological spin-on and spin-offs, dual-use



technologies, investment and skilled employment in the strategically significant industrial ‘crossover’ sectors of transport, aerospace, space and information systems.

### *1.1.2 Politico-Military Leadership*

The government’s agenda in protecting national security is complex, and funding is always insufficient. Focusing solely on military security, the budgetary battle commences at two levels. There will be the Service Chiefs of the army, navy and air force, and also representation from the defence-related scientific, counterterrorism and intelligence communities, pushing for higher allocations of government resources for defence as a whole. In the UK case, this is a battle that is waged against Whitehall mandarins (civil servants) and government ministers, with the Treasury holding the line in support of public finance plans as well as agreed spending limits for other Departments of State. At a second level, Service rivalry will surface, with Chiefs fighting amongst themselves to maintain or preferably increase their share of the final agreed defence budget. Decisions will be based on capability criteria, but it is likely that military culture rather than operational pragmatism and effectiveness will influence and persuade discussion, determining trade-offs between, for instance, artillery versus cruise missiles and drones versus manned fighter aircraft. Moreover, inevitably, there will be friction over how the costs of new and expensive toys like aircraft carriers, fifth-generation fighters and nuclear submarines will drain funding from the defence budget, leaving little for less glamorous, but no less important areas of military capability. The process of debating and agreeing the final Department budget and also its allocation amongst military stakeholders is akin to a leadership ‘beauty contest’, and is addressed by Bryan Watters in Chapter 2.

### *1.1.3 Defence Finance*

Once budgetary decisions have been agreed, the defence ‘pot’ of monies has to be carefully managed to ensure value for money for the taxpayer. As funding is always taut, the pressure is intense to find cost efficiencies, even though most of the time these masquerade as cost cutting. In the United Kingdom, the policy approach since the 1980s has been to adopt best-practice commercial

techniques to manage resources. As discussed by Irfan Ansari in Chapter 3, Value-for-Money (VfM) initiatives have been introduced to exploit economic (competition), efficiency (financial engineering) and effectiveness (capability) opportunities; the first two of these VfM elements relate to input cost savings, while the third has regard to output, ultimately impacting on military capability. Delegated budgets are now viewed as an essential element of defence finance for controlling excessive expenditure. However, as in the public sector more broadly, the art of restraining expenditure, in such areas as training and resource consumption, in order to hit annual budgeted targets can negatively impact on operational efficiency. Indeed, some governments now publish annual Resource Accounting and Budgeting (RAB) statements that take defence financial management to a new level. RAB merges the battle and business spaces by managing defence as though it is a business, inculcating into defence and planning staffs a more professional approach towards efficient defence management.

RAB calculates the cost and value of defence as expressed through cost operating and balance sheet statements. Military assets, such as submarines and main battle tanks, sit on the balance sheet, and are subject to (cost of use) depreciation as would assets in any commercial undertaking. The annual depreciation cost is then included in the cost statement. An additional cost of using taxpayer's capital is also estimated, based on the fact that if defence was a private business then it would need to borrow money from a bank, incurring an interest charge, or if it uses reserves lodged in a bank then there would be a loss of interest. This cost of capital is also loaded into the operating cost statement of defence. These two 'notional' costs of defence can be considerable, and when combined with other more traditional operating costs, the aggregative cost reflects the true cost of defence to society. This implies an opportunity cost of benefits foregone, meaning that the higher the level of military expenditure, the greater the diversion of scarce public resources from hospitals, universities and road networks. As defence is a public good financed by taxpayers, it is incumbent on the government and defence policymakers to ensure that resources are spent wisely and prudently. It is thus essential that there is transparency and accountability in the process. Some governments hide defence and procurement budgets from their citizens, and also engage in off-balance sheet spending. This loss of transparency erodes confidence in