ECONOMICS OF PEACE PROCESSES

Lucy L. Webster
Program Director, Economists Allied for Arms Reduction, New York, U.S.A.

Keywords: Accountability; Defense conversion; Demobilization, Democratization, Dual-use technology; Deficit spending; Economic adjustment; Feedback mechanisms; International Criminal Court; Confidence-building measures (CBMs); Military-industrial complex (MIC); Military spending; Reintegration; Peace dividend; Peacekeeping; Public good; Subsidiarity

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1. Introduction

The five articles within this topic discuss the economics of various peace processes and the impact of war and post-war adjustments on prosperity. A discussion of U.S. responses to cuts in military production and employment is followed by a discussion of economic incentives and disincentives for peace and an analysis of strategies for post-war conversion and reintegration in industrial countries and in less developed countries. The topic article then considers some possible applications of systems theory to create incentives and structures for peace. It also identifies and illustrates a number of principles that have been found to work in building institutions for peacemaking and peacekeeping.

The discussion of systems theory raises the question of the extent to which institutions must evolve organically and the extent to which they can be designed deliberately, especially in relation to the increasingly destructive power of warfare. The principle of accountability was given deliberate attention in the process leading to the adoption of the Rome Statute of the International Criminal Court in 1998, and its subsequent signing by 139 countries and its ratification by 52 of the 60 needed to bring this treaty into force. The commitment to hold individuals accountable for war crimes and crimes against humanity is a major step in building institutions to prevent war and ensure peace. Another step discussed within this topic concerns international peacekeeping, which has also been given deliberate attention by the international community, but with less effect than the efforts to create an International Criminal Court. Lawrence R. Klein considers the savings to human security and the global economy if military conflict were largely confined to international peacekeeping.

2. Military Spending, Production and Employment

Paul Davidson examines the effect of ending hostilities on output and employment with special reference to the United States. During war, governments spend heavily, up to approximately half of the Gross National Product, to cover the costs of armed forces and materials, borrowing in the financial markets to finance these expenditures. In contrast, he states, the end of hostilities can lead to severe unemployment as armed forces are demobilized and national production is reduced when government spending returns to peace-time patterns, thereby depressing aggregate demand.

In 1917, before the United States entered the First World War, the total federal debt was $3 billion compared to $25.5 billion at the end of 1919. The added $22.5 billion went mainly to the war effort and then to demobilization. During the 1920s, government expenditures declined even though the federal debt decreased by $9.3 billion and the federal government's annual surplus increased every year until 1927 when it was $1.2 billion. Annual surpluses then declined until 1931 when there was a deficit of $462 million. (In 1918 the Armed Forces totaled 2, 897,167 persons falling to 343,342 military personnel on active duty in 1920 and 255,031 by 1929.)

Davidson states that less government deficit spending after 1919 might have eased conditions in financial markets except that the newly created Federal Reserve maintained a high interest rate policy to fight inflation. Consumer prices, which had risen on average by less than 1 per cent a year since the Spanish-American war at the turn of the century, began to escalate in 1917 and continued to rise after the end of hostilities. By 1920 the consumer price index was 58 per cent higher than 1917. With the severe recession of 1920-22, consumer prices dropped by over 16% from 1920 to 1922 and then stabilized throughout the rest of the 1920s. To fight the inflation of the 1917-20 period, however, the Federal Reserve had raised its discount rate from 4 per cent in 1918 to as high as 7 per cent in 1920 and 1921. These relatively high interest rates in the period after the end of hostilities depressed private investment spending.

Even with low interest rates after the end of hostilities, he continues, private spending would have found it difficult to expand quickly enough to pick up the slack left by the large reduction in aggregate demand caused by cuts in wartime deficit-financed government spending. With the high interest rate policy of the Federal Reserve, private spending was totally insufficient. Also exports dropped from $10.7 billion in 1919 to $5 billion in 1922. Thus GNP fell by 9 per cent between 1919 and 1921, and unemployment increased from 1.4 per cent in 1918 to 11.7 percent by 1921.

3. United States Experiences of Post-War Adjustment

After World War II, neither growth nor employment fell very much. By the end of the war in mid 1945, the federal debt stood at $252 billion. Annual federal government spending, which had been less than $10 billion in 1940, increased to $14 billion in 1941 and to $95.2 billion in 1945. As a result of this government deficit spending, Davidson states, GNP grew by 16.1 per cent in 1941, 12.9 per cent in 1942, 13.2 per cent in 1943, and 7.2 per cent in 1944. The unemployment rate fell from 14.2 per cent in 1940 to 1.9 percent in 1945 and then increased to 3.9 per cent in 1946 when the number of troops was cut from 12 million in 1945 to 3 million in 1946. GNP for the entire year of 1945 fell by 0.1 percent. In 1946 as the nation moved towards a peacetime economy, federal government expenditures declined from $95.2 billion in 1945 to $61.7 billion, and the GNP fell by 11.9 per cent. In 1947 GNP fell by less than another 1 per cent before rising by 4.5 per cent in 1948. Thus, unlike World War I, Davidson writes, when the hostilities ceased the resulting downturn was mild and short-lived. He attributes this to several factors:

1. The G. I. Bill of Rights gave millions of servicemen and women the opportunity to attend college, and many of the millions of women who had taken paid jobs during the war quickly retired from the labor force. Consequently it only increased from 52.8 million in 1945 to 55.2 million in 1946 despite the demobilization of almost 9 million men and woman in 1946.

