

DEFENSE INDUSTRIAL INITIATIVES CURRENT ISSUES

Economic Growth in the Defense Sector

While the U.S. economy slowed in the third calendar quarter, defense spending leaped, far outstripping other government agencies. It is tempting to draw the conclusion that defense spending is somehow not aligned with the rest of the economy. Here is why that conclusion is incorrect.

According to the Commerce Department’s Bureau of Economic Analysis (BEA), which tracks U.S. economic activity, defense spending rose 18.0 percent from the second calendar quarter to the third, on a seasonally adjusted, annualized basis in constant dollars.¹ The third quarter of 2007 saw a similar increase, when the annualized rise in defense spending exceeded that of federal spending, which in turn also outpaced overall U.S. economic growth.

The BEA’s GDP estimate includes a high-level analysis of defense spending, which provides some insight on why spending rose in the third quarter. Recasting the GDP data on a quarterly basis in current dollars shows that the biggest dollar contributors to the increase were compensation, personnel support, weapons support, and installation support.

Why did defense spending increase?

The most significant explanation for the jump in spending is the late date of the FY2008 defense supplemental appropriations act, which was not approved until the end of June. The Defense Department had been doing everything it could to stretch dollars until the supplemental was passed, at which point all the accounts were made whole, with only one quarter remaining to spend it.

¹The BEA reports quarterly data on an annualized basis and calculates percentage change by multiplying the change from one quarter to the next (in real terms, -0.13%) by four (to get -0.5%).



Source: Department of Defense

Annualized Percent Change from Prior Period (measured in constant dollars)

	2007				2008		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
GDP	0.1	4.8	4.8	-0.2	0.9	2.8	-0.5
Federal	-3.6	6.7	7.2	-0.5	5.8	6.6	13.6
Defense	-5.9	8.5	10.2	-0.9	7.3	7.3	18.0
Non-Defense	1.2	3.1	1.2	0.4	2.9	5.0	4.5

Source: Bureau of Economic Analysis, “Gross Domestic Product: Third Quarter 2008 (Preliminary),” news release, November 25, 2008, <http://www.bea.gov/newsreleases/national/gdp/gdpnewsrelease.htm>.

For months, actions had been delayed, regular maintenance was pushed back, and contracts were not signed until the supplemental came in. Much of that delayed spending was in the three support categories that together accounted for 46 percent of the increase in spending.

Top growth categories:

Weapons support includes depot service and maintenance for new weapons systems. The BEA estimates depot maintenance service from contract awards data. Estimates for new weapons systems are derived from financial reports as a percentage of disbursements for each major weapons system. This category saw 76% annualized growth in current dollars in the third quarter.

With last summer’s high fuel prices, petroleum spending rose slightly more than 9 percent, a 37% annualized rate in current dollars. From the third quarter of 2007 to the third quarter of 2008, defense spending on petroleum rose more than 48 percent.

Personnel support includes contracts for consulting, training and education (estimated by the BEA based on contract awards), and direct hire of foreign nationals (estimated by the BEA based on a DOD survey). This category saw 40% annualized growth in current dollars in the third quarter.

Installation support includes BEA estimates for electricity, natural gas, telephone, postage, housekeeping, water, sewage and steam, communication, rent, contractor-operated facilities, and maintenance of real property and equipment. In the third quarter, this category saw 36% annualized growth in current dollars.

**Quarterly Defense Spending by Category
(measured in billions of current dollars)**

	2008		Chg.	Q3'08 / Q3'07	
	Quarterly (1)			Q2'08	Q3'07
	Q2	Q3			
Total Defense	\$180.8	\$189.9	\$9.1	5.0%	12.4%
Compensation	63.0	64.5	1.5	2.4	7.8
Petroleum	4.7	5.1	0.4	9.1	48.2
R&D	15.6	15.6	0.1	0.5	10.6
Installation support	10.1	11.0	0.9	8.9	13.7
Weapons support	7.7	9.1	1.5	19.0	18.6
Personnel support	19.2	21.1	1.9	9.9	17.9
Other consumption (2)	37.2	38.6	1.4	3.8	9.0
Investment (3)	23.6	25.0	1.4	5.9	19.4

(1) Calculated by dividing the government's annualized figures by four.

(2) Includes some purchases of aircraft, missiles, ships, vehicles, electronics and other durables, depreciation as measured by national income accounting, transportation and travel.

(3) Includes structures, some vehicles, aircraft, missiles, ships, electronics and software and other equipment.

Source: Bureau of Economic Analysis, News Release, November 25, 2008, Table 3, <http://www.bea.gov/newsreleases/national/gdp/gdpnewsrelease>, and Table 3.11.5, National Defense Consumption Expenditures and Gross Investment by Type, <http://www.bea.gov/national/nipaweb/SelectTable.asp?Selected=N> Because the data is in current dollars, not constant dollars, the annualized percentage increase in spending will vary from the constant-dollar figure.

For more information, please see:

Bureau of Economic Analysis (BEA), “National Income Accounts,” <http://www.bea.gov/national/index.htm>; and BEA, *Government Transactions: Methodology Papers: U.S. National Income and Product Accounts* (Washington, D.C.: Bureau of Economic Analysis, September 2005), <http://www.bea.gov/national/pdf/mp5.pdf>.

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