Proof that War Is Bad for the Economy

Top Economists Say War Is Bad for the Economy

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Preface: Many Americans – including influential talking heads – assume that war is good for the economy. As demonstrated below, it isn't true.

Nobel-prize winning economist Joseph Stiglitz says that war is bad for the economy:

Stiglitz wrote in 2003:

War is widely thought to be linked to economic good times. The second world war is often said to have brought the world out of depression, and war has since enhanced its reputation as a spur to economic growth. Some even suggest that capitalism needs wars, that without them, recession would always lurk on the horizon.

Today, we know that this is nonsense. The 1990s boom showed that peace is economically far better than war. The Gulf war of 1991 demonstrated that **wars can actually be bad for an economy.**

Stiglitz has also said that this decade's Iraq war has been very bad for the economy. Seethis, this and this.

Former Federal Reserve chairman Alan Greenspan also said in that war is bad for the economy.

In 1991, Greenspan said that a prolonged conflict in the Middle East would hurt the economy.

And he made this point again in 1999:

Societies need to buy as much military insurance as they need, but to spend more than that is to squander money that could go toward improving the productivity of the economy as a whole: with more efficient transportation systems, a better educated citizenry, and so on.

This is the point that retiring Rep. Barney Frank (D-Mass.) learned back in 1999 in a House Banking Committee hearing with then-Federal Reserve Chairman Alan Greenspan. Frank asked what factors were producing our then-strong economic performance. On Greenspan's list: "**The freeing up of resources previously employed to produce military products that was brought about by the end of the Cold War**." Are you saying, Frank asked, "that **dollar for dollar, military products are there as insurance … and to the extent you could put those dollars into other areas, maybe education and job**

trainings, maybe into transportation … that is going to have a good economic effect?" Greenspan agreed.

The New Republic noted in 2009:

Conservative Harvard economist Robert Barro has argued that increased military spending during WWII **actually depressed** other parts of the economy.

Also from the right, Robert Higgs has done good work showing that military spendingwasn't the primary source of the recovery and that GDP growth during WWII has been "greatly exaggerated."

And from the left, Larry Summers and Brad Delong argued back in 1988 that "five-sixths of the decline in output relative to the trend that occurred during the Depression had been made up before 1942."

War Spending Diverts Stimulus Away from the Real Civilian Economy

I noted in 2010:

You know about America's unemployment problem. You may have even heard that the U.S. may very well have suffered a permanent destruction of jobs.

But did you know that the defense employment sector is booming?

As I pointed out in August, public sector spending – and mainly defense spending – has accounted for virtually all of the new job creation in the past 10 years:

The U.S. has largely been financing job creation for ten years. Specifically, as the chief economist for BusinessWeek, Michael Mandel, points out, public spending has accounted for virtually all new job creation in the past 1o years:

Private sector job growth was almost non-existent over the past ten years. Take a look at this horrifying chart:

Between May 1999 and May 2009, employment in the private sector sector only rose by 1.1%, by far the lowest 10-year increase in the post-depression period.

It's impossible to overstate how bad this is. Basically speaking, the private sector job machine has almost completely stalled over the past ten years. Take a look at this chart:

Over the past 10 years, the private sector has generated roughly 1.1 million additional jobs, or about 100K per year. The public sector created about 2.4 million jobs.

But even that gives the private sector too much credit. Remember that the private sector includes health care, social assistance, and education, all areas which receive a lot of government support.

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Most of the industries which had positive job growth over the past ten years were in the HealthEdGov sector. In fact, financial job growth was nearly nonexistent once we take out the health insurers.

Let me finish with a final chart.

Without a decade of growing government support from rising health and education spending and soaring budget deficits, the labor market would have been flat on its back. [120]

Raw Story argues that the U.S. is building a largely military economy:

The use of the military-industrial complex as a quick, if dubious, way of jump-starting the economy is nothing new, but what is amazing is the divergence between the military economy and the civilian economy, as shown by this New York Times chart.

