Estimating war's effect on U.S. economy

BY JAMES V. KOCH

As an economist, I'm often asked what effects a war with Iraq would have on the economy. It depends substantially on the nature and length of any conflict.

These factors are somewhat unpredictable. But here's what we can say with more confidence.

First, a successful two-week war in Iraq might cost about $100 billion. This is not chicken feed, but it represents only about 1 percent of our annual gross domestic product. We've already incurred at least one-third of these costs.

If, however, the war lasts longer, and urban ground warfare occurs, then costs will escalate, perhaps $10 billion to $20 billion per week. A month-long war could cost $140 billion.

In addition, there might be costs associated with increased terrorist activities or attacks on Americans abroad.

Second, assuming victory, we will then be faced with costs of occupation, cleanup and reconstruction in Iraq. We're not simply going to walk away.

The Congressional Budget Office believes each year of occupation will cost $17 billion to $45 billion, and that our occupation could last five to 10 years. Thus, the range of costs over the next 10 years is $85 billion to $450 billion and will be higher if we initiate something equivalent to the Marshall Plan. The higher figure is roughly equal to the annual expenditures of the U.S. Department of Health and Human Services, which is responsible for Medicaid and Medicare.

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In contrast to the 1991 Persian Gulf War, it's not clear we will receive significant contributions from other countries to help pay this bill.

On the positive side, a successful war will eliminate uncertainty that has been plaguing consumers, businesses and Wall Street, and this would provide a powerful stimulus to the economy.

Further, a quick victory will reduce oil prices, which have inflated $5 to $10 per barrel because of supply uncertainties. If war begins, oil prices will spike upward from about $30 per barrel today to $50 per barrel or more. This implies a cost of $2.50 per gallon of gasoline here in Hampton Roads.

However, if the war is both quick and successful, oil prices will drop precipitously to about $20 to $25 per barrel.

This would provide a valuable dividend to the U.S. economy, amounting to a $3 billion reduction in costs for every $1 decline in the price of oil per barrel.

Because Iraq owns about 10 percent of the world's oil reserves, the entire world would benefit from lower energy costs if the Iraqi oil spigot is opened wide. However, it's quite possible that Saddam Hussein will destroy Iraq's oil production facilities; thus, lower oil prices would be delayed for several years, and we would have to pay to reverse this damage.

In Hampton Roads, the economic impact of a war will be magnified because about 25 percent of all economic activity within our region is directly related to the Department of Defense (down from almost 40 percent in 1985).

Whereas active-duty military personnel comprise less than 1 percent of the labor force nationally, here in Hampton Roads they constitute 11.4 percent. When these individuals depart (and many have already), it puts an obvious dent in regional economic activity.

Each additional carrier battle group that departs the region reduces the regional economic growth rate by 1 percent, if the deployment lasts an entire year. This can be offset partially by new personnel who are transferred here as a part of the overall military buildup.

War, then, will not be inexpensive. A lower-bound estimate of the cost of a one-month war is about $900 per U.S. citizen and an upper-bound estimate about $2,500 per person.

But costs are associated with inaction, too.

A nuclear or chemical attack on the United States generated by Saddam or those he influences, or a future Middle Eastern war propagated by an intimidating Iraq in possession of highly destructive weapons, would impose substantial costs on us. An economic argument in favor of action against Iraq is that it might enable us to avoid significant future costs.

If war ensues, it will be the result of a complexity of social, political and economic factors, many of which are not considered here.

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