2. As a result of the Marshall Plan and foreign and military aid in general, exports which had declined from $16.2 billion in 1945 to $14.8 billion in 1946, increased to $19.8 billion in 1947. Government expenditures on such aid programs continued to help finance an export boom through the next two decades. By 1970, exports had more than tripled to almost $61 billion.

3. The Federal Reserve had held down interest rates throughout the war and the Federal Reserve discount rate was never more than one per cent from 1940 to 1947. In 1948 when a recovery was under way it was raised to 1.5 per cent where it remained until 1950, and the rate on U.S. government securities was at the same levels, which Davidson states permitted rapid investment for conversion to peacetime production.

The post-war export boom plus the release of pent-up consumer and investment demand that could be financed at very low interest rates meant a relatively mild immediate post-war recession despite the fact that total federal government outlays on domestic production went down by one-third from $95.2 billion in 1945 to $61.7 billion in 1946. Direct federal spending fell by an additional 40 per cent to $37 billion in 1947 and then increased to $43.1 billion in 1950.

Davidson states that a great recession was avoided after World War II because two of Keynes's policies were undertaken: there were very low interest rates to encourage maximum private investment spending, and balance of payments surpluses were recycled to deficit nations, which could then continue to purchase goods and services. The Marshall Plan and other foreign and military aid programs filled this function.

Subsequently the Cold War from 1948, and the Korean War in 1950 increased United States national defense spending almost continuously from a low of $13 billion in 1948 to over $81 billion by 1969. Davidson concludes that it was the expansion of military expenditures starting with the Berlin Wall and including the Vietnam War plus a rapid growth in U.S. exports that led to one of the longest peacetime expansions in U.S. history.

The oil price shock of 1973 led to rapidly rising prices which induced a tight anti-inflationary monetary policy with interest rates on Treasury bills going from 4 per cent in 1972 to almost 8 per cent in 1974. This, Davidson states, resulted in a slow down in the US economy in 1974-75 when investment spending declined by almost 40 per cent and the unemployment rate rose to 8.5 per cent as the Vietnam hostilities ended and armed forces were reduced. After the second 1979 oil price shock and a tough anti-inflation monetary policy of Federal Reserve Chairman Volker, the interest rate on Treasury bills rose to 14 per cent in 1981, before falling to 10.69 per cent in 1982, and unemployment rose from 5.8 per cent in 1979 to 9.7 percent in 1982, briefly reaching double-digits during part of 1982. The subsequent military spending under Reagan plus his huge tax cuts pushed government deficits up from $73 billion in 1980 to 207.9 billion by 1983. This ‘military Keynesianism’ plus the tax cuts Davidson concludes brought the United States out of the serious recession of 1980-1982.

Twentieth century United States defense expenditures peaked at $303 billion in 1989 and then dropped slightly with the end of the Cold War to levels between $265 billion and $299 billion through 2000. Thus, states Davidson, any expansion during the 1990s cannot be attributed to additional ‘Keynesian’ military expenditures. Following the January 1990 end of ‘Desert Storm’ hostilities in the mid-East, there was no shooting war or cold war during the 1990s decade, and real federal government purchases declined by approximately 8 per cent. A brief recession in 1991-92 with GDP falling by 1 per cent and unemployment rising from 5.3 per cent in 1989 to 7.5 percent in 1992 coincided with new higher marginal tax rates that came into effect in 1991 and a brief dip in military spending in 1991.

Accordingly, Davidson states, the end of the Cold War was coincident with a brief recession and a rise in unemployment. Nevertheless, after 1992 there was a continuous rise in GDP and a continuous drop in the unemployment rate throughout the decade. For the year 1999, the civilian labor force unemployment rate was 4.2 per cent and GDP in real terms was 33 per cent larger than in 1990. This rate of growth in a decade had not been seen since the 1960s.

4. The Role of Deficit Spending for Growth and Employment

The conclusions of the Davidson analysis of the effects of ending hostilities on output and employment can be summarized as follows:

1. When the United States engaged in actual hostilities or in the Cold War hostilities that provoked a military build-up, this was normally associated with a period of economic expansion. In the cold war period, expansion was often closely related to the degree that the U.S. perceived increasing military dangers. When tensions were reduced, there was some economic slowdown or actual recession and rise in the civilian unemployment rate, which has led some to argue that U.S. economic

prosperity requires some form of continuous deficit spending by government. And it is often argued that the only politically acceptable form of Keynesianism involves what has been labeled military Keynesianism, i.e., increased deficit spending for expansion of the military defense establishment.

