

Does Military Expenditure Matter for Economic Growth: Post War Evidence from Sri Lanka

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Introduction

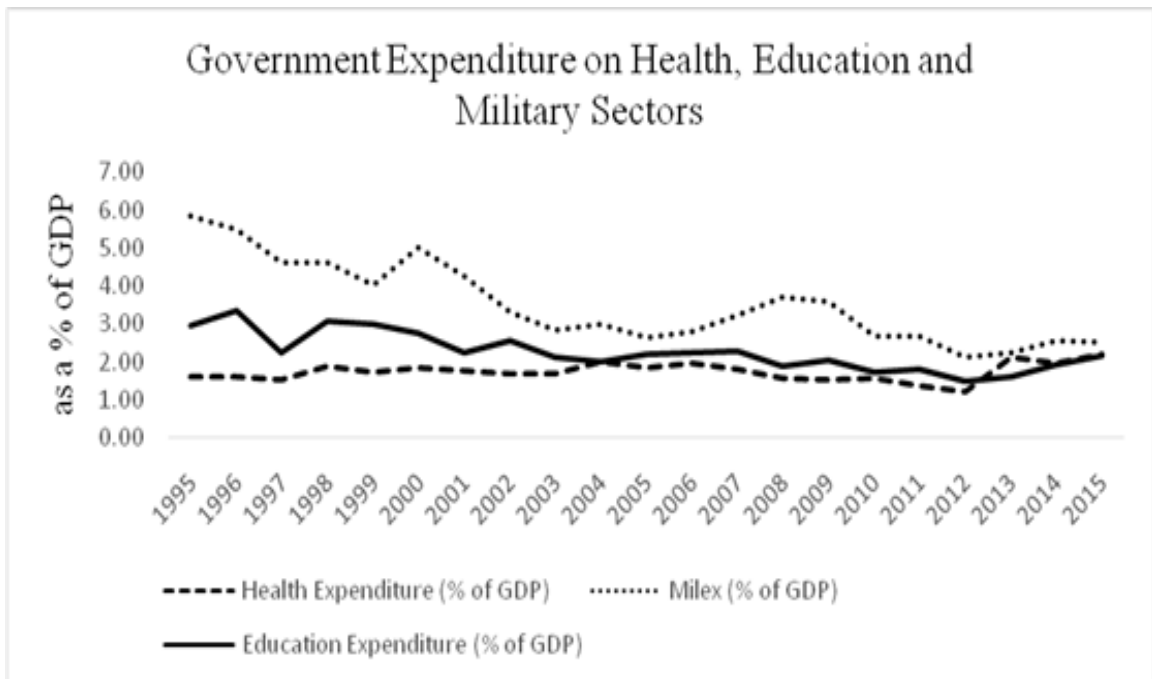
More often than not during past decade the political and terrorist turmoil mounted across the world in an exponential rate. In combating the mounting terrorist attacks launched by various terror groups the world economies have disbursed 1686 trillion in 2016 (SIPRI). Irrespective of developed or underdeveloped country the Military expenditure is one of the most important and common public good expenditures. When a war prevails in a country the military expenses are exponentially high. Military expenditure is essentially important for an economy in order to maintain the law and order within the country. However, what economic value of such expenses will have on economic growth is a question that should be addressed in an objective manner. The impact of military expenditure on economic growth is still inconclusive in the economic literature. This controversy induced the researchers to investigate the real economic impact of Military expenditure on economic growth in Sri Lanka. The Sri Lankan economy suffered from thirty-year ethnic conflict from 1979 to 2009. During the period of war and terrorism activities, the economic, social and cultural environment largely were disturbed and it compressed the economic growth as well as the economic development. Over 30 years of the period from 1979 to end of May 2009, Sri Lankan government prioritized military sector than the civilian sector for protecting the nation from the terrorists. However, it caused to decline the economic development, huge burden on debts and enlarge rich poor gap in Sri Lanka.

Keynesian economists stand that more allocations on public sector will create multiple impact on economic growth. The classical economists believe that more allocations on the public sector has an adverse impact on economic growth because they promoted an economy without government interventions. Consequently, many scholars attempted to study impact of military allocations on economic growth in developing and developed country context with war situations as well as without war. In the Sri Lankan context, few studies have been conducted on defense economics and this study attempts to contribute to the vacuum in the literature by considering military allocations on economic growth in the post war period.

