How Booming Cannons Hurt Booming Economies

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Many aficionados of the information economy are starting to believe that we may be in the early stages of a 20-year-long boom. For instance, Peter Schwartz wrote about it in a July 1997 cover story called "The Long Boom." In a period like this, the economy's annual growth rate would average close to 4 percent, compared with the 2 to 2.5 percent average of the '70s and '80s. With such a growth rate and the implied high corporate earnings, the current high prices of blue-chip stocks could be justified. There is some basis for the "long boom" view, some of which I examined in a recent column (see Economics, June).

But it's always a good idea to ask what could go wrong. This month, and in my December column, I'll look at three scenarios that could end the boom, examining them not in the order of their likelihood but in the order of the damage each would likely cause.

WAR ZONING

First, the most harmful: war. (I'll tackle regulation and tax policy next month.) Far from being a boon to economies, as the cliché goes, war hurts and can even destroy them. Even for countries, like the United States, that generally manage to fight on other people's territory, war hurts. The most obvious danger is that war can kill a large number of a nation's youth -- World War II, for example, cost the United States more than 400,000 lives, almost all of them people under 40. Another obvious harmful effect of war on the economy is the diversion of resources -- both physical and human -- from productive, peaceful activities to military ones.

In 1944, for example, at the peak of World War II-related production in the United States, war spending was equal to 42 percent of the U.S. gross national product. This was a loss to the economy. By contrast, even the worst year of the Great Depression, 1933, cost the U.S. economy only about 35 percent of GNP. And the real contrast between the two periods is actually even more stark because measuring war spending by percentage of GNP doesn't fully account for the war's cost. That's because during the war, the federal government imposed price controls on virtually all goods used in the war effort, including gasoline, rubber, nylon, food, and most importantly, manpower. One predictable result of price controls was widespread shortages; the government responded by rationing what was left after it had taken the resources it wanted at the prices it had set. The prices the government paid, therefore, were below the true costs of the resources it used--meaning war spending cost the economy even more than the official figure suggests.

War also hurts economies by giving governments the opportunity and the excuse to take on new powers -- powers they don't fully relinquish when the war is over. During World War II, for example, the income tax, which previously had applied only to high-income people, was imposed even on low-income people -- the "class tax" became the "mass tax." Also, the federal government introduced withholding to make it easier to collect people's money. After the war, income taxes never reverted to anything close to their prewar levels, and withholding is still with us today. The government uses much of the money to finance the welfare state. Rent control in New York, a supposedly temporary measure introduced in 1942, still remains 57 years later and has destroyed parts of that great city.

BUNKER DOWN

The good news is that the probability of another major war in the next few years is very low -- I would put it at less than 5 percent. The biggest rival to the United States in the world today is China. Although U.S. government officials have actually given the Chinese government some of the technology necessary to attack us, it is unlikely the United States and China will come to blows. The wars in which the United States is likely to engage are skirmishes in small nations around the world, like Serbia and Kosovo. If a war costs the United States more than a few thousand lives, the political pressure to cut future losses and get out would be immense. Because the costs of Kosovo-scale skirmishes are small, they can be fought with only a slight increase in the defense budget and without major new regulation of the domestic economy.

But there is some bad news. Other governments, unable to compete with the United States in conventional wars, may instead use unconventional methods like planting bombs (perhaps even nuclear devices) or spreading anthrax in major U.S. cities. The technology already exists, and all it would take to set that in motion is U.S. provocation against an aging dictator with little to lose. That dictator would surely be able to find a few zealots who would sacrifice their own lives to take out thousands of American citizens.

If a foreign government did use terrorist methods in U.S. cities, we would face a choice. One option would be to change our foreign policy by refraining from meddling in other countries' affairs. Why do people fear a bomb exploding in Washington, D.C., but not, say, in Ottawa? To ask the question is almost to answer it. Few nations in the world have much of a grudge against Canada's government because it rarely meddles in other nations' business. Not so with the U.S. government, which meddles constantly around the world and has yet to see a country that it does not consider a "vital U.S. interest."

The other choice would be to change the open nature of U.S. society completely. This would include increased restrictions on internal travel -- building on the precedent set by the Clinton administration for passengers on commercial airlines (who must show picture identification) -- and other restrictions on our freedoms that various bureaucracies in Washington probably have added to their wish list already.

If the second option were chosen, that would end the boom -- and a good deal more.