In the past nine years, non-industrial production in the US has declined by some 19 percent. It took about four years for manufacturing to return to levels seen before the 2001 recession — and all those gains were wiped out in the current recession.

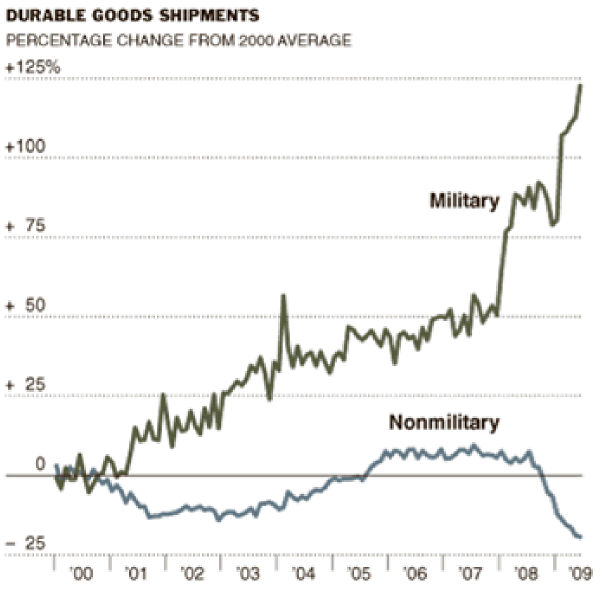
By contrast, military manufacturing is now 123 percent greater than it was in 2000 — it has more than doubled while the rest of the manufacturing sector has been shrinking…

It's important to note the trajectory — the military economy is nearly three times as large, proportionally to the rest of the economy, as it was at the beginning of the Bush administration. And it is the only manufacturing sector showing any growth. Extrapolate that trend, and what do you get?

The change in leadership in Washington does not appear to be abating that trend…[121]

So most of the job creation has been by the public sector. But because the job creation has been financed with loans from China and private banks, trillions in unnecessary interest charges have been incurred by the U.S.

And this shows military versus non-military durable goods shipments:



DURABLE GOODS SHIPMENTS AND ORDERS

	PERCENTAGE CHANGE FIRST HALF '08 to FIRST HALF '09	
MILITARY	SHIPMENTS	ORDERS
Aircraft	+23%	+18%
Other military	+10	– 6
TOTAL MILITARY	+15	+ 3
NONMILITARY		
Primary metals	–40	–44
Fabricated metals	–12	–18
Machinery	–18	–29
Computers	–18	–20
Communication equipment	–33	–18
Semiconductors	–33	na
Electrical equip. & appliances	–20	–26
Motor vehicles & parts	–30	–31
Aircraft	– 7%	–65%
TOTAL NONMILITARY	–20	–27

Source: Census Bureau via Haver Analytics

[Click here to view full image.]

So we're running up our debt (which will eventually decrease economic growth), but the only jobs we're creating are military and other public sector jobs.

PhD economist Dean Baker points out that America's massive military spending on unnecessary and unpopular wars lowers economic growth and increasesunemployment:

Defense spending means that the government is pulling away resources from the uses determined by the market and instead using them to buy weapons and supplies and to pay for soldiers and other military personnel. In standard economic models, defense spending is a direct drain on the economy, reducing efficiency, slowing growth and costing jobs.

A few years ago, the Center for Economic and Policy Research commissioned Global Insight, one of the leading economic modeling firms, to project the impact of a sustained increase in defense spending equal to 1.0 percentage point of GDP. This was roughly equal to the cost of the Iraq War.

Global Insight's model projected that after 20 years the economy would be about 0.6 percentage points smaller as a result of the additional defense spending. Slower growth would imply a loss of almost 700,000 jobs compared to a situation in which defense spending had not been increased. Construction and manufacturing were especially big job losers in the projections, losing 210,000 and 90,000 jobs, respectively.