2. However, the history of the immediate post World War II period and the 1990's shows that military Keynesianism spending is not a necessary condition for producing a prosperous growing nation with rapidly increasing GDP and declining unemployment rates approaching full employment of the civilian labor force. During these two post-war periods, Davidson concludes, "the Federal Reserve pursued a very accommodating monetary policy. Especially in the 1990s, whenever it looked like the economy would stall, the Federal Reserve reduced interest rates quickly and provided liquidity that helped stimulate innovations and investment expenditures."

3. Also, "whether the United States ran surpluses or deficits in its trade balances, it acted as the engine of growth for its trading partners in the rest of the world." When running surpluses, it returned them to U.S. trading partners through the Marshall Plan and other aid programs. When running trade deficits it treated them with benign neglect and did not ordinarily try to reduce imports to improve its trade position. The growth of U.S. imports was a great stimulus for economic growth in the rest of the world. The resulting prosperity of these nations fed back into a demand for U.S. exports. This contrasted with the 1970s and early to mid-1980s when slow growth and significant recession in the United States reduced the U.S. import demand stimulus to the rest of the world and also the demand of the rest of the world for U.S. exports. "The result was a feedback mechanism that tended to induce worldwide recession and depression," Davidson states. He also concludes that the foreign trade sector was a stimulus to U.S. growth in the final decade of the twentieth century.

(At the same time, Davidson states that unless there is a "new financial architecture for the international monetary and payments system, the persistent substantial deficits in the U.S. balance of payments can force the United States to reign in its import demand", which he says could trigger "a global recession that might rival The Great Depression of 1929-1940.")

Thus he concludes that, as in the 1950s, the 1990s prosperity was based on low interest rates and rapidly growing export markets for U.S. products. The growth in these foreign markets in the 1950s was the result of foreign aid to finance foreign purchases of U.S. goods. In the 1990s it was due to benign neglect of the deficit in the United States balance of payments, which permitted imports to rise more rapidly than exports. The huge demand of the United States for foreign goods and services induced Keynesian growth in other nations, which in turn permitted the expansion of U.S. exports that have more than picked up the slack left by the abandonment of the military Keynesianism of the Reagan era.

5. Peace Agreements and the Cost of Conflict

In a second article within the Economics of Peace and Security topic, J. Grussendorf and I.

R. Kurtz examine economic dimensions of peace agreements. They look at economic incentives for agreements as an alternative to arms spending, the relationship between peace agreements and aid, trade and investments, the economic obstacles to concluding peace agreements, and the way such agreements relate to the broader process of peace building.

Although in the past, war may have presented one means for maximizing resources and increasing territory, many argue that the costs of modern war are not commensurate with any possible gains. Increasingly sophisticated modern weaponry has dramatically increased the destructiveness of wars and the cost of preparing for them. The maintenance of large military structures has substantial costs even without war; a phenomenon Victor Sidel calls "destruction without detonation."

The costs of major military campaigns are also staggering; Seymour Melman estimates that the total cost of the Vietnam conflict, for example, went far beyond $150 billion in direct outlays. If one includes war-related debt, foregone production, veterans' benefits, etc., it may have reached $676 billion. Some of the costs are, however, more direct. They emerge not only in terms of the classic "guns vs. butter" tradeoff in which spending for social programs is diverted to the military, but also in terms of the allocation of resources for military rather than civilian economic development.

Aside from loss of territory for the losing side, all countries and groups engaged in war suffer the destruction of human life and resources. The UN Food and Agricultural Organization and the World Food Program estimate that war and its aftermath pose a greater threat to food security than draught and weather conditions. Grussendorf and Kurtz point out that the immediate economic effects of conflict are the loss of productive capacity: human capital lost through casualties and displaced populations, and the loss of material wealth: destroyed manufacturing plants and economic structures for the normal running of a healthy economy. Economic upheaval can lead to changes in institutions with adverse effects on trade; conflict can create uncertainty in markets, and reduce international trade and investment.

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Biographical sketch

Lucy Law Webster is Senior Fellow of the Institute for Global Policy and the UN NGO representative of Economists Allied for Arms Reduction (ECAAR) where she is also a member of the Board of Directors. From 1981 to 1995 she worked in various parts of the United Nations secretariat. She was an information consultant in UNICEF, UNDP and UNEP and then Special Assistant to the Secretary General of the Second World Conference to Combat Racism. From 1988 until her UN retirement she was a Political Affairs Officer serving as Assistant Secretary of the First Committee of the General Assembly, as Secretary of the UN Disarmament Commission Working Group on Science and Technology for Disarmament and Development, as Editor of two UN publications concerning disarmament, and as the press and NGO liaison officer for the 1990 and the 1995 NPT Review Conferences. After leaving the UN Secretariat she worked as a staff director of ECAAR. Prior to joining the UN secretariat she worked in international opinion and marketing research based in London England and as an honorary officer of the World Federalist Movement. She has a BA degree in Political Science from Wellesley College, an MSc in International Relations from Long Island University and is currently a student in the Economics Department of the Graduate Faculty of the New School University in New York City.