The Long-Term Economic Implications of the Ukraine War

Description

USA: The human suffering in Ukraine is predicated on massive U.S. military aid, and is transforming an ailing country into a bankrupt failed state.

Douglas Macgregor recently argued in these pages that Washington's refusal to acknowledge Russia's legitimate security interests in Ukraine and to negotiate an end to the war will cement "the path to protracted conflict and human suffering." As Macgregor observed, even while the tide is now turning in Ukraine, Washington's foreign policy continues to be fueled by the ideological self-delusion of the true believers: "Like the 'best and the brightest' of the 1960s they are eager to sacrifice realism to wishful thinking, to wallow in the splash of publicity and self-promotion in one public visit to Ukraine after another."

It is indeed a spectacle eerily reminiscent of events over half a century ago, when Washington's proxy war in Vietnam was escalated even as it was failing. The U.S./NATO-led proxy war against Russia in Ukraine has already bankrupted the Ukrainian economy, an outcome some observers saw nine months ago. It will also accelerate the decline of the U.S. international role and global economic prospects. When great powers fail to balance their economic base with their military power and strategic commitments, they risk imperial overstretch. That is America's key global risk in the 2020s. And due to the U.S. role in the world economy, the global repercussions of such overstretch will be adverse, extensive, and long-lasting.

In *The Best and the Brightest* (1972), David Halberstam argued that it was the refusal of U.S. elite policymakers and intellectuals to recognize the true economic and human costs of Vietnam escalation that led them to sacrifice realism for wishful thinking. As the idea that South might not win against North Vietnam was simply dismissed, Secretary of State Dean Rusk said, "We will not pull out until the war is won."

Similarly, in September, Secretary of State Antony Blinken pledged lasting U.S. support for Ukraine during a visit to Kiev, while the Biden administration helped Ukraine's military recapture territory occupied by Russia. “This is a pivotal moment,” he declared to Ukrainians, “as your counteroffensive is now underway and proving effective,” adding: “We will support the people of Ukraine for as long as it takes.”

By the late fall, the status quo had reversed, though it remained suppressed in mainstream media. Convinced that an outright military victory was now out of reach, Gen. Mark Milley, chairman of the Joint Chiefs of Staff, pushed for a diplomatic outcome, even as Biden’s true believers struggled “to clean up Milley remarks on Ukraine diplomacy.” Later, European Commission President Ursula von der Leyen acknowledged Ukraine’s losses in the war with Russia amounted to 100,000 soldiers and 20,000 civilians, though her tweet was quickly deleted and a new one was released without the death count.

Ideological self-delusions come with a price. Just as the Vietnam escalation of President Johnson’s true believers demolished his domestic “Great Society” dream, President Biden’s blind faith in his advisers is undermining his domestic agenda.

At the eve of the Christmas season, President Volodymyr Zelensky delivered an emotional wartime appeal to a joint meeting of Congress pleading for more military assistance from the lawmakers. This, he vowed, was necessary for “eventual victory.”

Yet, *already half a year before*—months before the Russian winter operations—his own government, together with European Commission, estimated that Russia’s invasion had caused over $97 billion in direct damages to Ukraine and it could cost $350 billion to rebuild the country.

In the proxy war, economic and humanitarian aid to Ukraine has been abundant and historic. By late fall, Congress had passed three aid packages, which totaled $68 billion, while the Biden administration submitted a new aid request of $38 billion, which would bring the total to $106 billion. Although designed to last through September 2023, it will be depleted by May at the current rate of spending ($6.8 billion per month). By then, the Biden White House must ask for additional funds amid recessionary global prospects.

Internationally, America provides the bulk of total aid to Ukraine (62 percent). Aid from non-U.S. sources amounts to $41.4 billion. The international total of over $110 billion accounts for *more than half* of Ukraine’s pre-war GDP ($200 billion). Moreover, due the kinds of equipment being procured to support Ukraine, the “money Congress appropriates in year one does not get fully spent until year five” (read: in the *late 2020s)*.

