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Institute of Economics
Scuola Superiore Sant'Anna

Piazza Martiri della Libertà, 33 - 56127 Pisa, Italy
ph. +39 050 88.33.43
institute.economics@sssup.it

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**Does public R&D funding crowd-in private
R&D investment? Evidence from military
R&D expenditures for US states**

Gianluca Pallante ^a
Emanuele Russo ^a
Andrea Roventini ^{a,b}

^a Institute of Economics and EmbeDS Department, Scuola Superiore Sant'Anna, Pisa, Italy.

^b OFCE Sciences Po, Sophia-Antipolis, France.

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Does public R&D funding crowd-in private R&D investment? Evidence from military R&D expenditures for US states

Gianluca Pallante^{*1}, Emanuele Russo³, and Andrea Roventini^{1,2}

¹Institute of Economics and EMbeDS, Sant'Anna School of Advanced Studies, Pisa, Italy

²OFCE Sciences Po, Sophia-Antipolis, France

³Bank of Italy, Genoa Branch, Italy

Abstract

Military Research and Development (R&D) expenditures arguably represent one of the main innovation policy levers for US policy makers. They are sizeable, with a clear-cut public purpose (national defense) and with the government being their exclusive buyer. Exploiting a longitudinal dataset linking public R&D obligations to private R&D expenditures for US states, we investigate the impact of defense R&D on privately-financed R&D. To address potential endogeneity in the allocation of funds, we use an instrumental variable identification strategy leveraging the differential exposure of US states to national shocks in federal military R&D. We document considerable "crowding-in" effects with elasticities in the 0.11-0.14 range. These positive effects extend also to the labor market, when focusing on employment in selected R&D intensive industries and especially for engineers.

Keywords: R&D · Innovation policy · Defense · Mission-oriented innovation

JEL classification: O30 · O31 · O32 · O38 · H56 · H57

*Corresponding author: gianluca.pallante@santannapisa.it - EMbeDS and Institute of Economics, Scuola Superiore Sant'Anna, piazza Martiri della Libertá 33, 56127, Pisa (IT).

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1 Introduction

Firms' innovation activities play a crucial role in fostering productivity and economic growth (Nelson and Winter, 1982; Dosi et al., 1988; Romer, 1990; Aghion and Howitt, 1992; Dosi et al., 2010). Yet, R&D underinvestment is a well documented feature of contemporary economies, and governments are seeking new ways to boost research in the private sector (Bloom et al., 2019). The large presence of knowledge spillovers makes social returns to R&D considerably higher than private ones, thus, resulting in lower R&D efforts than the socially desired level (Nelson, 1959; Arrow, 1962; Lucking et al., 2019). This is exacerbated by financial constraints on innovative firms, by the inherent uncertainty associated to research investments as well as other types of barriers to innovation (Hall and Lerner, 2010; D'Este et al., 2012; Garicano and Steinwender, 2016; Pellegrino and Savona, 2017). Against this background, the effectiveness of public support in stimulating private R&D expenditures is subject to large empirical and theoretical debates and shall not be taken for granted (see e.g., David et al., 2000; Becker, 2015, for surveys on the topic). In this work, we contribute to these debates providing empirical evidence about the impact of defense-related R&D funded by the US government, and empirically assess whether it stimulates or substitutes privately-financed and conducted R&D.

Especially in the US, among different types of non-conventional innovation policies, the experience of public support to military R&D appears to be particularly relevant (Mowery, 2010, 2012). Historically, defense R&D has been the largest component of federal R&D spending and promoted a wide range of civilian innovations (cf. Section 2.1). However, much of the empirical evidence on the impact of defense R&D is anecdotal and based on historical case studies (Nelson, 1982; Mazzucato, 2015; Foray et al., 2012; Azoulay et al., 2019), while quantitative econometric assessments are relatively few and rarely focused on the estimation of causal effects.¹ As a first notable exception, Moretti et al. (2019) estimate an elasticity of

¹Early studies investigating the effectiveness of public R&D in promoting private R&D and innovation lacked a causal perspective (Mansfield and Switzer, 1984; Lichtenberg, 1984, 1987). More recently, empirical papers have identified causal effects of R&D support for selected public agencies. Some examples include: Howell (2017), Azoulay et al. (2019) and Gross and Sampat (2020) for the US; Santoleri et al. (2020) for Europe; Bronzini and Iachini (2014) for Italy and Moretti et al. (2019) for a panel of OECD countries and industries. At the theoretical level, Dosi et al. (2020) test mission-oriented policies in a macroeconomic agent-based model and find positive effects on innovation, productivity and GDP growth.

public R&D to private R&D in a panel of countries and industries, using defense-related R&D as an instrumental variable for public R&D. Howell et al. (2021) focus on a "bottom-up" reform of the Air Force SBIR programme that allowed defense contractors to propose research ideas. Finally, Gross and Sampat (2020) analyze the long run impact of the Office of Scientific Research and Development (OSRD), a large mission-driven organization supporting R&D during World War II in the US. They find long-lasting impacts in the post-war period on the direction of patenting and on the rise of geographical technology clusters.

We contribute to the existing literature by adopting a macro-regional perspective focusing on US states as our unit of analysis.² To the best of our knowledge, this is the first study estimating region-wide effects. For instance, Moretti et al. (2019) document positive elasticities at the industry-country level, thus, incorporating spillovers that occur within-sector and across countries. Our estimated parameter, instead, embeds local effects, including also for R&D externalities among different sectors and type of performers. This is an important advantage given the theoretical relevance of agglomeration mechanisms and localized knowledge spillovers (cf. Section 2.2). Furthermore, we are able to identify employment effects that remained overlooked in the current literature.

In our investigation we combine different data sources to assemble a longitudinal dataset that associates, at the US state-level, defense and non-defense federal R&D obligations to non-federally funded private R&D expenditures for the period 1968-2017, as well as to high-tech employment for the period 1998-2018. We then exploit the geographical and temporal variations in our data to estimate the elasticity of non-federally funded private R&D investment to defense R&D expenditures employing panel fixed effect regressions.

Endogeneity problems may arise in this setting primarily because military funds for R&D are not randomly assigned geographically. Their allocation may well be driven by characteristics that likely determine the amount of private R&D conducted in a given state. To address endogeneity concerns and infer causal effects we use a recently developed identification strategy that builds on differential state exposures to national spending shocks (Nakamura and Steinsson, 2014; Guren et al., 2020). More specifically, we leverage two inherent characteristic of defense R&D funding: (i) as for general military procurement, changes in national military

²In this respect, our work links to the macroeconomic literature on regional and local effects of public spending (Fishback and Kachanovskaya, 2015; Auerbach et al., 2020; Bernardini et al., 2020).

R&D obligations are arguably exogenous to the business cycle and to productivity levels, being driven by geopolitical events (Ramey, 2011; Moretti et al., 2019); (ii) the total R&D funds assigned to each state are differently sensitive (with respect to other states) to changes in national R&D budget. Drawing upon these two facts, we instrument changes in state-level defense R&D obligations using variations in national defense R&D obligations interacted with state dummies.

The empirical results show that federally-financed military R&D *crowds-in* privately-funded R&D. In particular, IV estimates are systematically higher than OLS with elasticities in the range 0.11% - 0.14% over a 4-5 year horizon. This suggests that the final impact of public defense R&D on total R&D significantly exceeds its dollar value. Such stimulus also translates to employment in R&D-intensive industries and in particular for engineering occupations with elasticities between 0.05% - 0.1%. Our results are robust to a series of tests and alternative specifications including the presence of weak instruments; the inclusion of other innovation policy variables; measurement errors; corrections for outliers and missing values.

The rest of the paper is organized as follows: Section 2 provides some historical and theoretical backgrounds regarding defense R&D; Section 3 describes our dataset; Section 4 presents the econometric specification and the identification strategy while Section 5 presents and discusses the results; finally, Section 6 concludes.

2 Historical and theoretical backgrounds

In this section we first discuss the historical role played by R&D financing from the Department of Defense (DoD) in shaping innovation in the US economy (cf. Section 2.1). Then, we present an overview of the literature focusing on the main theoretical mechanisms underlying crowding-in (or crowding-out) effects of public R&D, with a specific emphasis on the characteristics of military R&D (cf. Section 2.2).

2.1 Defense R&D and innovation in the US since World War II

Defense R&D has been historically the major component of US federal R&D spending (with a share raging from 40% to 60%, cf. Figure 1). Right from the beginning, its focus has been on the creation of an industrial base to support military innova-

tion and build technological superiority for the US. Several historical studies have pointed out that public defense R&D took a central role in the US system of innovation since World War II, substantially affecting technology discovery and diffusion in various industries (see e.g., Nelson and Winter, 1982; Alic et al., 1992; Ruttan, 2006; Mowery, 2010; Block and Keller, 2015; Mazzucato, 2015).

In 1941, the Roosevelt administration created the Office of Scientific Research and Development (OSRD) aimed at coordinating and supporting R&D efforts in areas that were considered strategic during wartime, such as weapon development, medicine or transport and communication. This represented an unprecedented change in US innovation policies, both in terms of the scale of R&D spending and in the way of supporting science through external contracts (Gross and Sampat, 2020). Research financed by the OSRD fostered major scientific discoveries that later became of utmost societal importance, including, for instance, antibiotics, atomic energy and electrical computing. Moreover, it fostered the creation of a national R&D infrastructure made by federally funded labs, many of which located in universities or private corporations (Kleinman, 1995; Westwick, 2003; Block and Keller, 2015; Gross and Sampat, 2020).³

During the cold war, military R&D spending further expanded its influence, acting as a *de facto* industrial policy (Moretti et al., 2019). More specifically, public defense R&D has been interpreted as a particular example of "mission-oriented" innovation policy, being concerned with the achievement of well-defined technological objectives defined by the funding entities (Mowery, 2010; Mazzucato, 2015). Several innovations made by defense scientists during the post-war period fostered civilian spinoffs in a wide range of fields such as commercial aircrafts, information technologies, semiconductors and satellite communications (Nelson, 1982; Block and Keller, 2015). It has been also argued that research funded by defense agencies promoted the emergence and diffusion of radical innovations and general purpose technologies (Ruttan, 2006; Mazzucato, 2015).⁴ Against this background, government procurement represented a key element of the "innovation model" of defense agencies. Often R&D financing was complemented by government purchases of technologies and products developed by contractors. In this respect, the DoD acted

³Consistently, Gross and Sampat (2020) empirically show that OSRD-supported research contributed to shaping the direction and location of US inventive activity in the postwar period.

⁴As an illustrative example, consider the ARPANET project led by the DARPA agency. ARPANET is widely seen as the ancestor of the Internet (Mowery, 2010). For a recent discussion of the DARPA model see Azoulay et al. (2019).

as "experimental user", providing market demand that allowed firms to survive and select the most promising product varieties, thus, curbing the uncertainties associated to the new technology (Malerba et al., 2007; Mowery, 2010).⁵ Despite achieving unquestionable successes in several fields, there were also instances where the application of military technologies to the civilian sector failed (e.g., the Concorde supersonic aircraft) or turned out to be costly and long-delayed (e.g., the commercialization of the microwave, a spin-off of radar technology, took about 20 years Alic et al., 1992). In some specific cases – such as the focus by the Navy on light water nuclear reactors (Cowan, 1990) or the Air Force programs for the development of numerically controlled machine tools (Stowsky, 1992) – the effects of DoD interventions became even detrimental, distorting R&D efforts away from the most promising technological trajectories.

