

## **Global Recession and US National Security**

Testimony Before the House Armed Services Committee

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We should start by noting that during the five years preceding the current downturn, 2002-2007, the world economy performed exceedingly well, one of the best half decades in history. Growth was high and widely spread, inflation was low in most countries. This exceptional performance may have created unsustainable expectations about the future, particularly in young adults who do not recall earlier, less buoyant periods.

The impact of the current global recession on US national security, interpreted broadly, is extremely complex. There are pluses and minuses. Start with some of the pluses.

It will be easier to recruit and retain desired persons for the US armed services at US unemployment rates of 8-10 percent than at unemployment rates of 4-5 percent, with lower signing bonuses.

One of the characteristics of the 2002-2007 global boom was a sharp rise in the prices of primary products – especially petroleum (used for cooking in many poor countries in the form of kerosene, and for transport) and staple foods such as rice, wheat, corn, and vegetable oils. This created great anxiety in many countries about major social unrest, leading often to large government subsidies. Such prices have greatly receded

since mid-2008, although they generally remain significantly higher than they were six years ago. Social pressures from this source have greatly eased. Of course, producers of these products – assuming the rise in world prices was passed on to farmers –will have lower incomes. But the potential social problems were mainly in urban areas, where consumers predominate. The World Bank has estimated that more than half of developing countries will benefit from the price declines (Global Economic Prospects, 2009, p.45).

Third, the oil revenues of all exporting countries, while higher than early in the decade, have declined sharply from the elevated levels of late 2007 and early 2008, when oil prices briefly exceeded \$140 a barrel. This includes in particular the revenues of Russia, Iran, and Venezuela, each of which in different ways has posed problems for the United States, greatly facilitated by high government and foreign exchange revenues. All three countries have become fiscally undisciplined, and all will have to cut their expenditures sharply in view of their declines in revenue, unless they are willing to countenance a sharp increase in domestic inflation – which would increase domestic disaffection with their respective governments. The decline in oil prices is directly linked to the slowdown in world economic activity, so in this respect the slowdown can be said to benefit US national security. Concretely, Iran will have to balance more carefully its financial and material support for Hezbollah against pressing requirements for domestic expenditure.

On the other hand, the recession implies a decline in demand, including demand for labor-intensive products made in many developing countries. According to World Bank projections, world trade is likely to fall in 2009 for the first time since 1982, the last

major recession. This contrasts with an annual growth in trade volume in excess of seven percent a few years ago. Thus a major source of new jobs, pulling people from the countryside into urban areas in many countries, will disappear, and perhaps briefly go into reverse. There will be disappointed migrants, and millions of workers laid off. For example, it is said that in China already over 20 million migrants have lost their jobs, mainly in low-skilled manufacturing and in construction; in addition, several million newly graduated students will have difficulty finding jobs in the current economic environment. The Chinese authorities are greatly concerned about the eruption of social unrest, and have already taken a number of steps to head it off, e.g. by providing loans for self-employment by new college graduates, and by taking steps to increase real living standards in rural areas.

It is worth noting that in the oil-exporting Gulf Arab countries the impact of the decline in new jobs will fall mainly on foreigners rather than on residents, since most of the work in the private sector, and much in the public sector, is performed by temporary migrants from other countries. Of course budget reductions may have an impact on the incomes of residents, although these countries typically have substantial public savings on which they can draw to avoid any major reduction.

The recruiting ground for terrorists – and for criminal gangs – is among idle, disaffected, and alienated young men. They are not typically from among the poorest people in the world, but from people that by world standards would be considered “lower middle class.” The recession will increase the numbers of such people, but probably not massively unless the recession becomes much worse than is now generally expected.

Some countries are more vulnerable than others. Large numbers of Pakistanis working in the Gulf area may lose their jobs, returning to Pakistan and depriving that country of their remittances. Pakistan has a large current account deficit that will need to be financed as exports and remittances decline, if a sharp decline in domestic output is to be avoided.

. The most important effect of the financial crisis and subsequent recession may be the least tangible: a serious worldwide erosion of confidence in American competence, a confidence which previously almost carried a sense of invincibility. The rest of the world typically placed more confidence in American competence than was warranted – most Americans knew better. But the events of the past six years have brought American competence under severe doubt, starting with the post-combat phase of the war in Iraq, which the United States is generally viewed as having bungled. This was reinforced by the perceived debacle over handling Hurricane Katrina. Now the subprime mortgage crisis, at the heart of the seemingly invincible American financial system, leading to a wider financial crisis and now a global recession, further undermines confidence in American competence. This crisis clearly started in the United States, not in some emerging market or (as in 1992) in a feckless Europe. This loss of invincibility may embolden existing hostile groups to try through some dramatic act to bring the system of American capitalism, now vulnerable, crashing down for good.