The good news: Ukraine would have been a failed state without the aid. The bad news: The very same aid will prolong Ukrainians’ suffering.

Even as international media touted the mirage of Ukraine’s military triumph, the country’s real GDP declined over 35 percent on an annual basis in the third quarter of 2022—*before* Russia’s recent massive infrastructure attack.

Only a year ago, Ukraine, under Zelensky ’s leadership, was still positioned to play a critical role as a bridge between Eastern and Western Europe itself, thanks to its vital position in China’s Bridge and Belt Initiative (BRI). Before the Russian invasion, he flirted with neutrality until then–Prime Minister Boris Johnson made it very clear that was not acceptable to the U.S. and its allies, which wanted to "weaken Russia," as Secretary of Defense Austin acknowledged later. The U.S./NATO geopolitical plans envisaged Ukraine as a massive military base.

The direct physical damage to infrastructure soared to $127 billion already in September; that's over 60 percent of pre-war GDP. The impact on the productive capacity of key sectors, due to damage or occupation, is substantial and long-lasting. The population share with income below the national poverty line in Ukraine may more than triple reaching nearly 60 percent in 2022, with major downside risks if the war and energy security situations worsen.

The nine months of war have caused massive population displacement. Over a third of the population has been displaced and over half of all Ukrainian children have been forced to leave their homes. As of October 2022, the number of Ukrainian refugees recorded in Europe was 7.8 million, and the number of internally displaced people was 6.5 million.

In 2022, U.S. GDP growth on a year-to-year basis is likely to remain stagnant between 0.1 percent and 0.2 percent, which, however, is predicated on unsustainable debt-taking that is accelerated by the proxy war in Ukraine.

The key role in this debt belongs to military expenditures; as with Vietnam escalation, the best and the brightest serve mainly as enablers. For decades, the U.S. has used partnerships and proxy forces to wage war under the radar in at least 17 countries. In the past two decades alone, the cost of its global war on terror to the U.S. and its partners stands at $8 trillion and 900,000 deaths. The costs in target countries are far, far higher.

From the economic standpoint, these military expenditures, including U.S. Ukrainian aid, should be seen as massive, recurrent, multiyear bastard Keynesianism: a series of military stimulus packages to prop up the American economy—not Ukraine's!—amid deepening secular stagnation. Unlike Keynesian stimuli that can have an accelerator effect in the civilian economy, these packages mainly benefit the Pentagon and Big Defense—the military–industrial complex and its revolving-door elites.

By the end of 2022, federal debt held by the public is projected to equal 98 percent of GDP. In the nonpartisan CBO's projections, debt as a percentage of GDP begins to rise in 2024, surpasses its historical high in 2031 (when it reaches 107 percent), and continues to climb thereafter, rising to 185 percent of GDP in 2052.

The high and rising debt as a percentage of the U.S. GDP will slow economic growth, push up interest payments to foreign holders of U.S. debt, and heighten the risk of a fiscal crisis. As the Biden administration is extends its Ukraine doctrine from Russia to Iran, Taiwan, and elsewhere, defense allocations are soaring, which will further contribute to rising debt, twin deficits, and real interest rates.

In a recent *Foreign Affairs* commentary, veteran economist Mohamed A. El-Erian warned that we are not facing just extraordinarily challenging business-cycle fluctuations, but structural and secular long-term pressures. As a result, "the global economy may never be the same."

In fact, the "old normal" has been history since 2008 and the consequent debt crises. During the past decade, the world economy has been driven by geopolitical agendas, not by economic priorities. The results have been predictably catastrophic. The risk of recession casts a dark shadow over the U.S. economy. The Eurozone already faces a deep one. Japan's economy is shrinking. The United Kingdom is struggling with the worst fall in living standards since records began. In the 1940s, war threatened to result in excessive debt. Today, excessive debt risks wars that will have no winners, thanks to the best and the brightest.

by Dan Steinbock

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1. Army-Wars-Conflict Zones-Military Tech.
2. Main
3. Opinion-Comments
4. Politics-Geopolitics-Gov.-Events

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