During the 90s, after the end of the cold war, the share of defense R&D declined, albeit still accounting for a large proportion (about 40%) of total federal spending. Between 2001 and 2010, in the aftermath of the 9/11 terrorist attacks, DoD financing of R&D experimented a new upswing, driven by the outbreak of conflicts in Afghanistan and Iraq. In recent policy debates (Cox et al., 2014; Griffin, 2019), concerns were raised about the innovative performances of the US defense sector and the ability of the DoD to keep acting as major financier of breakthrough ideas. Howell et al. (2021) show that, since 1990, defense R&D spending has become more concentrated in few large contractors with declining innovation rates.

2.2 Crowding-in and crowding-out effects of military R&D: mechanisms at play

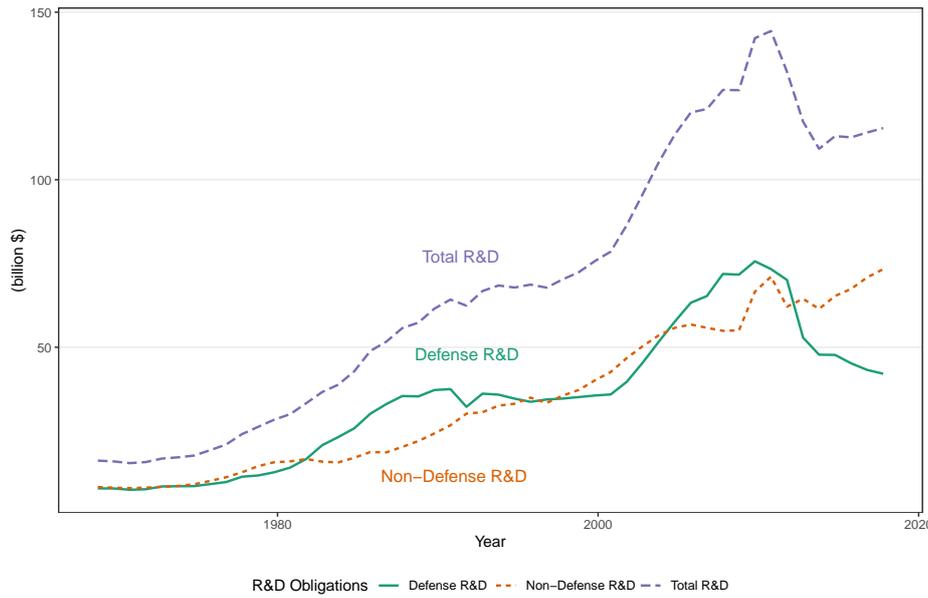
The innovation literature has emphasized different theoretical mechanisms through which public funding may foster (or displace) R&D investments of private companies⁶

For a single firm, receiving a public grant could stimulate additional R&D spending if its innovative activities are financially constrained (this is particularly

⁵For instance, in the early phase of the semiconductor industry, government demand offered a niche market for transistors, supporting major technology advances (Malerba et al., 2007).

⁶Given the focus of our paper, the discussion in this section will centre on spillovers that affect private R&D spending. See Sempere (2018) for a more general discussion of spillovers from defense R&D. For a survey of empirical results on the effects of public R&D on private R&D see David et al. (2000).

Figure 1: Levels of federal R&D obligations - defense vs non-defense.



relevant for small and young companies, see Hall and Lerner, 2010 and Garicano and Steinwender, 2016). If the firm is willing to invest but lacks financial resources, the provision of a public subsidy could lead to the implementation of (not yet financed) R&D projects.⁷ Moreover, government support may ease the access to additional external finance and spur follow-on R&D investment by the firm (i.e., crowding-in effect). This could be driven by two main channels - namely, "certification" (the grant provides market signals about firm quality, see Lerner, 2000) and "funding" (the grant allows the demonstration of viability of an early-stage project, see Howell, 2017). In the specific context of defense R&D, given the dual-use characteristic of several military technologies (Cowan and Foray, 1995), both channels may be linked to the opportunities arising from civilian spinoffs of publicly-financed R&D projects. Nevertheless, the effectiveness of these mechanisms rests crucially upon: (i) the availability of R&D inputs; (ii) government ability to target financially-constrained firms and projects with great potential for spillovers, while discouraging rent-seeking behaviours. On this matter, Cowan and Foray (1995) argue that the scope for generating civilian spinoffs is greater for early-stage and process-oriented technologies.

Public R&D support may as well spill-over outside the boundaries of the firm

⁷The grant may be particularly effective if it helps overcome some of the fixed R&D costs, allowing the implementation of additional plans Moretti et al. (2019).

and generate externalities at the local level (Jaffe et al., 1993; Henderson et al., 2005). Effects could materialize within-industry when the grant fosters additional R&D expenditures by competitors of the awarded firm. By nurturing local industry clusters, public funding may foster intra-sectoral flows of technical knowledge and human capital, making companies more productive and willing to invest in R&D (Marshall, 1890; Glaeser et al., 1992; Moretti, 2021). Spillovers may occur as well across different sectors and type of performers. As reported in the previous section, DoD spending had a crucial role in creating local R&D infrastructures and capabilities (Mowery and Rosenberg, 1981; Mowery and Langlois, 1996; Gross and Sampat, 2020). This, in turn, may trigger agglomeration effects and the creation of new technology hubs (see e.g., the debate on federally-funded R&D and place-based innovation policies in Gruber and Johnson, 2019). Agglomeration externalities may be particularly relevant for mission-type of R&D expenditures, such as for the military case, that target products and technologies with high degree of complexity (Alic, 2007; Sempere, 2017). Complex activities are becoming increasingly concentrated in large cities as they require a diverse set of skills and complementary services with high coordination costs (Balland et al., 2020).

Public funding may also have a negative impact on local business R&D. For instance, Cowan and Foray (1995) point out that defense and civilian sectors use the same R&D resources. If the supply of inputs is sufficiently rigid in the short-run, government funding of defense R&D may displace civilian R&D. Moreover, local firms could free-ride on R&D activities conducted by awarded companies and reduce their R&D spending (Sempere, 2018; Moretti et al., 2019).

Whether positive effects associated to public spending will prevail (or viceversa) remain subject to an open debate (see e.g. David et al., 2000, for an early survey of the empirical literature). Our empirical analysis in Section 5 aims exactly at contributing to this debate.

3 Data

Our longitudinal dataset comprises data for 50 US states and the District of Columbia for the period 1968-2017.⁸ The main variables are described below. In Appendix A, we report figures and summary statistics concerning our dataset.

⁸Data are available from the authors upon request.

Public R&D expenditures. We employ data from Survey of Federal Funds for Research and Development led by the National Science Foundation (NSF) to measure defense and non-defense R&D spending. The survey provides annual data on federal R&D obligations disaggregated by funding agency and state of performance from 1968 onwards.⁹ Federal R&D obligations represent the amounts committed in a given fiscal year regardless of when the actual payment takes place.¹⁰ As such, they should be intended as a broad measure of public support including both R&D procurement (i.e., contracts for R&D services) and grants such as those awarded by the Small Business Innovation Research program.¹¹ We select only obligations by the Department of Defense to build our defense-related R&D variable. As a control variable, we also aggregate obligations from other agencies to get a proxy of non-defense R&D. The series are deflated using the price indexes (with base year 2012) respectively for federal defense R&D investment and for federal non-defense R&D investment provided by the Bureau of Economic Analysis (BEA).¹²

Private R&D expenditures. Data on private R&D expenditures come from the Business R&D and Innovation Survey (BRDIS).¹³ BRDIS provides data on total private R&D expenditures by state, disaggregated by funding source. To avoid double counting and to get a reliable proxy of additional R&D investments, we only consider the non-federally financed component of private R&D. Notice that we are

⁹Only 10 large agencies report data on the geographic distribution of obligations including: the Departments of Agriculture, Commerce, Energy, Defense, Health and Human Services, the Interior, and Transportation; the Environmental Protection Agency; NASA; and NSF. These agencies account for roughly the 97% of total R&D obligations (Pece, 2020). Survey respondents are asked to indicate the state where the research was performed by the primary contractor or grantee. In absence of this information, federal agencies should assign obligations to a specific state based on the headquarters of the performer.

¹⁰This implies that the actual outlays associated to a given obligations may be distributed through one or more payment tranches in subsequent periods. Unfortunately, data on federal R&D outlays are not collected at the state-level and, therefore, cannot be used for our purposes. We discuss the issue in Section 5 and provide results using national outlays to construct our instrumental variables.

¹¹For detailed definition of federal obligations see the Circular A-11 by the US Office of Management and Budget which provides guidance for federal agencies on budget preparation.

¹²The price index for federal defense R&D is contained in Table 3.11.4 from the BEA website "Price Indexes for National Defense Consumption Expenditures and Gross Investment by Type". The price index for federal non-defense R&D is contained in Table 3.9.4 from the BEA website "Price Indexes for Government Consumption Expenditures and Gross Investment".

¹³This is a stratified survey jointly run by the NSF and the Census Bureau that is representative for the population of for-profit non-farm companies with five or more employees. The BRDIS initial year is 2008. The predecessor of BRDIS is the Survey of Industrial Research and Development (SIRD) which covers the period 1953-2007. According to the NSF (Wolfe, 2008), there is no evidence suggesting that the redesign of the survey from SIRD to BRDIS introduced structural breaks in the data. Nevertheless, in our analysis, potential changes affecting all states in 2008 are absorbed by the specific time dummy.

not able to discern among different private sources of funding (possibly other than company). In Section 5 we explicitly address this issue. The private R&D series also present a non-negligible number of missing values for two main reasons. First, for the period 1981-1997 the survey was biannual. Second, confidentiality issues prevent publication of data for those states with a small number of surveyed firms. We linearly interpolate missing values between observations only when the gap is not greater than one year in order to minimize potential biases due to measurement errors.¹⁴ On the contrary, no forward or backward extrapolation is performed. Private R&D data are transformed in real terms using the R&D price index (base year 2012) from the BEA.¹⁵ Unfortunately, BRDIS data are not broken down by industry for US states, that is why we cannot estimate more granular regressions at the industry-state level.

Employment in R&D-intensive industries. We rely on the BEA Regional Accounts, which provide employment figures by state and 3-digit industries.¹⁶ The change in industry classification in 1997 from SIC to NAICS does not allow us to get consistent time series for the whole time span. Therefore, we focus on the period 1998-2018 which follows the introduction of the NAICS system. We focus on the 5 industries that accounts for most of the domestic R&D performance (National Science Board, 2018): chemicals manufacturing (NAICS 365); computer and electronic products manufacturing (NAICS 334); transportation equipment manufacturing (NAICS 336); information (NAICS 51); and professional, scientific, and technical services (NAICS 54).

R&D-related occupations. Data are obtained from the Occupational Employment Statistics database compiled by the Bureau of Labor Statistics. We focus on STEM occupations, in particular on those that are labeled as "Research, Development, Design, and Practitioners". Starting from 6-digit R&D-related occupations (SOC classification rev. 2010), we aggregate data at the 3-digit level and come up with the following categories: Computer Occupations 15-1100; Architects, Surveyors, and Cartographers 17-1000; Engineers 17-2000; Life scientists 19-1000 and Social

¹⁴To evaluate possible distortions arising from the interpolation we report in Section 5 results for the period 1999-2017 which displays almost no missing values. Results appear to be robust to the presence of missing observations.

¹⁵This is available in Table 1.2.4 "Price Indexes for Gross Domestic Product by Major Type of Product" from the BEA website.

