War in Iraq Unlikely to be Shot in the Arm for Economy

By: Andrew Brod

Brod, Andrew (2003). War in Iraq Unlikely to be Shot in the Arm for Economy. *Greensboro News and Record*, February 23, 2003

Article:

The clock is ticking, and war in Iraq seems imminent. Debates have been raging in the United Nations and the North Atlantic Treaty Organization, but it appears that it's only a matter of time before the United States follows through on President Bush's threat to disarm Saddam Hussein by force. And because the American economy is sluggish right now, one can hear an old refrain mixing in with the barking of the dogs of war: that in spite of its horrors, at least a war will be "good for the economy."

The thinking behind this notion is that wartime spending provides a boost to the economy by increasing the demand for manufacturing and other key sectors. Using government spending as an economic stimulus is a hallmark of liberal economic policy, but when applied to war the idea has adherents from across the political spectrum.

It's worth noting that on a personal level, the question of whether war confers economic benefits depends on one's circumstances. If you own stock in the defense industry, then war probably helps your personal bottom line. If you're a retailer in Fayetteville, then war is hell because so many of your customers have been shipped out.

It's also worth noting that we can only talk about a particular war, not war in general. If we spent absolutely nothing on the military, the country would be unable to protect its economic interests and in the long run we'd definitely be worse off. As Aristotle said, "We make war that we may live in peace."

Whenever this issue comes up, someone mentions the example of World War II. Didn't America's war effort pull us out of the Great Depression? Most economists say yes. President Roosevelt's New Deal failed to end the Depression, and our entry into World War II was a factor in finally reviving the economy. The Depression had left many of the country's productive resources unused, with factories idled and millions of people unemployed. The war employed those resources at a time when nothing else had worked.

But the combination of the worst economic downturn and the most expensive war in American history made this a singular event, and it's rarely useful to try to draw general conclusions from singular events.

What is generally true is that wars tend to increase aggregate demand, i.e. the demand for all the goods and services produced by the economy. And yes, strong aggregate demand is good, everything else being equal. The problem is that everything else is generally not equal. Before we can know whether a war will stimulate the economy, we need to factor in the state of the economy, the cost of the war, and the way government goes about paying for it.

For example, in the 1960s the Vietnam War did more harm than good because the economy was already strong and the extensive domestic programs of the President Johnson's Great Society were already providing large injections of government spending. Adding the war to all that sort of overheated things and contributed to the unprecedented combination of high inflation *and* high unemployment in the 1970s.

The economic situation in early 2003 makes a World War II-style shot in the arm unlikely. First, while the current economy is no treat, it's hardly the basket case it was in the 1930s. There is slack in the economy, and the utilization of our manufacturing capacity has fallen steadily during the recent recession. But the rate of utilization is expected to move back towards a respectable 79-80 percent this year. The rest of the economy shows signs of a mild recovery. Current unemployment is troublesome but nothing like the historic highs of the past.

Second, Gulf War II isn't expected to be nearly as expensive as previous wars, and hence is unlikely to generate a noticeable degree of spending. According to a 2002 study by a group of analysts writing for the American Academy of Arts & Sciences, the total cost of World War II was on the order of 130 percent of annual Gross Domestic Product, so that war effort clearly dominated the economy. The Vietnam War's total cost was about 12 percent of annual GDP. The cost of the first Gulf War was only about 1 percent of GDP, and the cost of the second one is expected to be in the same ballpark.

The modern American war involves fewer troops and more hardware than previous wars. Consequently, not only has the amount of wartime spending changed, but so has the timing. A recent report by Economy.com notes that "much of the budgeted cost of a war is now simply re-stocking ... this can increasingly be done at a more leisurely pace, reducing any actual short-term spending and stimulus."

The third reason we should not expect any particular economic benefit from a war in Iraq lies in the Bush administration's insistence on pursuing large tax cuts at home. The administration initially pushed tax cuts because the economy was strong, then it pushed them because the economy was weak. I suppose we can expect administration officials to argue for tax cuts now because of the war.

Tax cuts affect the government's budget like spending programs, in that both either reduce the government's budget surplus or increase the deficit. Now that we've returned to budget deficits under the Bush administration, this means that Gulf War II will be financed by government borrowing. This will tend to undo the low interest rates that so many consumers have depended on over the last couple of years.

In one sense, all this emphasis on spending is misleading. Unless an economy has a lot of slack, wartime spending tends to replace normal spending. And wartime spending is generally inferior to other kinds of public spending. The type of government spending that yields the greatest long-term benefits is state and local expenditures on roads, schools, and hospitals. Such spending is an investment with benefits that accrue year after year, while military spending is more like consumption, with short-lived benefits.

There is one economic benefit of war to which many analysts have pointed: the elimination of uncertainty about war. Some have said that uncertainty is a significant factor in the currently sluggish economy. Uncertainty has caused prices of oil and other commodities to fluctuate dramatically in recent months, and has increased the volatility of international financial markets. The thinking is that once the shooting war begins in Iraq, these markets will get back to normal. Look for oil prices to fall, just as they did in Gulf War I.

I'm skeptical about construing this as an economic benefit, however. The argument reminds me of the old joke about the guy who repeatedly hits himself on the head with a hammer. Why does he do it? Because it feels so good when he stops!

In any case, the real uncertainty regarding Iraq may be what happens *after* the U.S. has its way militarily, and who knows when that uncertainty will be resolved? Will regime change in Iraq get bogged down by factional disputes? Will there be new terrorist attacks on the U.S.? We and the economy may be in for a long ride.