The scenario we asked Global Insight [recognized as the most consistentlyaccurate forecasting company in the world] to model turned out to have vastly underestimated the increase in defense spending associated with current policy. In the most recent quarter, defense spending was equal to 5.6 percent of GDP. By comparison, before the September 11th attacks, the Congressional Budget Office projected that defense spending in 2009 would be equal to just 2.4 percent of GDP. Our post-September 11th build-up was equal to 3.2 percentage points of GDP compared to the pre-attack baseline. This means that the Global Insight projections of job loss are far too low…

The projected job loss from this increase in defense spending would be close to 2 million. In other words, the standard economic models that project job loss from efforts to stem global warming also project that the increase in defense spending since 2000 will cost the economy close to 2 million jobs in the long run.

The Political Economy Research Institute at the University of Massachusetts, Amherst has also shown that non-military spending creates more jobs than military spending.

So we're running up our debt – which will eventually decrease economic growth – and creating many fewer jobs than if we spent the money on non-military purposes.

Indeed, economists long ago showed that believing that war is good for the economy is falling for a "broken window fallacy". Specifically, if a window in a store is broken, it means that the window-maker gets paid to make a new window, and he, in turn, has money to pay others. However, if the window hadn't been broken, the shop-owner would have spent that money on other things, such as food, clothing, health care, consumer electronics, recreation, or something else, so there's no net benefit to the economy.

Similarly, the money spent on the war effort is money that cannot be spent on other sectors of the economy. Those arguing that war is good for the economy are only closing one eye and looking at only half the picture.

Military Leaders Say Endless War Is Bad For the Economy

I noted in 2010:

All of the spending on unnecessary wars adds up.

The U.S. is adding trillions to its debt burden to finance its multiple wars in Iraq, Afghanistan, Yemen, etc.

Two top American economists – Carmen Reinhart and Kenneth Rogoff – show that the more indebted a country is, with a government debt/GDP ratio of 0.9, and external debt/GDP of 0.6 being critical thresholds, the more GDP growth drops materially.

Specifically, Reinhart and Rogoff write:

The relationship between government debt and real GDP growth is weak for debt/GDP ratios below a threshold of 90 percent of GDP. Above 90 percent, median growth rates fall by one percent, and average growth falls considerably more. We find that the threshold for public debt is similar in advanced and emerging economies…

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(Remember Greenspan's comment.)

I also wrote in 2010:

It is ironic that America's huge military spending is what made us an empire … but our huge military is what is bankrupting us … thus destroying our status as an empire.

The former head of the Joint Chiefs of Staff Admiral Mullen agrees:

The Pentagon needs to cut back on spending.

“We’re going to have to do that if it’s going to survive at all,” Mullen said, “and do it in a way that is predictable.”

Indeed, Mullen said:

For industry and adequate defense funding to survive … the two must work together. Otherwise, he added, “**this wave of debt” will carry over from year to year, and eventually, the defense budget will be cut just to facilitate the debt**.

Former Secretary of Defense Robert Gates agrees as well. As David Ignatius wrote in the Washington Post in 2010:

After a decade of war and financial crisis, America has run up debts that pose a national security problem, not just an economic one.

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One of the strongest voices arguing for fiscal responsibility as a national security issue has been Defense Secretary Bob Gates. He gave a landmark speech in Kansas on May 8, invoking President Dwight Eisenhower’s warnings about the dangers of an imbalanced military-industrial state.

“Eisenhower was wary of seeing his beloved republic turn into a muscle-bound, garrison state — militarily strong, but economically stagnant and strategically insolvent,” Gates said. He warned that America was in a “parlous fiscal condition” and that the “gusher” of military spending that followed Sept. 11, 2001, must be capped. “We can’t have a strong military if we have a weak economy,” Gates told reporters who covered the Kansas speech.

On Thursday the defense secretary reiterated his pitch that Congress must stop shoveling money at the military, telling Pentagon reporters: “The defense budget process should no longer be characterized by ‘business as usual’ within this building — or outside of it.”

While some might want to start another war, America’s top military leaders and economists say that would be a very bad idea.

Indeed, military strategists have known for 2,500 years that prolonged wars are disastrous for the nation.