¹⁶For selected sectors we observe only 2-digit, whilst for other the aggregation becomes more granular at 4-digit level

Scientists and related workers 19-3000.¹⁷

Additional variables. We complement our dataset with data on state-level GDP and population from the BEA Regional Accounts.¹⁸ Also, as additional control variables, we include some state-specific measures of innovation policies. First, we obtain data on defense non-R&D procurement from the Federal Procurement Data System Next Generation (FPDS-NG), provided by the General Services Administration (GSA). FPDS reports all primary contracts from agencies subject to mandatory reporting and for purchases above the threshold value of \$2,500 from 1980 onwards. Each entry is classified by funding agency and has a 4-digit Product Service Code (PSC) which allow us to rule out contracts associated to the performance of R&D (PSC codes starting with A). Second, we use data from Lucking (2019) on state tax credits, corporate income taxes and user cost of R&D capital to capture possible variations in the regional tax system.

4 Econometric specification and identification strategy

4.1 Econometric specification

To measure the effects of military R&D spending on private R&D we build a longitudinal dataset relating defense R&D obligations (i.e., our public R&D spending proxy) to private R&D expenditure (cf. Section 3). We use the geographical and temporal variation of our data to estimate the following model:

$$\Delta^h RDpriv_{i,t} = \beta \Delta^h RDdef_{i,t} + \gamma' \Delta^h \mathbf{W}_{i,t} + \alpha_i + \lambda_t + \varepsilon_{i,t}, \quad (1)$$

where $\Delta^h RDpriv$ stands for log changes of privately-financed R&D between year t and $t - h$ in state i , $\Delta^h RDdef$ denotes h -year log changes of total R&D obligations from the Department of Defense (DoD) between year t and $t - h$ in state i , and $\Delta^h \mathbf{W}$ is a vector of state by year observables, measured in h -year log changes,

¹⁷The 2010 SOC revision introduced some minor classification changes. In aggregating, we considered only those occupations that allows us to keep consistency at the 3-digit level before and after the revision. Notice that, in the 2010 classification, the group 15-1100 "Computer occupations" coincides with the 3-digit category 15-1000. Due to the high number of missing values, we could not retrieve reliable data for the 15-2000 category "Mathematical Science Occupations".

¹⁸GDP series are transformed in constant dollars (base year 2012) using the US GDP deflator. Concerning population data, we also used data from the Census Bureau and find no significant differences with respect to the BEA data.

used as control variables.¹⁹ All regressions include state fixed effects (α_i) to control for state-invariant characteristics and year dummies (λ_t) to absorb US-wide shocks over time.

Notice that this model proxies a log-level specification allowing for state-specific linear trends. One needs to account for state-specific trends as U.S. states experienced rather heterogeneous trajectories in terms of R&D investments and innovation performances (Akcigit et al., 2017), as shown by Figure A.2. Hence, our specification may be rationalized as a first-order approximation of the steady-state demand for R&D from a CES production function (Moretti et al., 2019)²⁰. In this setting, the parameter of interest (β) shall be interpreted as the elasticity of non-federally financed business R&D to defense R&D spending.

We take variables in per capita terms to normalize for the different population size.²¹ Also, to account for the potential geographical correlation in the error structure we cluster standard errors by state.

4.2 The identification strategy

Our focus is on the identification of the β parameter associated to public defense R&D. Our baseline regressions already take into account a large set of potentially confounding factors including invariant country trends (e.g., geography, size), US-wide shocks, other innovation policy tools (i.e., non-military R&D, tax credits, non-R&D procurement), state GDP and population. Nevertheless, even after controlling for these factors, different sources of endogeneity may bias our estimates. A major concern is represented by the political nature of government R&D (Mintz, 1992). Indeed, as other forms of public spending, R&D obligations are not randomly distributed across states as the criteria adopted for their allocation are often likely correlated with unobserved state-specific characteristics that may well be determinants of R&D investing decisions by firms. For instance, politicians may pick winners (or losers), thus, financing states that are doing particularly well (or

¹⁹As common in the empirical literature on fiscal multipliers (see e.g., Nakamura and Steinsson, 2014) we use variations in public and private spending over a time horizon of h years. For the sake of transparency, in Section 5 we report results from separate regressions for $h \in \{2, 3, 4, 5\}$.

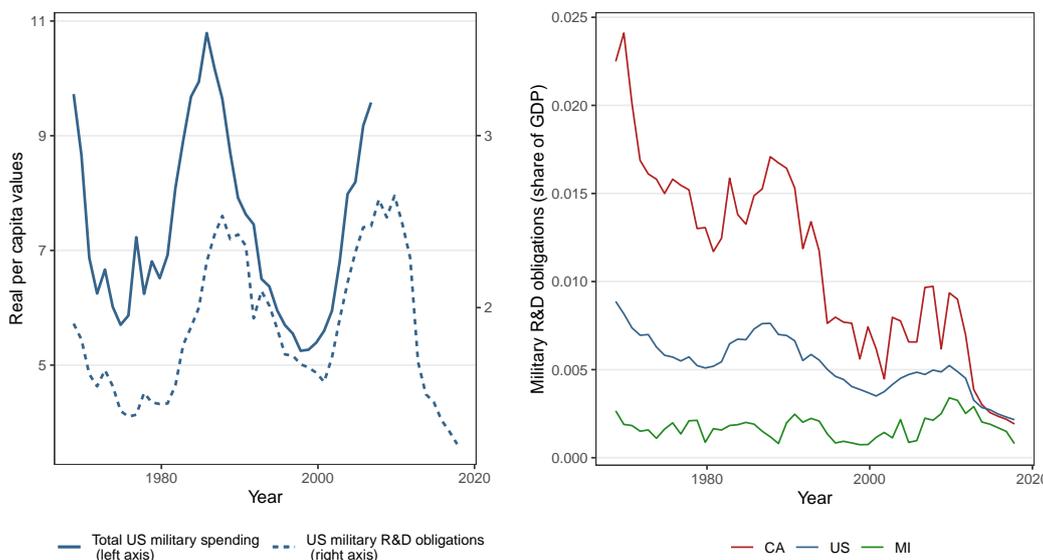
²⁰For the sake of comparison we also estimated a log-level specification without state-specific trends and symmetrical to the baseline model in Moretti et al. (2019). Results are very similar and reported in Table B.1 and show less conservative estimates when compared to ours.

²¹To check for potential biases arising from normalizing by population, we run regressions without dividing variables by population. Results are reported in Table B.3 and do not differ significantly from those obtained with per capita variables.

are struggling). Similarly, variations in public R&D may be accompanied by state-specific regulatory norms that influence private spending decisions. A second endogeneity concern comes from the potential measurement error affecting our spending variable. Obligations may measure imperfectly effective R&D spending as outlays occurs with some lags or because revisions and de-obligations may correct the initially obligated amount. Finally, the dependent variable may be subject as well to measurement errors since it also includes R&D financed by private channels other than the company. If one is interested in estimating the effect on company-financed R&D (rather than on private R&D as a whole) this will likely introduce bias.

To deal with endogeneity we draw upon a well-established macro identification strategy (Nakamura and Steinsson, 2014, 2018; Guren et al., 2020; Cloyne et al., 2020). We leverage two fundamental characteristics of public defense R&D. The left panel in Figure 2 shows that, similarly to general defense procurement, R&D obligations by the DoD at the national level are driven by exogenous (mainly geopolitical) events. As discussed in Section 2.1, large variations in DoD R&D efforts follow military buildups associated specific historical episodes. For instance, for the time period covered by our dataset, we can easily find the increase in military spending and R&D during the Reagan administration and following the 9/11 terrorist attacks. Second, data suggest that US states display systematically different sensitivities to changes in national R&D spending (cf. the right panel in Figure 2). In our example, when national defense R&D rises, obligations allocated to California increase much more than in Michigan. These patterns are remarkably stable over time and suggest that state-specific variations in public military R&D display a systematic component which is arguably exogenous to current private R&D shocks. Summarizing, our identification builds on two assumptions derived from the institutional characteristics of US defense R&D spending: (i) national shocks to R&D obligations are arguably exogenous to economic factors determining private R&D spending decisions; (ii) the allocation of these shocks to US states can be decomposed into a systematic component (arguably exogenous) and a residual part that is likely correlated with shocks in private R&D. Following Nakamura and Steinsson (2014), we isolate the arguably exogenous component by instrumenting $\Delta^h RDdef_{i,t}$ using national growth rates interacted with state dummies. Thus, our first stage is:

Figure 2: Characteristics of defense R&D: national patterns and geographical allocation



Notes: The left panel contrasts the evolution of military spending and military R&D obligations. The former is the sum of prime military contracts as in Nakamura and Steinsson (2014). Data for this series and are available only until 2006. Defense R&D obligations are taken from the National Science Foundation. Both variables are deflated and divided by total US population. The right panel shows the heterogeneous response of California and Michigan to variations in national R&D obligations (normalized by GDP).

$$\Delta^h RDdef_{i,t} = \theta_i \Delta^h RDdef_{US,t} + \gamma' \Delta^h \mathbf{W}_{i,t} + \alpha_i + \lambda_t + u_{i,t}, \quad (2)$$

where $\Delta^h RDdef_{US,t}$ denotes log changes of US defense obligations between t and $t - h$, while θ_i represents the idiosyncratic coefficient accounting for different state-specific sensitivities to national shocks.²²

To better clarify how our instrument works, let us consider the case of New Mexico, a state characterized by a relevant share of the defense and aerospace industry. In Figure B.1 we contrast actual changes in federal defense spending (blue line) with variations isolated by our IV (red line). During the buildup in the Reagan administration, New Mexico received a disproportionate amount of R&D obligations. Part of such variation is likely driven by contingent factors that plausibly affected also private R&D investment. The IV instead considers only the

²²The parameter theta is estimated interacting state dummies with $\Delta^h RDdef_{US,t}$. To simplify our notation we denote $\sum_{i \in I} \theta_i I_i \Delta^h RDdef_{US,t}$ with $\theta_i \Delta^h RDdef_{US,t}$, where I_i is an indicator function for state i .

variation due to systematic characteristics and smooths the excess of R&D funding. Notice that the IV also removes large fluctuations in the short run since these may as well depend on endogenous drivers.

A way to interpret this identification strategy is as an exposure research design (Goldsmith-Pinkham et al., 2020). States are differentially exposed to common national spending shocks. In this setting, US variation in DoD R&D obligations over a given time horizon represents a treatment that is assigned non-randomly to states. The key challenge to identification concerns the selection of exogenous measures of exposure in order to retrieve the quasi-random variation in treatment assignment (Goldsmith-Pinkham et al., 2020).²³ In a simple "Bartik" setting, local shares commonly play this role. Our design instead uses as proxies of exposures the sensitivity parameters (θ_i) estimated in the first-stage regression (cf. Eq. 2). As discussed, the sensitivities reflect a systematic component that – after conditioning for state fixed effects and other time-variant and state-specific variables – is likely uncorrelated with unobserved factors affecting private investment decisions. If holding, this assumption entails the conditional independence of θ_i from $RDdef$. Another condition required in IV settings is monotonicity. In our case, monotonicity requires the absence of "defiers", namely, states that respond negatively to variations in national shocks (i.e. $\Delta^h RDdef$ negatively correlated with $\Delta^h RDdef_{US,t}$). If also monotonicity holds, the parameter β correctly estimate an average causal response.²⁴

To investigate the validity of our research design, Figure B.2 contrasts the estimated exposure parameters from the first stage regression with the average log changes in $RDpriv$. Notice, first, that the estimated sensitivity coefficients (θ_i) are positive, show substantial heterogeneity, spanning considerable variation across states. We consider the positive sign of the estimated responses as supportive of the monotonicity assumption since "defiers" would likely show a negative coefficient. Moreover, sensitivities are not correlated with averages of the outcome variable ($\Delta^h RDpriv$), that is, states responding more to shocks in federal defense-related R&D do not exhibit larger increases in private R&D spending. We take this evidence as bearing support to the conditional independence of θ_i .

