

World View: The Elusive Costs of War

By Jeffrey E. Garten

Newsweek International

April 19 issue - As America's occupation of Iraq takes a turn for the worse, there is a risk of widening collateral damage. A growing quagmire could roil politics throughout the Persian Gulf and broader Islamic world. It could further strain U.S. relationships with its partners in the G7 industrial countries. It could embolden terrorists everywhere. Scenarios like these are obvious. But should we also be worried about the war's spillover to the global economy?

The relationship between war and economic prospects has never been straightforward. A case can be made that it was World War II, with its impact on manufacturing production, that pulled the United States out of the Great Depression. The requirements for supplying U.N. forces during the Korean War gave Japan the boost it needed to recover from total devastation in 1945. On the other hand, the Vietnam War had a number of negative effects, having ushered in a decade of both high inflation and economic stagnation in most of the Western world.

As a market, Iraq is small potatoes in a \$30 trillion dollar world economy. True, it has huge oil reserves, but since the country has been under international trade sanctions for the last decade, its absence as a major petroleum exporter will not have significant impact on global markets for awhile. If the war delays Iraqi reconstruction, that, too, would cause barely a ripple in the much larger arena of international trade and investment.

The bigger danger of a long and difficult war is what it would do to politics and economics in the major industrial countries. In the

United States, for example, escalating military costs will add to serious fiscal strains that already exist. Washington will have to spend hundreds of millions more dollars on the war and on homeland security. In order to get such funds appropriated by Congress, however, the Bush administration will need to buy off critics of the war by funding domestic social programs dear to them.

Widening U.S. deficits would require more financing from abroad. At the same time they could lead to a weakening dollar and possibly higher interest rates to keep foreign money flowing in. Escalating rates would undermine U.S. and global economic growth. They could also cause a withdrawal of funds from emerging markets as investors in Asia and Latin America seek higher returns on Wall Street.

The price of oil and the security of energy supplies is of course another risk. If the Iraq conflagration spreads to Saudi Arabia—if terrorists manage to sabotage some oilfields or if they attack the kingdom's rulers—all bets are off regarding oil prices and the state of the world economy.

Another danger of a drawn-out conflict in Iraq is that the attention of top officials everywhere will be diverted from a pressing economic agenda. Geopolitical priorities and domestic-security considerations will dictate how leaders spend their political capital. In the face of terrorism on Europe's own soil—and the perception that the Islamic world will become more radicalized because of what's going on in Iraq—the willingness of France, Germany and others to undertake essential regulatory and social-policy reforms will diminish even further than it already has.

Trade ministers from the United States, the European Union and Japan will be unable to make the tough decisions to revive global trade negotiations. In countries as diverse as the Philippines, Turkey, Uzbekistan and Mexico, money will be spent on domestic security at the expense of development efforts in critical areas such as education and medical care. As more funds pour into Iraq, there is bound to be a negative impact on foreign aid flows to Africa or to global HIV/AIDS programs.

Perhaps the biggest danger, and the most difficult to quantify, is that a long and difficult war will add to the investor and consumer unease that has already been building in many parts of the world—particularly the middle class in America and Western Europe. In the United States the mess in Iraq will add to rising anxieties about declining wages, job security, healthcare costs and pensions. Millions throughout the European Union are deeply worried about their ability to maintain living standards in the face of fraying social programs and ferocious economic international competition.

Moods like these are dangerous, for they lead politicians to xenophobic nationalism and economic protectionism, and they eventually take the buoyancy out of financial markets. In a highly networked global economy, the interconnections have multiplied beyond anyone's full comprehension. In addition to other problems, the economic damage of what started out as an effort to liberate one small nation could well reverberate for years to come.

Garten is dean of the Yale School of Management.

© 2004 Newsweek, Inc.