War Causes Inflation … Which Hurts Consumers

As I noted in 2010, war always causes inflation … which hurts consumers:

Liberal economist James Galbraith wrote in 2004:

Inflation applies the law of the jungle to war finance. Prices and profits rise, wages and their purchasing power fall. **Thugs, profiteers and the well connected get rich. Working people and the poor make out as they can. Savings erode, through the unseen mechanism of the “inflation tax”** — meaning that the government runs a big deficit in nominal terms, but a smaller one when inflation is factored in.

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There is profiteering. Firms with monopoly power usually keep some in reserve. In wartime, if the climate is permissive, they bring it out and use it. Gas prices can go up when refining capacity becomes short — due partly to too many mergers. More generally, when sales to consumers are slow, businesses ought to cut prices — but many of them don't. Instead, they raise prices to meet their income targets and hope that the market won't collapse.

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Libertarian Congressman Ron Paul agreed in 2007:

Congress and the Federal Reserve Bank have a cozy, unspoken arrangement that makes war easier to finance. Congress has an insatiable appetite for new spending, but raising taxes is politically unpopular. The Federal Reserve, however, is happy to accommodate deficit spending by creating new money through the Treasury Department. In exchange, Congress leaves the Fed alone to operate free of pesky oversight and free of political scrutiny. Monetary policy is utterly ignored in Washington, even though the Federal Reserve system is a creation of Congress.

The result of this arrangement is inflation. And inflation finances war.

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Blanchard Economic Research pointed out in 2001:

War has a profound effect on the economy, our government and its fiscal and monetary policies. These effects have consistently led to high inflation.

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David Hackett Fischer is a Professor of History and Economic History at Brandeis. [H]is book, The Great Wave, Price Revolutions and the Rhythm of History … finds that … **periods of high inflation are caused by, and cause, a breakdown in order and a loss of faith in political institutions. He also finds that war is a triggering influence on inflation, political disorder, social conflict and economic disruption.**

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Other economists agree with Professor Fischer's link between inflation and war.

James Grant, the respected editor of Grant's Interest Rate Observer, supplies us with the most timely perspective on the effect of war on inflation in the September 14 issue of his newsletter:

"War is inflationary**. It is always wasteful no matter how just the cause. It is cost without income, destruction financed (more often than not) by credit creation. It is the essence of inflation."**

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Libertarian economics writer Lew Rockwell noted in 2008:

You can line up 100 professional war historians and political scientists to talk about the 20th century, and not one is likely to mention the role of the Fed in funding US militarism. And yet it is true**: the Fed is the institution that has created the money to fund the wars.** In this role, it has solved a major problem that the state has confronted for all of human history. **A state without money or a state that must tax its citizens to raise money for its wars is necessarily limited in its imperial ambitions. Keep in mind that this is only a problem for the state. It is not a problem for the people. The inability of the state to fund its unlimited ambitions is worth more for the people than every kind of legal check and balance. It is more valuable than all the constitutions every devised.**

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Reflecting on the calamity of this war, Ludwig von Mises wrote in 1919

One can say without exaggeration that inflation is an indispensable means of militarism. Without it, the repercussions of war on welfare become obvious much more quickly and penetratingly; war weariness would set in much earlier.

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In the entire run-up to war, George Bush just assumed as a matter of policy that it was his decision alone whether to invade Iraq. The objections by Ron Paul and some other members of Congress and vast numbers of the American population were reduced to little more than white noise in the background. Imagine if he had to raise the money for the war through taxes. It never would have happened. But he didn't have to. He knew the money would be there. So despite a $200 billion deficit, a $9 trillion debt, $5 trillion in outstanding debt instruments held by the public, a federal budget of $3 trillion, and falling tax receipts in 2001, Bush contemplated a war that has cost $525 billion dollars — or $4,681 per household. Imagine if he had gone to the American people to request that. What would have happened? I think we know the answer to that question. And those are government figures; the actual cost of this war will be far higher — perhaps $20,000 per household.

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If the state has the power and is asked to choose between doing good and waging war, what will it choose? Certainly in the American context, the choice has always been for war.