²³Borusyak et al. (2022) propose different identifying assumption, less suited to our practical application, relying on the exogeneity of shocks rather than of exposures.

²⁴More specifically, it estimates a weighted average of state-year causal responses for "compliers", namely, states that respond positively to variations in national shocks.

Finally, notice that conditional independence is less likely to be satisfied when (log) levels are used instead of (log) changes as the outcome variable. This possibly stems from the fact that exposure to shocks and the outcome variable are more likely to be co-determined when considered in levels (Goldsmith-Pinkham et al., 2020). That is why estimating the model in log differences would likely provide more reliable results.

5 Results

We estimate our model in Eq. 1 over different time spans (h) via both OLS and IV, employing the instrumental variables specified in Eq. 2. The estimation results are reported in Table 1. We do find positive and statistically significant effects of defense R&D obligations on private R&D over time horizons of 4 and 5 years. We progressively include controls (i.e., state GDP and non-defense R&D obligations) and show that our estimates remain remarkably stable.

A comparison between OLS and IV coefficients shows that OLS estimates are always downward biased. This may suggest that the allocation process of defense R&D expenditures tend to favor states that are under-investing in private R&D. At the same time, “attenuation bias” due to measurement errors may also drive the downward bias. Overall, IV results suggest that a 1% increase in military R&D funding over 4-5 years crowds-in private R&D expenditures with an elasticity between 0.11% and 0.14%. In terms of dollar values, these elasticities entails that each dollar of government spending generates between 0.57 and 0.72 dollars of additional R&D in the private sector.²⁵

Over shorter time intervals, we do not find significant effects of defense-related R&D on private one. Quite plausibly, private R&D expenditures appear to be sticky and respond only to spending shocks occurring over sufficiently large time horizons. This may also be related to the duration of R&D projects, as well as the appointment of project managers, which is typically in the 3-5 years range (Azoulay et al., 2019). On the contrary, standard macroeconomic variables such as GDP are typically sensitive also to 2-year spending variations as found, for instance, in Nakamura and Steinsson (2014) and Auerbach et al. (2020).

²⁵Dollar values are obtained from elasticity measures using the average ratio RD_{priv}/RD_{def} observed in the sample. Notice that the dollar value may change significantly depending since the ratio can vary across time and between states (Ramey, 2019).

From a theoretical perspective, in Section 2.2 we described different mechanisms that may drive these results.²⁶ First, DoD financing could relax financial constraints and help firms overcoming fixed costs associated to R&D, spurring additional private expenditures. Second, a potential interpretation of our results, although not formally tested, focuses on the local spillovers triggered by defense R&D grants. These may take place both within and across sectors, as well as among different types of local performers (e.g. university, firms, FFRDCs or government labs). Historically, military R&D expenditures played a key role in creating and supporting local innovation capabilities, in turn, fostering agglomeration economies and geographical clustering. Such effects could potentially be reinforced given that military technologies, particularly in their early-stages, exhibit a large scope for promoting civilian spinoff projects.

5.1 Robustness analysis

The foregoing results may be affected by different issues which could introduce substantial biases in the estimates. In this section, we control for different potential problems resulting from weak instruments, the omission of relevant variables, measurement errors, missing values, model specification (level vs. growth rates), outliers, the influence of key states, and population normalization. We find that the main result of our empirical analysis is confirmed: defense-related public R&D does crowd-in private R&D expenditures. In the following, we provide more details about the robustness checks we performed.

The first issue is linked to our identification strategy. TSLS estimates and the associated standard errors may not be reliable if instruments are weakly correlated with the endogenous regressor. Under weak instruments TSLS coefficients are biased towards OLS ones and standard inference procedures may not be reliable. In this work, a weak first-stage regression could also result from the many-instrument problem as we have 51 instruments (i.e., 51 state dummies interacted with national variations in defense R&D). To investigate the relevance of these concerns, Figure 3 compares the TSLS with the Limited Information Maximum Likelihood (LIML) estimator which tends to reduce biases from many and weak instruments. Estimations using LIML show higher and significant coefficients over 4-5 year variations,

²⁶For a detailed conceptual framework on the effects of military R&D on innovation see Mowery (2010).

Table 1: Main estimates: elasticity of non-federally funded private R&D to defense R&D obligations

Military R&D ($\Delta^h RD_{def}$)	Dependent variable: Privately-funded R&D ($\Delta^h RD_{priv}$)					
	OLS			IV		
	(1)	(2)	(3)	(4)	(5)	(6)
($h = 2$)	0.018 (0.02)	0.017 (0.02)	0.017 (0.02)	0.093 (0.08)	0.098 (0.079)	0.095 (0.076)
($h = 3$)	0.023 (0.021)	0.022 (0.021)	0.021 (0.021)	0.07 (0.058)	0.067 (0.059)	0.066 (0.055)
($h = 4$)	0.044* (0.026)	0.041 (0.026)	0.04 (0.025)	0.134* (0.08)	0.137* (0.079)	0.138* (0.07)
($h = 5$)	0.043 (0.027)	0.04 (0.027)	0.04 (0.027)	0.11* (0.056)	0.112** (0.055)	0.109** (0.053)
Non Military R&D	\times	\checkmark	\checkmark	\times	\checkmark	\checkmark
State GDP	\times	\times	\checkmark	\times	\times	\checkmark

Notes: the table reports OLS and TSLS estimations. The sample period is 1968-2017. We run separate regressions for each h , where the dependent variable is the h -year log-change in private R&D (privately financed, in real per capita terms). The main regressor is the h -year log-change in defense R&D obligations (in real per capita terms). Control variables include the h -year log-changes of non-military R&D obligations and state GDP (both in real per capita terms). All regressions include state and time fixed effects. Standard errors in parenthesis are clustered by state.

* $p < 0.1$; ** $p < 0.05$; *** $p < 0.01$

Table 2: First-stage effective F -statistics

	Effective F -statistics			
	$h = 2$	$h = 3$	$h = 4$	$h = 5$
F-stat	80.15	115.01	97.93	77.78
Critical values - Worst case bias 5%				
TOLS	30.87	33.29	33.5	34.55
LIML	16.56	24.93	24.3	27.09

Notes: the table reports for each h the effective F -statistics by Olea and Pflueger (2013) and the associated 5% critical values for the TOLS and LIML estimators. The null hypothesis is that of weak instruments. Rejections imply that the bias is not large, relative to a "worst-case" benchmark. The F -statistics refer to the first stage of the baseline model including non-military R&D obligations and state GDP as controls.

largely confirming our baseline results. Furthermore, we report in Table 2 the values of the effective F -statistic by Olea and Pflueger (2013).²⁷ At any time horizon h , we are able to reject at the 5% confidence level the null of a non-negligible bias for both TOLS and LIML. Thus, also first stage pre-screening clearly hints at the general reliability of our results.

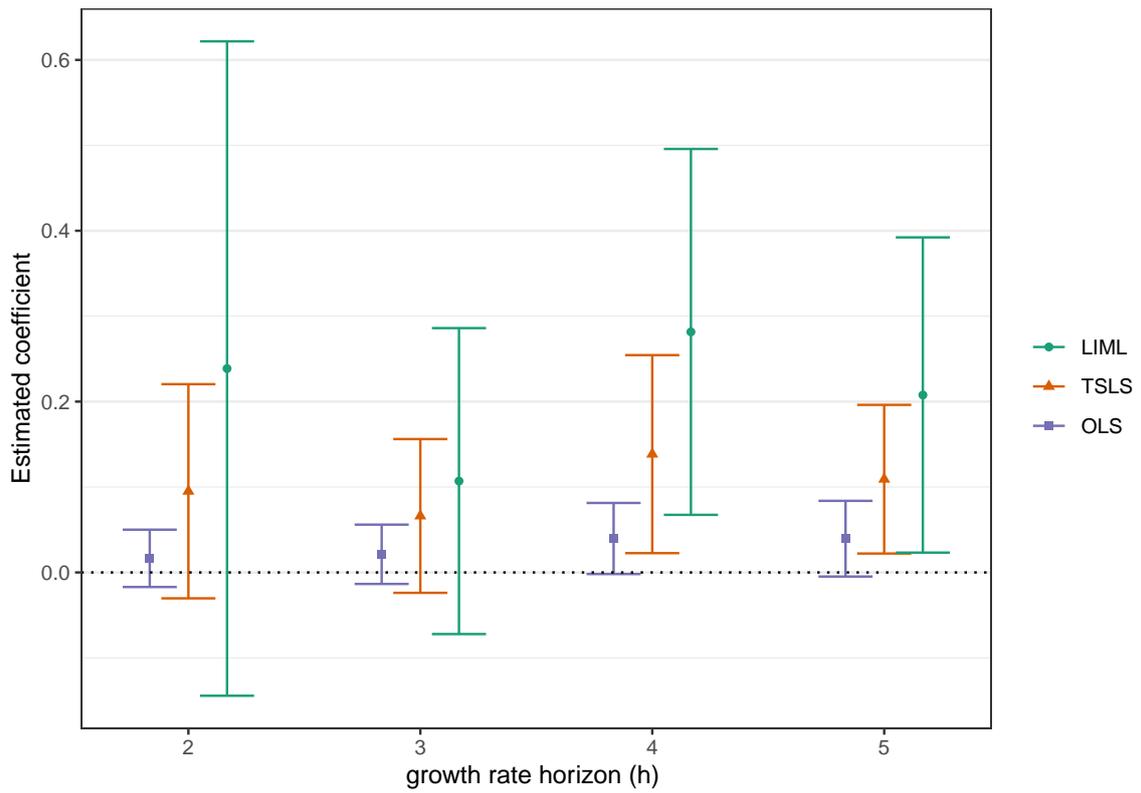
We then consider some alternative specifications and robustness checks. Results are reported in Table 3. First, differences in tax policies across states may influence R&D investments and employment (Wilson, 2009; Chang, 2018; Lucking, 2019), thus, acting as a potential confounding factor in our analysis. To control for different taxation regimes, we include in our regressions state-specific R&D tax credits, corporate income tax rates and the user cost of R&D capital (which combines both).²⁸ Results show that the estimated elasticity between military R&D and private R&D slightly increases and remains statistically significant, as compared to our baseline specifications.

Another possible concern comes from the omission of non-R&D procurement. The magnitude and composition of government demand may indeed act as a *de facto* innovation policy (Edler and Georghiou, 2007; Guerzoni and Raiteri, 2015;

²⁷The use of the effective F -statistic is highly recommended in settings with heteroscedasticity and clustering (Andrews et al., 2019), as in our case. This is a test for the null hypothesis of weak instruments. Rejection entails that the bias of the TOLS or LIML is not large, relative to a "worst-case" benchmark.

²⁸Notice that, in order to be consistent with our specification, we included the variation between t and $t + h$ of these variables. We also run regressions using levels at time t and find no substantial differences. Results are available upon request from the authors.

Figure 3: Comparison across estimators: OLS, TSLS, LIML



Notes: Coefficients refer to our baseline estimation including log changes of non-military R&D obligations and GDP as controls. Confidence intervals at the 10% level are computed using standard errors clustered by state.

Slavtchev and Wiederhold, 2016; Raiteri, 2018). This is especially relevant for defense procurement as DoD R&D contracts have been often substantially complemented by purchases of the developed product/technology (Mowery, 2010).²⁹ Thus, we expect military R&D obligations to be correlated with non-R&D procurement. To guard against this concern, we aggregated total non-R&D procurement by state and included it as a control in our regression. Results largely confirm our baseline estimations, albeit with a small loss in precision.

