

Will This War Help This Economy?



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With 2003 well underway, the state of the U.S. economy continues to be shaky. Given the many geopolitical fears being grappled with, activity has slowed – and consumer and investor confidence have been sufficiently impacted – to keep any rebound in both economic activity and the stock market in check.

Many are pointing to Iraq as both the cause and the *potential cure* for this financial funk. From both policy makers in Washington and the talking heads in the financial press, we are hearing the same refrain. All will be well, they tell us, following the seemingly inevitable U.S.-led invasion of Iraq.

One of the rationalizations underlying this theory is that war is good for an economy (if we conveniently forget, for the moment, the *cost of war* in lives lost, sovereignty and principles compromised and the rest). From a purely economic perspective, this has in the past been perversely true. Historians and economists agree that the massive economic boost from military and related spending in World War II finally succeeded in rescuing the U.S. economy from the ravages of the Great Depression. Immediately leading up to that world war and through the end of 1944, defense spending as a percentage of our gross national product soared by over 41 percent, according to Yale University economics professor William Nordhaus. Against the backdrop of an economy that had already been in depression for a decade, this proved a powerful stimulus.

In stark contrast, however, the overall impact on our nation's total economic output of a war against – and even subsequent likely occupation of – Iraq will be fairly negligible. Unlike in World War II when major portions of then-key manufacturing and armaments industries saw business increase dramatically due to the war effort, no such outcome is likely this time around. The percentage of both American workers and American companies that will “benefit” from war spending now is nothing like it was in the 1940s. Don't forget, folks, that much of the raw materials and hardware in *this* war do not employ a single American worker. Further, the fact that today's wars are much more high tech and sophisticated argue against an overall boost for the broad economy. One example of this was Gulf War Part One; the economic impact of that

exercise translated into a mere 0.3 percent increase in gross national product.

Something else must be remembered here as well. By the time U.S. involvement in World War I was at hand, the U.S. economy had already stumbled through nearly 10 years of recession, debt liquidation, asset price deflation and more; all inevitable corrections to the bubble created in the 1920s. Simply put, the economy had *already* gone through a sufficient cleansing of speculation, unmanageable debt and all the rest necessary for a longer-term expansion to be able to take hold.

That is plainly not the case today. Though we have suffered – so far – through three years' worth of debt liquidation, falling stock prices and other things necessary to correct the excesses and speculation of the 1990s, no sane person can believe that the economy can move forward from its present state. Consumers are still carrying record levels of debt. Bankruptcies are continuing to rise. Credit conditions for business are tight, in spite of the Federal Reserve's efforts to pump up the money supply and further cheapen the cost of credit. In short, we remain much closer to the beginning of a multi-year cleansing and retrenchment than to its end, war spending or not. Therefore, the notion that the economy is poised to benefit from even a fairly expensive war against Iraq (and God knows who else) is absurd.

It is quite likely that once the bombs start to fall, Wall Street will stage a powerful rally, much as it did when the first Gulf War got underway. Particularly if oil fields are secured, there is not a further substantial spike in oil prices, and the war's first days do not quickly give rise to terrorist activities or the like, it could be an *especially* powerful one. With it will come the inevitable propaganda that the soaring stock market is setting the stage for a great economic rebound; and that American investors, workers and consumers can now again throw caution and common sense to the wind, take their credit cards back out of their pockets and patriotically yell “charge!”

Realize, however, that even this “best case scenario” will do little more than provide a temporarily cheery – but dangerously deceptive – bounce. And further realize that if you buy into the idea that a war against Iraq will solve all of the economy's existing, long-term problems, you will be doing so to your ultimate peril. ■