And progressive economics writer Chris Martenson explains as part of his "Crash Course" on economics:

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If we look at the entire sweep of history, we can make an utterly obvious claim: **All wars are inflationary. Period. No exceptions**.

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So if anybody tries to tell you that you haven't sacrificed for the war, let them know you sacrificed a large portion of your savings and your paycheck to the effort, thank you very much.

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The bottom line is that war always causes inflation, at least when it is funded through money-printing instead of a pay-as-you-go system of taxes and/or bonds. It might be great for a handful of defense contractors, but war is bad for Main Street, stealing wealth from people by making their dollars worth less.

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And as discussed above, liberals such as James Galbraith and conservatives such as Ron Paul agree that we wouldn't get into as many wars – and the wars which we did wage would be ended more quickly – it if the people were required to pay for them directly instead of war being paid out of the "hidden tax" of inflation.

The father of modern economics – Adam Smith – agreed:

Were the expence of war to be defrayed always by a revenue raised within the year [instead of financing it with long-term public debt], the taxes from which that extraordinary revenue was drawn would last no longer than the war. The ability of private people to accumulate, though less during the war, would have been greater during the peace than under the system of funding. War would not necessarily have occasioned the destruction of any old capitals, and peace would have occasioned the accumulation of many more new. **Wars would in general be more speedily concluded, and less wantonly undertaken. The people feeling, during the continuance of the war, the complete burden of it, would soon grow weary of it, and government, in order to humour them, would not be under the necessity of carrying it on longer than it was necessary to do so. The foresight of the heavy and unavoidable burdens of war would hinder the people from wantonly calling for it when there was no real or solid interest to fight for.** The seasons during which the ability of private people to accumulate was somewhat impaired, would occur more rarely, and be of shorter continuance. Those on the contrary, during which that ability was in the highest vigour, would be of much longer duration than they can well be under the system of funding.

War Increases Terrorism … And Terrorism Hurts the Economy

Security experts – conservative hawks and liberal doves alike – agree that waging war in the Middle Eastweakens national security and increases terrorism. See this, this, this, this, this, this and this.

Terrorism – in turn – terrorism is bad for the economy. Specifically, a study by Harvard and the National Bureau of Economic Research (NBER) points out:

From an economic standpoint, terrorism has been described to have four main effects (see, e.g., US Congress, Joint Economic Committee, 2002). First, the capital stock (human and physical) of a country is reduced as a result of terrorist attacks. Second, the terrorist threat induces higher levels of uncertainty. Third, terrorism promotes increases in counter-terrorism expenditures, drawing resources from productive sectors for use in security. Fourth, terrorism is known to affect negatively specific industries such as tourism.

The Harvard/NBER concludes:

In accordance with the predictions of the model, higher levels of terrorist risks are associated with lower levels of net foreign direct investment positions, even after controlling for other types of country risks. On average, a standard deviation increase in the terrorist risk is associated with a fall in the net foreign direct investment position of about 5 percent of GDP.

So the more unnecessary wars American launches and the more innocent civilians we kill, the less foreign investment in America, the more destruction to our capital stock, the higher the level of uncertainty, the more counter-terrorism expenditures and the less expenditures in more productive sectors, and the greater the hit to tourism and some other industries.

Moreover:

Terrorism has contributed to a decline in the global economy (for example, European Commission, 2001).

So military adventurism increases terrorism which hurts the world economy. And see this.

The Proof Is In the Pudding

I noted last year:

This is a no-brainer, if you think about it.

We've been in Afghanistan for almost twice as long as World War II. We've been in Iraq for years longer than WWII. We've been involved in 7 or 8 wars in the last decade. And yet still in a depression. (And see this).

If wars really helped the economy, don't you think things would have improved by now?

Indeed, the Iraq war alone could end up costing more than World War II. And given the other wars we've been involved in this decade, I believe that the total price tag for the so-called "War on Terror" will definitely support that of the "Greatest War".

Postscript on Iran: Well-known economist Nouriel Roubini says that attacking Iran would lead to global recession. The IMF says that Iran cutting off oil supplies could raise crude prices 30%.