Our empirical analysis could be also biased by measurement errors due to the fact that we do not observe the effective outlays at the state level, as we can only use obligation measures. Luckily enough, data on defense R&D outlays are available at the national level. Leveraging this information we constructed our IV interacting state dummies with national variations in military R&D outlays. Under the assumption that the timing of the mismatch between national obligations and outlays is correlated with the one unobserved at the state level, this new IV estimation will correct for the aforementioned measurement error. Even with this correction, estimates appear not to change significantly, thus, suggesting that this specific form of measurement error may not play a crucial role for our analysis.

Data on private R&D display a non-negligible number of missing values in the first period of our sample. For this reason, we also estimated our model for the period 1998-2017 in which we observe almost no missing values (as the SIRD survey becomes annual). We show that even in this restricted sample our main results hold with elasticities close to those estimated employing the whole time period.

As anticipated in Section 4.2, our dependent variable may be affected by measurement errors as well because it mixes R&D financed by both companies and other private channels (e.g., non-profit institutions). While it is safe to read our estimated parameter as the elasticity for privately-funded R&D, caution is needed when extending the interpretation to company-financed R&D. Leveraging the fact that since 2009 the data allows us to disambiguate between private R&D expenditures financed by company and by other private entities, we ranked US state in terms of average incidence of the non-company component between 2009 and 2017. We then run the regressions selecting only the 20 states with the lowest incidence

²⁹The independent R&D program represents an even more extreme example in this respect (Lichtenberg, 1995). Overhead funds included in non-R&D procurement contracts were used by the Department of Defense to finance indirectly R&D performers.

(among them the highest ratio is 8%).³⁰ Results are presented in Table 4 and largely confirm our general findings. We take this as encouraging evidence in favour of the possibility to interpret our elasticity as related to company-financed R&D.

Finally, in the Appendix B we report some additional robustness checks. First, we estimate a model in levels using the same specification in Moretti et al. (2019). More specifically, we regress levels of private R&D against lagged values of defense R&D obligations. Differently from our difference specification, in this setting state fixed effects do not absorb state-specific trends but only allow for heterogeneous intercepts. The model yields less conservative estimates (cf Table B.1) with higher elasticities of defense R&D that are in line with those reported in Moretti et al. (2019). Moreover, we assess whether our results are driven by the dynamics of single states by dropping observations of one state at the time (cf. Figure B.3). We show that estimates remain remarkably stable with North Dakota having the largest (slightly negative) influence. We also investigate the potential impact of outliers using winsorized variables and find no substantial effect (cf. Table B.2). To conclude, we ran regressions without normalizing variables by population. Results in Table B.3 also corroborate our general findings.

5.2 Employment effects in R&D intensive sectors and occupations

So far we robustly documented crowding-in effects of public military R&D funding on private R&D expenditures. Yet, higher expenditures may translate either in higher R&D employment or in increasing costs (e.g., wages and intermediate goods). Whether one of these two effects prevails may depend on the supply elasticity of R&D workers and inputs, as well as on other characteristics of the innovation system (e.g., firms organizational routines, private and public R&D networks). To shed a light on these issues, we empirically study the impact of public military R&D expenditures on employment. However, data on private R&D employment are not available at the state level. Therefore, we focus on employment in R&D-intensive industries and occupations (cf. Section 3) and we estimate the following model:³¹

³⁰We repeated the same exercise using the bottom 15 states and find no substantial differences, albeit estimates for $h = 4$ slightly loose significance. Results are available upon request from the authors.

³¹We focus on the top 5 R&D-intensive industries. We also run regressions for other R&D-intensive industries and find no statistically significant results except for Miscellaneous manufacturing (NAICS 339) which shows elasticities in the 0.035 - 0.05 range. Results are available upon request from the authors. Regarding occupations, we aggregated at the 3 digit level occupations

Table 3: Alternative specifications and robustness checks

Military R&D ($\Delta^h RD_{def}$)	Dependent variable: Privately-funded R&D ($\Delta^h RD_{priv}$)		
	Corporate tax	R&D tax credit	User cost of R&D capital
$h = 2$	0.102 (0.068)	0.119* (0.064)	0.105 (0.068)
$h = 3$	0.086* (0.05)	0.104** (0.051)	0.089* (0.049)
$h = 4$	0.14** (0.069)	0.153** (0.072)	0.147** (0.068)
$h = 5$	0.11** (0.052)	0.112** (0.053)	0.12** (0.052)
	Non-R&D procurement	Outlays	Restricted sample
$h = 2$	0.074 (0.077)	0.092 (0.065)	0.053 (0.073)
$h = 3$	0.046 (0.059)	0.099* (0.056)	0.061 (0.05)
$h = 4$	0.117 (0.077)	0.11* (0.06)	0.126* (0.064)
$h = 5$	0.096* (0.055)	0.085 (0.051)	0.102* (0.056)

Notes: the table reports TSLS estimations for different specifications and time horizons h . Across all specifications, the dependent variable is the h -year log-change in private R&D (privately financed, in real per capita terms) while the main regressor is the h -year log-change in defense R&D obligations (in real per capita terms). All regressions include the h -year log-changes of non-military R&D obligations and state GDP (both in real per capita terms) as control variables as well as state and time fixed effects. The sample period is 1968-2017 except for the "Non-R&D procurement" case which uses 1980-2017 and the "Restricted sample" regression which uses 1998-2017. The top three specifications include respectively h -year variations in corporate tax rates, R&D tax credits and user costs of R&D capital as controls. The "Non-R&D procurement" regression includes h -year log-changes in total non-R&D procurement. The "Outlays" specification uses national variations in outlays (instead of obligations) interacted with state dummies as instrumental variables. Standard errors in parenthesis are clustered by state.

* $p < 0.1$; ** $p < 0.05$; *** $p < 0.01$

Table 4: Regressions to account for the incidence of R&D financed by private institutions (other than companies)

Military R&D ($\Delta^h RD_{def}$)	Dependent variable: Privately-funded R&D ($\Delta^h RD_{priv}$)					
	OLS			IV		
	(1)	(2)	(3)	(4)	(5)	(6)
($h = 2$)	0.007 (0.02)	0.002 (0.023)	0.002 (0.024)	0.151 (0.09)	0.153 (0.091)	0.146 (0.093)
($h = 3$)	0.042* (0.022)	0.044* (0.021)	0.043* (0.021)	0.107 (0.072)	0.102 (0.073)	0.093 (0.072)
($h = 4$)	0.041 (0.033)	0.041 (0.033)	0.038 (0.033)	0.231** (0.098)	0.23** (0.097)	0.209** (0.093)
($h = 5$)	0.044 (0.034)	0.044 (0.034)	0.044 (0.035)	0.179** (0.068)	0.178** (0.065)	0.148* (0.073)
Non Military R&D	x	✓	✓	x	✓	✓
State GDP	x	x	✓	x	x	✓

Notes: the table reports results for the same regressions in Table 1 on a restricted sample. In these regressions we only select the 20 states with the lowest ration between R&D financed by private entities (other than the firm) over total R&D paid for by the company. Control variables include the h -year log-changes of non-military R&D obligations and state GDP (both in real per capita terms). All regressions include state and time fixed effects. Standard errors in parenthesis are clustered by state.

* $p < 0.1$; ** $p < 0.05$; *** $p < 0.01$

$$\Delta^h RDemp_{i,k,t} = \beta \Delta^h RDdef_{i,t} + \gamma' \Delta^h \mathbf{W}_{i,t} + \alpha_i + \lambda_t + \varepsilon_{i,t}, \quad (3)$$

where $\Delta^h RDemp_{i,k,t}$ stands for log changes of employment between year t and $t - h$ in state i and industry/occupation k (this is the only difference with respect to the previous model, cf. Eq. 1).

Table 5 displays the results for selected R&D-intensive industries. We find positive and significant employment effects in Computer and electronic product manufacturing (NAICS 334) and Transportation Equipment (NAICS 336). Not surprisingly, effects appear to be concentrated in sectors that receive a disproportional amount of defense R&D funds (Mowery, 2010, highlights that about 75% of defense R&D is concentrated in the aircraft and electrical equipment industries). The estimated employment elasticities are in the range of 0.08-0.1% and are lower than those of private R&D expenditures. The timing of the response is instead similar as also employment appears to respond mainly to spending shocks occurring in 4-5 year time horizons.

Results for different R&D-related occupational categories are provided in Table 6. We find sizeable effects only for the employment of engineers with elasticities between 0.05 and 0.07%. Notice that in this occupational group, a large space is occupied by jobs that are very much related to defense R&D, such as aerospace and electrical engineers. In contrast to effects at the industry level, the employment of engineers turns out to be stimulated also by 2-3 year spending shocks.

Also for employment regressions, we run a series of robustness checks controlling for confounding factors (i.e., tax policies and non-R&D procurement), measurement errors stemming from the use of obligation data, and normalization by population. Results are presented in Table B.4. They largely confirm our baseline estimations, albeit with reduced statistical significance for employment in the Computer and Electronic Products industry.

6 Conclusion

In this paper we study whether government-financed defense R&D is effective in fostering privately-funded R&D investment and employment. Our interest in mili-

classified as "Research, Development, Design, and Practitioners". More details are reported in Section 3.

Table 5: Employment elasticities of defense R&D obligations in high-tech industries

Industry	<i>Dependent variable:</i> Employment ($\Delta^h RDemp$)			
	$h = 2$	$h = 3$	$h = 4$	$h = 5$
Chemicals (NAICS 325)	0.049 (0.049)	0.054 (0.054)	0.06 (0.054)	0.045 (0.052)
Computer and electronic products (NAICS 334)	0.02 (0.038)	0.034 (0.047)	0.079* (0.043)	0.084* (0.044)
Transportation equipment (NAICS 336)	0.014 (0.074)	0.12*** (0.024)	0.099*** (0.025)	0.078* (0.039)
Information (NAICS 51)	0.005 (0.017)	0.017 (0.017)	0.026 (0.016)	0.026 (0.017)
Professional, scientific, and technical services (NAICS 54)	-0.006 (0.007)	-0.006 (0.008)	-0.004 (0.009)	-0.004 (0.01)

Notes: the table reports industry-by-industry TOLS estimations. The sample period is 1998-2018. We run separate regressions for each h and industry category, where the dependent variable is the h -year log-change in industry employment (normalized by state population). The main regressor is the h -year log-change in defense R&D obligations (in real per capita terms). All regression include state and time fixed effects as well as baseline control variables, i.e., the h -year log-changes of non-military R&D obligations and state GDP (both in real per capita terms). Standard errors in parenthesis are clustered by state.

* $p < 0.1$; ** $p < 0.05$; *** $p < 0.01$

Table 6: Employment elasticities of defense R&D obligations in R&D-related occupations

Occupation	<i>Dependent variable:</i> Employment ($\Delta^h RDemp$)			
	$h = 2$	$h = 3$	$h = 4$	$h = 5$
Computer Occupations (SOC 15-1100)	-0.061 (0.043)	-0.061 (0.049)	-0.028 (0.046)	-0.007 (0.047)
Architects, Surveyors, and Cartographers (SOC 17-1000)	0.021 (0.064)	0.055 (0.066)	0.066 (0.063)	0.059 (0.06)
Engineers (SOC 17-2000)	0.053*** (0.018)	0.066*** (0.023)	0.067*** (0.023)	0.067*** (0.023)
Life Scientists (SOC 19-1000)	0.084 (0.062)	0.1 (0.067)	0.11 (0.072)	0.083 (0.075)
Physical Scientists (SOC 19-2000)	-0.072* (0.043)	-0.025 (0.043)	0.006 (0.046)	0.023 (0.051)
Social Scientists and Related Workers (SOC 19-3000)	-0.046 (0.059)	-0.046 (0.059)	-0.035 (0.054)	-0.041 (0.049)

Notes: the table reports occupation-by-occupation TSLS estimations. The sample period is 1999-2018. We run separate regressions for each h and occupation category, where the dependent variable is the h -year log-change in occupation employment (normalized by state population). The main regressor is the h -year log-change in defense R&D obligations (in real per capita terms). All regression include state and time fixed effects as well as baseline control variables, i.e., the h -year log-changes of non-military R&D obligations and state GDP (both in real per capita terms). Standard errors in parenthesis are clustered by state.