Research Problem

Even after 8 years of the ending the war, the Sri Lankan government has failed to prioritize economic services and social services than military sector. Still the Sri Lankan government allocates more public funds to the military sector than primary sectors of education and health. The Figure 1 shows government allocations on health, education and military sector as a percentage of Gross Domestic Production (GDP). It clearly shows that even after the end of the war, the Sri Lankan government is incapable of reducing military allocations. However, it has remained a puzzle whether the Military expenses (Milex) really affects the economic growth in Sri Lanka. Understanding the influence of Milex on economic growth is necessary to realize the future growth potentials in the Sri Lankan economy.

Figure 1: Government Expenditure on Health Education and Military Sectors from 1995 to 2015



Source: World Bank database and Indexamundi database

Objectives

This study aims to achieve following objectives,

To explore long run association between Military allocations and economic growth in post war period in Sri Lanka.

To analyze causal relationship between Military allocations and economic growth in post war period.

Theoretical and Empirical Review

During the great depression in Europe, Keynes (1936) advocated that increased in government expenditure and tax cuts stimulate economic growth through demand side. The Keynesian paradigm considered that public expenditure plays a major role in the short run to boom economy to a desired level. In other words, Keynesian theory states that public expenditure causes on economic growth because it is a fiscal policy instrument to achieve short term economic stability and long term economic growth. Moreover, Wagner's law supports the argument and concludes that the public expenditure impact on economic growth. Law of increasing state activity or Wagner's law (Wagner, 1893) states the relative growth of the government sector is an inherent characteristic of industrialized economies. According to the Wagner's law economic growth causes to public expenditure. However, both Keynesian and Wagner's law are applicable in short run rather in long run. As a counter argument for Keynesian and Wagner's law, classical economists (Smith, Malthus, Ricardo, Mill,) note that growing public expenditure and increasing public debt reduce economic growth and destabilize modern economies. This is due to the reason that classical economists not allowed government intervention in the market economy. Further, Benoit (1973 and 1978) originated the academic discussion on Milex and economic growth and revealed that no any adverse impact from defense expenditure on economic growth among 44 developing nations all over the world. Later, a large volume of studies focused to analyze the relationship between Milex and economic growth in difference context (Dunne, Nikolaidou, & Vougas, 2001; Danek, 2013; Mintz & Huang, 1990; Yildirim, Sezgin, & Öcal, 2005; Rashid & Arif, 2012).

Methodology

This study is based on the post war period from 4th quarter of 2009 to 4th quarter of 2016. Various standard statistical tools are used for the study. The independent variable is Military allocations and the dependent variable is Gross Domestic Production (GDP). Data for Military allocation were gathered from the Indexmundi data base and GDP data obtained from the Annual reports of Central Bank. GDP data available in quarterly basis but Milex data available only on an annual basis. Hence, we converted annual Milex data into quarterly frequency by using option available in the EViews statistical software. First, Augmented Dickey Fuller test is used to determine stationary of data set. Then, Johansen Cointegrations and two-way Granger causality tests are employed to enhance objectives of this study.

Results and Discussion

Both data are non-stationary at level. However, first difference series of both Milex and GDP shows stationary at 1 Percent significance level. Table 1 and 2 shows the results of Cointegration test and causality test respectively. Cointegration results confirm the presence of long run association between two variables under both trace and Maximum eigen value statistics which indicates that both GDP and Milex move into the same direction in the long run. However, no causal relationship is established from Milex to GDP and vice versa.

Table 1: Results of Cointegration Test

H ₀	Trace test			Max-Eigen test		
	Trace	5% C.V.	Probability**	Max Eigen	5% C.V.*	Probability**
r = 0*	28.85	15.49	0.000	22.93	15.49	0.001
r ≤ 1*	5.92	3.84	0.014	5.92	3.84	0.014

Note: Trace statistic and Max-eigenvalue test indicates 2 cointegrating equations at the 0.05 level,

* denotes rejection of the hypothesis at the 0.05 level

**MacKinnon-Haug-Michelis (1999) p-values

Table 2: Results of Two-Way Granger Causality Test

Null Hypothesis:	F-Statistic	Prob.
DMILEX does not Granger Cause DGDP	0.09929	0.9059
DGDP does not Granger Cause DMILEX	0.17542	0.8403

Conclusion

In the post war period, the results discovered that defense expense and economic growth move together in the long run, while Milex is not causing on economic growth. Further, economic growth does not cause on military expenditure allocations. This result is consistent with the other global findings such as Khan (2004); Habibullah, et al. (2008); and Anwar, et al. (2012). Interestingly, the findings contend that the military expenditure does not contribute for the economic growth in Sri Lanka rather it has become a big burden for the fiscal discipline in Sri Lanka. Finally, this study implies that allocation of more public funds among economic services and social services is more beneficial than military sector allocations in Sri Lanka.

Keywords: Economic Growth; Military Expenditure; Post War

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