* $p < 0.1$; ** $p < 0.05$; *** $p < 0.01$

tary R&D is motivated by its great relevance in the US innovation policy landscape (Mowery, 2010, 2012; Mazzucato, 2015). To tackle the issue, we assembled a longitudinal dataset for U.S. states including R&D obligations from the DoD, private R&D expenditures, employment in R&D-intensive industries and occupations. Leveraging some characteristics of defense R&D funding, we employed a state-of-the-art IV identification strategy (Nakamura and Steinsson, 2014, 2018; Guren et al., 2020; Cloyne et al., 2020) based on differential state exposures to national shocks in order to isolate exogenous variations in defense R&D and provide a causal interpretation to our estimates.

Our results shows that an increase in defense R&D over 4-5 years crowds-in privately-funded R&D investments with an elasticity between 0.11% and 0.14%. This implies that one dollar of federally-financed military R&D spurs between 0.57 and 0.72 dollars of additional private R&D expenditures. We also find positive effects of defense-related R&D on employment in high-tech sectors and in engineering occupations, albeit with lower elasticities (i.e., 0.05-0.1 %). Such results are robust to a wide ensemble of robustness checks including additional controls (e.g., tax policies, non-R&D procurement), outliers sensitivity and alternative specifications.

From a policy perspective, the main conclusion from this work is that defense R&D support by the US government did stimulate additional innovation efforts in the private sector. This is of particular interest for policy makers given the large role played by defense R&D in the US and the ongoing debates about its effectiveness (Cox et al., 2014; Griffin, 2019). More generally, our effort lies between a recent stream of studies aimed at informing policies with causal evidence about industrial policies (Criscuolo et al., 2022). Albeit not tested formally, results appear to hint at localized spillovers, possibly occurring also across sectors, as main drivers of crowding-in. As such, this has also indirect implications for policies targeting regional innovation and local clustering. Nevertheless, further research is needed in order to deliver more comprehensive policy prescriptions. First, we plan to investigate in a comparative fashion how to extrapolate lessons from military interventions to other mission-oriented programs focused on different societal goals.³² Second, using more granular data at the geographical level (e.g. contract-level information on grants) we aim to delve into the mechanisms underlying crowding-

³²For a broad historical comparison among different mission-oriented programs see Foray et al. (2012).

in, investigating the characteristics of local spillovers. Shedding more light on mechanisms at play will allow us to better isolate the main drivers of success of US defense innovation. A major policy uncertainty, in fact, concerns the different performances of military R&D in the US vis-à-vis other countries.

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Appendix A Main variables and descriptives

Figure A.1: Defense R&D obligations per capita by state

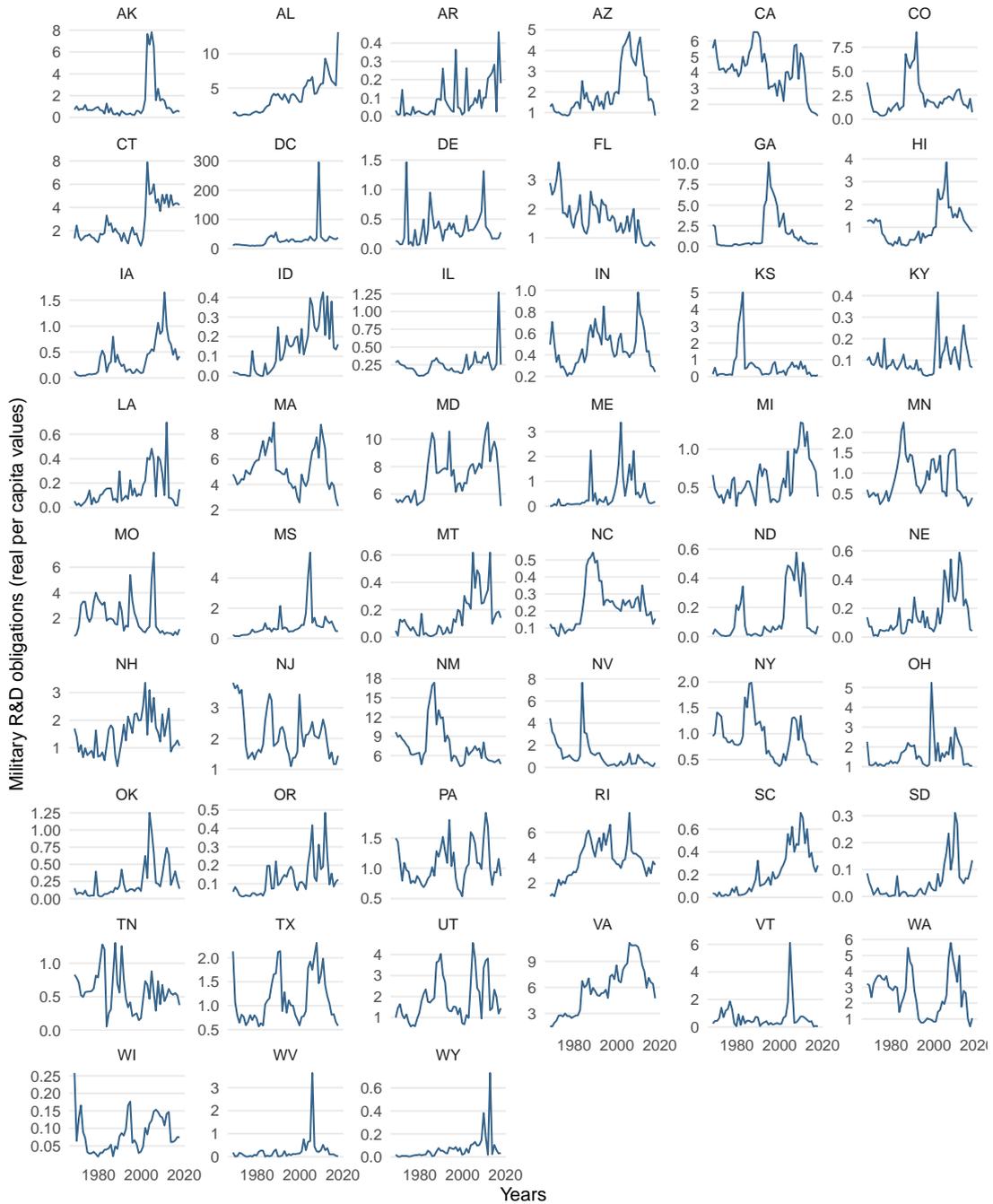
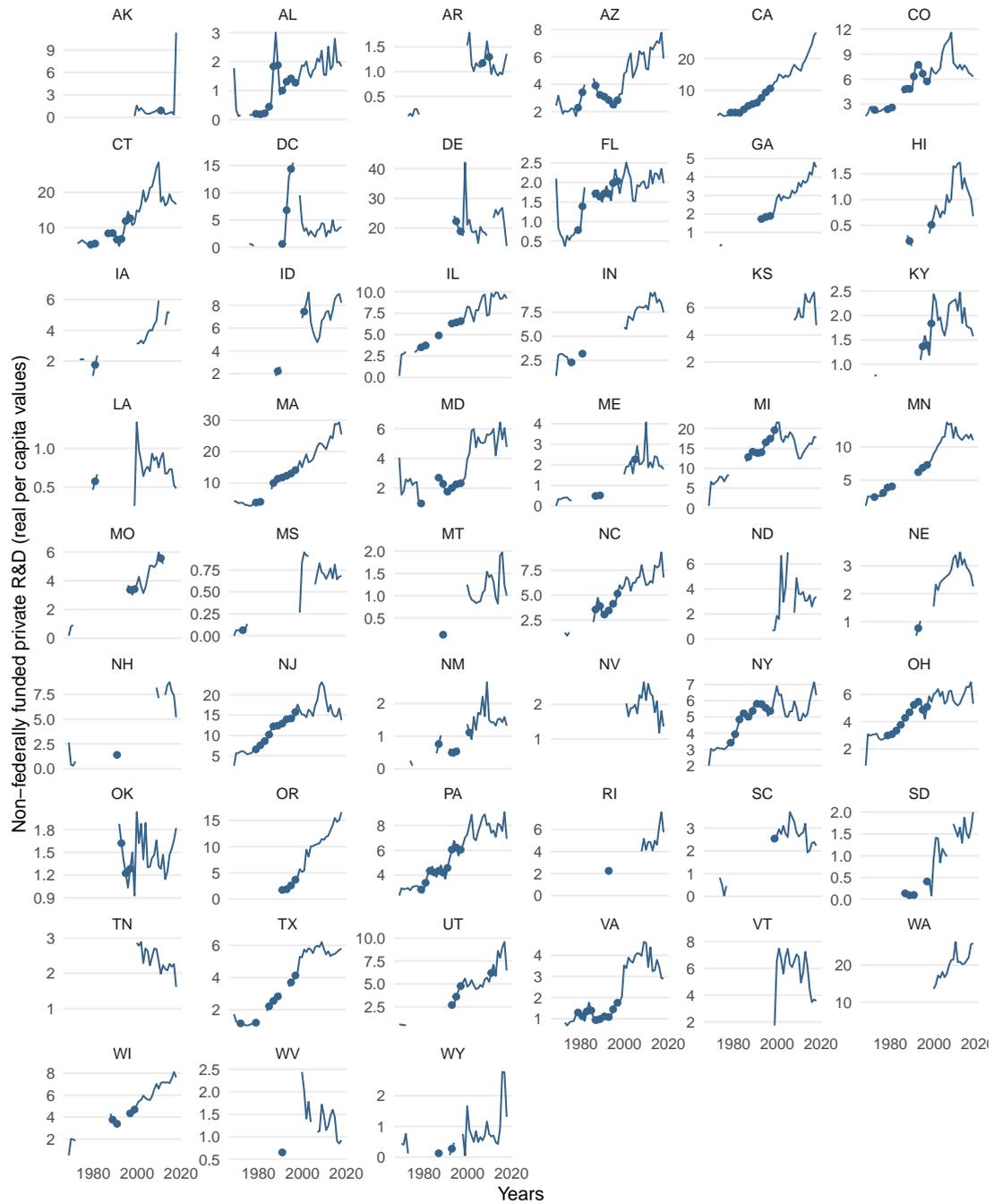


Figure A.2: Non-federally funded private R&D per capita by state



Notes: Dots represent interpolated values

Table A.1: Summary statistics by state (5-years log variations of defense and private R&D)

State	Private R&D ($\Delta^5 RD_{priv}$)				Defense R&D ($\Delta^5 RD_{def}$)			
	<i>mean</i>	<i>sd</i>	<i>min</i>	<i>max</i>	<i>mean</i>	<i>sd</i>	<i>min</i>	<i>max</i>
AK	0.08	1.10	-1.16	3.28	-0.24	1.53	-1.53	3.06
AL	0.31	0.69	-0.83	2.62	0.22	0.38	-0.55	0.98
AR	-0.00	0.33	-0.56	0.69	0.53	1.19	-1.43	2.15
AZ	0.11	0.30	-0.44	0.77	0.02	0.52	-1.19	1.08
CA	0.30	0.17	-0.02	0.69	-0.13	0.49	-1.22	0.95
CO	0.09	0.28	-0.49	0.52	-0.17	0.86	-1.96	1.56
CT	0.11	0.36	-0.56	0.97	0.11	0.68	-0.91	2.03
DC	0.05	1.24	-1.69	3.23	0.06	0.71	-1.95	2.34
DE	-0.03	0.34	-0.79	0.56	-0.09	0.58	-1.32	0.75
FL	0.08	0.35	-1.20	1.05	-0.20	0.33	-1.01	0.56
GA	0.20	0.14	-0.06	0.48	-0.56	0.85	-1.46	2.69
HI	0.17	0.45	-0.57	0.80	0.01	0.77	-0.99	1.34
IA	0.10	0.32	-0.71	0.43	0.56	0.89	-0.71	1.81
ID	0.04	0.32	-0.56	0.46	0.06	0.63	-1.08	1.23
IL	0.12	0.13	-0.09	0.40	0.07	0.57	-0.71	1.14
IN	0.12	0.32	-0.33	1.19	-0.18	0.57	-0.97	0.85
KS	0.12	0.27	-0.40	0.32	-1.78	1.19	-3.28	-0.39
KY	0.09	0.31	-0.43	0.58	0.28	0.99	-1.16	2.75
LA	-0.04	0.40	-0.59	1.04	-0.45	1.55	-3.75	2.05
MA	0.17	0.24	-0.34	0.89	-0.04	0.42	-0.86	0.78
MD	0.04	0.45	-1.11	0.92	-0.01	0.21	-0.49	0.36
ME	0.04	0.30	-0.54	0.59	-0.60	0.75	-1.64	0.75
MI	0.13	0.49	-0.42	2.66	0.05	0.64	-1.18	1.24
MN	0.19	0.22	-0.20	0.72	-0.09	0.76	-1.43	1.06
MO	0.18	0.15	0.03	0.46	-0.30	1.20	-2.23	1.98
MS	-0.02	0.29	-0.48	0.74	-0.08	0.54	-1.11	0.44
MT	0.14	0.37	-0.63	0.67	-0.18	0.88	-1.48	2.01
NC	0.14	0.23	-0.31	0.58	-0.17	0.37	-1.04	0.57
ND	0.27	0.82	-0.65	1.78	-0.51	1.94	-3.17	2.25
NE	0.09	0.22	-0.29	0.50	0.07	1.40	-2.44	2.50
NH	0.30	0.62	-0.36	1.31	-0.24	0.58	-0.82	0.49
NJ	0.12	0.24	-0.41	0.83	-0.11	0.48	-1.02	0.83
NM	0.09	0.48	-0.72	0.95	-0.11	0.29	-0.75	0.45
NV	-0.06	0.35	-0.79	0.40	-0.08	1.02	-1.89	1.68
NY	0.09	0.18	-0.32	0.45	-0.11	0.58	-1.08	1.14
OH	0.11	0.25	-0.22	1.41	-0.02	0.52	-1.14	1.28
OK	0.02	0.32	-0.44	0.71	0.13	1.12	-1.96	2.20
OR	0.44	0.28	0.11	0.99	-0.02	0.81	-1.48	1.33
PA	0.12	0.18	-0.23	0.52	-0.03	0.43	-1.06	1.05
RI	0.19	0.19	-0.03	0.45	-0.23	0.22	-0.52	0.08
SC	-0.06	0.21	-0.38	0.26	0.11	0.64	-0.93	1.17
SD	0.50	0.79	-0.57	2.59	0.29	1.51	-3.51	2.62
TN	-0.10	0.13	-0.27	0.17	0.04	0.58	-0.92	1.58
TX	0.10	0.22	-0.49	0.58	-0.06	0.60	-1.03	1.19
US	0.16	0.10	-0.03	0.35	-0.03	0.29	-0.61	0.45
UT	0.22	0.25	-0.23	0.69	0.01	0.79	-1.17	1.83
VA	0.17	0.35	-0.58	0.89	0.10	0.38	-0.60	1.00
VT	-0.06	0.46	-0.71	1.38	-0.39	1.87	-3.10	3.37
WA	0.13	0.16	-0.21	0.45	0.01	1.07	-2.24	1.30
WI	0.15	0.09	0.02	0.35	0.07	0.66	-0.80	1.35
WV	-0.14	0.27	-0.46	0.26	-0.95	1.03	-3.24	0.45
WY	0.17	1.08	-2.17	2.77	0.06	1.30	-3.03	1.95

Table A.2: Cross-correlations among main variables

	Private R&D	Military R&D	Non Military R&D	State GDP
<i>h</i> = 5				
$\Delta^h RD_{priv}$	1			
$\Delta^h RD_{def}$	0.12	1		
$\Delta^h RD_{non - def}$	0.17	0.1	1	
$\Delta^h GDP$	0.12	0.14	0.05	1
<i>h</i> = 4				
$\Delta^h RD_{priv}$	1			
$\Delta^h RD_{def}$	0.08	1		
$\Delta^h RD_{non - def}$	0.18	0.08	1	
$\Delta^h GDP$	0.06	0.1	0.01	1
<i>h</i> = 3				
$\Delta^h RD_{priv}$	1			
$\Delta^h RD_{def}$	0.04	1		
$\Delta^h RD_{non - def}$	0.15	0.05	1	
$\Delta^h GDP$	0.02	0.08	-0.02	1

Notes: *RD_{priv}* stands for private, non-federally funded R&D. *RD_{def}* represents total defense R&D obligations. *RD_{non - def}* stands for total non-defense R&D obligations. *GDP* is total state GDP. All variables are taken in real per capita terms. Correlations are computed for log changes over different time horizons (*h*).

Appendix B Additional results and robustness checks

Figure B.1: Actual variations in R&D obligations vs. first stage predictions for New Mexico

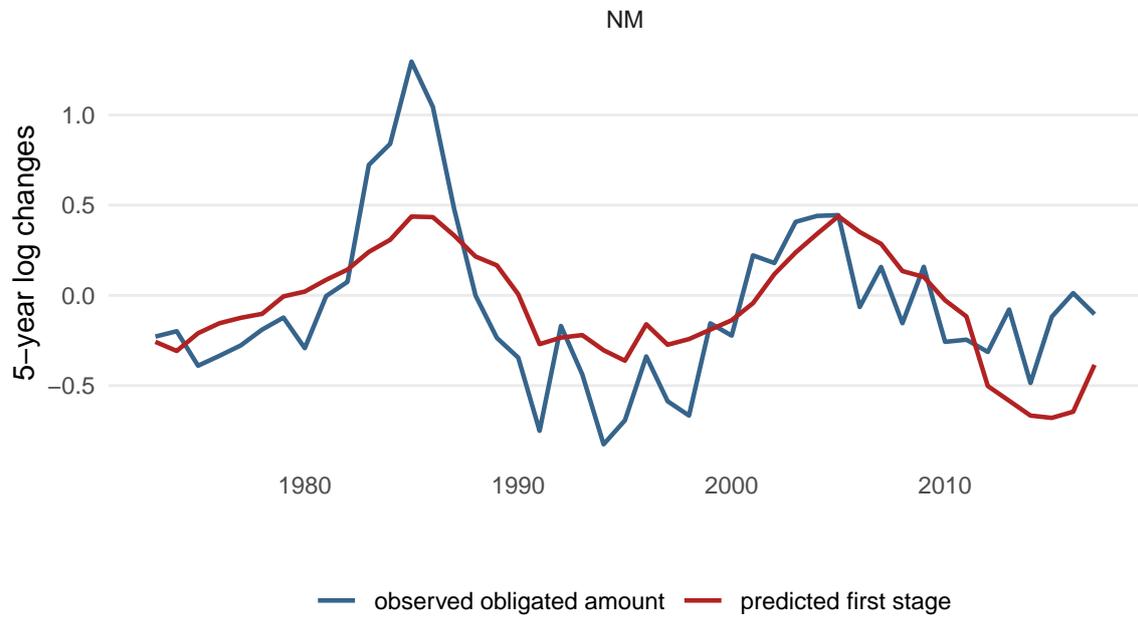


Figure B.2: State sensitivities to changes in national defense R&D vs. average log changes in private R&D

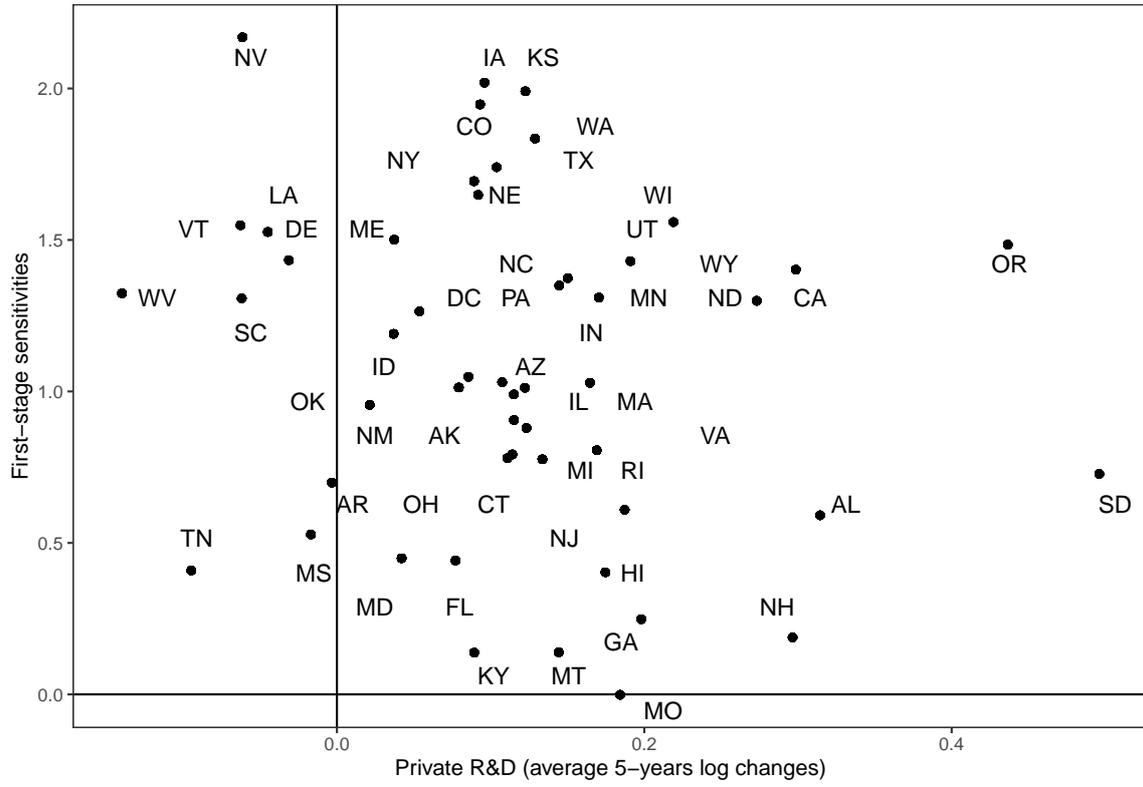
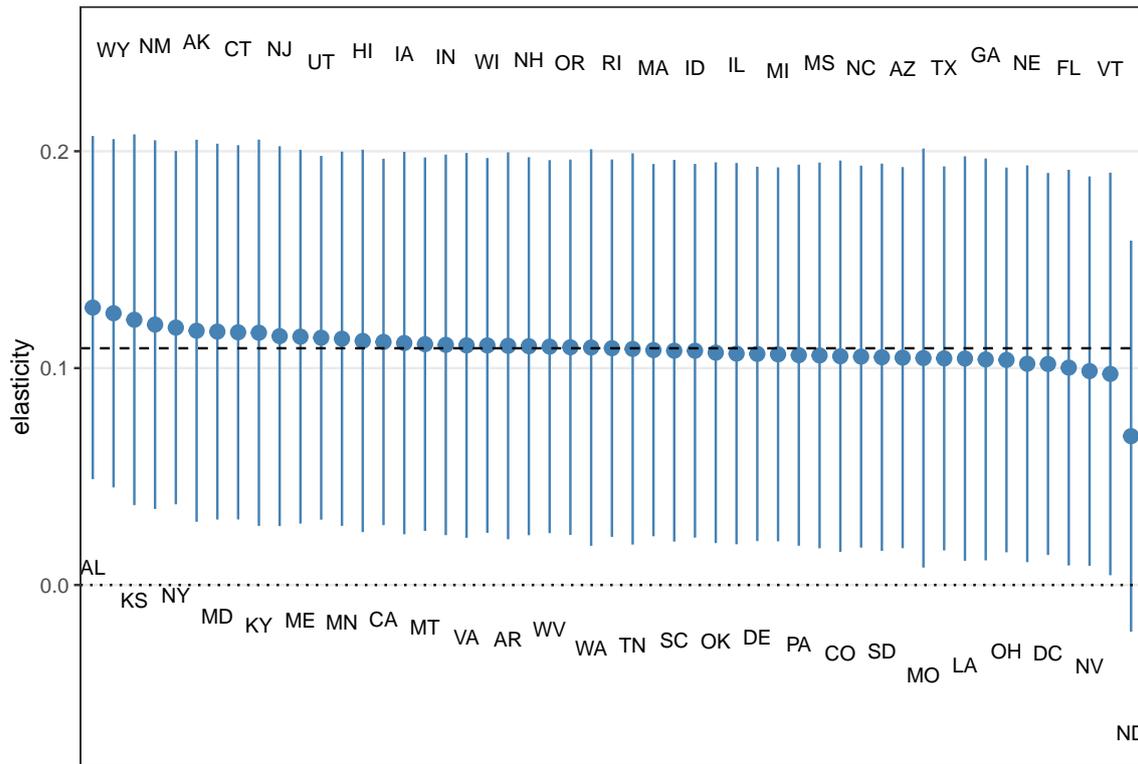


Figure B.3: Sensitivity of estimates to state inclusion



Notes: The dashed line represents our baseline IV estimate for $h = 5$. For each state i we ran the IV regression over the interval $h = 5$ excluding observations for i . The figure shows the point estimate and the associated 90% confidence interval (standard errors are clustered by state).

Table B.1: Estimates from the log level specification

	Dependent variable: Privately-funded R&D (ln RD_{priv})							
	OLS		IV					
			(k = 5)		(k = 10)		(k = 15)	
$\ln RD_{def_{t-1}}$	0.106*** (0.035)	0.107*** (0.036)	0.247*** (0.089)	0.249*** (0.089)	0.314** (0.138)	0.315** (0.137)	0.427** (0.195)	0.423** (0.189)
Non Military R&D	✓	✓	✓	✓	✓	✓	✓	✓
Non Military R&D (lagged)	✗	✓	✗	✓	✗	✓	✗	✓
State GDP	✓	✓	✓	✓	✓	✓	✓	✓
State GDP(lagged)	✗	✓	✗	✓	✗	✓	✗	✓

Notes: OLS and TSLS estimations with state and year fixed effects. The level specification is: $\ln RD_{priv_{i,t}} = \beta \ln RD_{def_{i,t-1}} + \delta' W_{i,t} + \alpha_i + \lambda_t + \varepsilon_{i,t}$. The dependent variable is the log of non-federally funded R&D expenditures. The main regressor is the lagged log of defense R&D obligations. The vector of controls include the contemporaneous and lagged logs of non-defense R&D obligations and state GDP. All variables are taken in real per capita terms. In TSLS estimations we use a simple Bartik-type of instrument, also similar to Moretti et al. (2019): $IV = share_{i,t-1} RD_{def_{US,t-1}}$. Where $share$ stands for a k -years moving average of the state share in public R&D and $RD_{def_{US}}$ is national defense R&D. We report results for three different values for k (i.e., 5, 10 and 15). Standard errors in parenthesis are clustered by state.

*p<0.1; **p<0.05; ***p<0.01

Table B.2: Outliers robustness: regressions using winsorized data (at 1st and 99th percentiles)

Military R&D ($\Delta^h RD_{def}$)		Dependent variable: Private R&D ($\Delta^h RD_{priv}$)					
		No correction			Winsorized		
$h = 2$	No correction	0.093 (0.08)	0.098 (0.079)	0.095 (0.076)	0.102 (0.074)	0.107 (0.074)	0.105 (0.071)
	Winsorized	0.082 (0.081)	0.086 (0.08)	0.083 (0.078)	0.091 (0.076)	0.094 (0.076)	0.092 (0.073)
$h = 3$	No correction	0.07 (0.058)	0.067 (0.059)	0.066 (0.055)	0.075 (0.055)	0.074 (0.055)	0.073 (0.052)
	Winsorized	0.072 (0.058)	0.07 (0.058)	0.069 (0.054)	0.077 (0.055)	0.076 (0.055)	0.075 (0.052)
$h = 4$	No correction	0.134* (0.08)	0.137* (0.079)	0.138* (0.07)	0.132* (0.073)	0.134* (0.073)	0.134* (0.067)
	Winsorized	0.139* (0.083)	0.142* (0.081)	0.141* (0.073)	0.137* (0.076)	0.138* (0.075)	0.137* (0.069)
$h = 5$	No correction	0.11* (0.056)	0.112** (0.055)	0.109** (0.053)	0.108** (0.05)	0.109** (0.049)	0.106** (0.049)
	Winsorized	0.113* (0.057)	0.114** (0.057)	0.111** (0.055)	0.111** (0.051)	0.111** (0.051)	0.107** (0.051)
Non Military R&D		✗	✓	✓	✗	✓	✓
State GDP		✗	✗	✓	✗	✗	✓

Notes: TSLS estimations with state and year fixed effects. The sample period is 1968-2017. We run separate regressions for each h , where the dependent variable is the h -year log-change in private R&D (privately financed, in real per capita terms). The main regressor is the h -year log-change in defense R&D obligations (in real per capita terms). Winsorization occurs at the 1st and 99th percentiles. Control variables include the h -year log-changes of non-military R&D obligations and state GDP (both in real per capita terms). Standard errors in parenthesis are clustered by state.

*p<0.1; **p<0.05; ***p<0.01

Table B.3: Regressions without normalizing by population

Military R&D ($\Delta^h RD_{def}$)	Dependent variable: Privately-funded R&D ($\Delta^h RD_{priv}$)					
	OLS			IV		
	(1)	(2)	(3)	(4)	(5)	(6)
$h = 2$	0.017 (0.02)	0.017 (0.02)	0.016 (0.02)	0.088 (0.078)	0.086 (0.072)	0.088 (0.069)
$h = 3$	0.021 (0.02)	0.02 (0.02)	0.019 (0.02)	0.063 (0.056)	0.05 (0.049)	0.046 (0.048)
$h = 4$	0.041 (0.025)	0.041* (0.024)	0.038 (0.024)	0.126 (0.076)	0.107 (0.066)	0.111* (0.062)
$h = 5$	0.041 (0.027)	0.041 (0.027)	0.038 (0.026)	0.102* (0.054)	0.099* (0.054)	0.099* (0.053)
No controls	✓	✗	✗	✓	✗	✗
Only Population	✗	✓	✗	✗	✓	✗
Baseline (includ. pop)	✗	✗	✓	✗	✗	✓

Notes: OLS and TSLS estimations with state and year fixed effects. The sample period is 1968-2017. We run separate regressions for each h , where the dependent variable is the h -year log-change in firms R&D (privately financed, in real terms). The main regressor is the h -year log-change in defense R&D obligations (in real terms). Baseline controls include h -year log-changes of state population, GDP and non-defense R&D obligations (in real terms). Standard errors in parenthesis are clustered by state.

* $p < 0.1$; ** $p < 0.05$; *** $p < 0.01$

Table B.4: Employment regressions: robustness checks

Industry/Occupation	Dependent variable: Employment ($\Delta^h RDemp$)								
	R&D tax credit				Corporate tax				
	($h = 2$)	($h = 3$)	($h = 4$)	($h = 5$)	($h = 2$)	($h = 3$)	($h = 4$)	($h = 5$)	
Engineers (SOC 17-2000)	0.048** (0.018)	0.062** (0.024)	0.062** (0.025)	0.069** (0.03)	0.042** (0.018)	0.056** (0.023)	0.059** (0.024)	0.064** (0.029)	
Computer and electronic products (NAICS 334)	0.011 (0.039)	0.011 (0.048)	0.065 (0.042)	0.068* (0.04)	0.013 (0.038)	0.015 (0.046)	0.06 (0.04)	0.062 (0.039)	
Transportation equipment (NAICS 336)	-0.121 (0.188)	0.101*** (0.027)	0.081*** (0.026)	0.058 (0.036)	-0.142 (0.212)	0.1*** (0.026)	0.085*** (0.021)	0.068** (0.033)	
Industry/Occupation	User cost of R&D capital				Non-R&D procurement				
	Engineers (SOC 17-2000)	0.044** (0.018)	0.059** (0.023)	0.065** (0.025)	0.07** (0.029)	0.055*** (0.019)	0.068*** (0.023)	0.069*** (0.023)	0.069*** (0.023)
	Computer and electronic products (NAICS 334)	0.012 (0.039)	0.014 (0.047)	0.061 (0.042)	0.064 (0.04)	0.021 (0.038)	0.033 (0.047)	0.079* (0.043)	0.084* (0.043)
Transportation equipment (NAICS 336)	-0.147 (0.214)	0.104*** (0.028)	0.09*** (0.022)	0.071** (0.034)	0.01 (0.077)	0.123*** (0.023)	0.102*** (0.024)	0.074* (0.037)	
Industry/Occupation	Outlays				No population normalization				
	Engineers (SOC 17-2000)	0.019 (0.027)	0.02 (0.031)	0.039 (0.031)	0.049* (0.028)	0.06*** (0.02)	0.076*** (0.025)	0.08*** (0.024)	0.082*** (0.024)
	Computer and electronic products (NAICS 334)	0.045 (0.041)	0.045 (0.045)	0.073 (0.045)	0.072 (0.045)	0.014 (0.036)	0.016 (0.046)	0.059 (0.047)	0.065 (0.049)
Transportation equipment (NAICS 336)	0.055 (0.033)	0.067* (0.034)	0.08** (0.033)	0.066 (0.043)	-0.019 (0.103)	0.115*** (0.023)	0.091*** (0.025)	0.074* (0.037)	

Notes: the table reports TSLS estimations by industry/occupation for different specifications and time horizons h . Across all specifications, the dependent variable is the h -year log-change of employment in the industry/occupation (in per capita terms) while the main regressor is the h -year log-change in defense R&D obligations (in real per capita terms). All regressions include the h -year log-changes of non-military R&D obligations and state GDP (both in real per capita terms) as control variables as well as state and time fixed effects. The sample period is 1968-2017 except for the "Non-R&D procurement" regression which uses 1980-2017. The first three specifications include respectively h -year variations in corporate tax rates, R&D tax credits and user costs of R&D capital as controls. The "Non-R&D procurement" regression includes h -year log-changes in total non-R&D procurement. The "Outlays" specification uses national variations in outlays (instead of obligations) interacted with state dummies as instrumental variables. "No population normalization" refers to a regression in which both the main regressor and the controls are not divided by population. Standard errors in parenthesis are clustered by state.

* $p < 0.1$; ** $p < 0.05$; *** $p < 0.01$