

Full Length Research Paper

Wars and the current crisis in the American economy

Adil H. Mouhammed

University of Illinois, Springfield, USA. E-mail: amouhammed@gmail.com.

Accepted 4 October, 2010

The purpose of this paper is to explain clearly that the recent economic crisis in the U.S. economy is grounded in the wars in Afghanistan and Iraq aimed at controlling world oil and the globe. These goals reflect the dominance of militarism, of oil corporations, and of the financiers represented by the Federal Reserve (Fed). These institutions represent the dominant triangle of the American higher-plane capitalism. On the one hand, the wars have been increasing government spending on militarism, which generates huge budget deficit and public debt and a higher rate of inflation and a lower exchange rate of the dollar. On the other hand, the two wars are increasing the prices of oil, which contribute significantly for increasing the cost of doing business. The Fed had to defend its position by increasing interest rates by reducing lending. For their own survival, businesses have to increase prices and cut cost. All these private and public actions cumulatively generate stagflation (high inflation and unemployment) and the Great Recession of December 2007.

Key words: Militarism, oil corporations, financiers, budget deficit, inflation, unemployment, peace economy, Veblen, Melman.

INTRODUCTION

The economy has been in recession since December 2007. The unemployment rate increased to 5.6 percent on December, 2009 (Table 1), and the budget deficit increased to about \$500 billion in 2008. Given the huge increases in government spending, the economy has been losing jobs and will not be able to create high-paying jobs. In the near future low-wage jobs and high cost of living do indicate the financial squeeze the American working people have been suffering from.

Many causes have been provided to explain the recent economic situation, and this paper tries to contribute to this discussion. The paper contends that the malaise is explained by the domination of three important institutions are militarism, oil corporations, and the Fed. This has been a deadly dominant triangle. The American government under the leadership of President Bush tried to benefit oil corporations by occupying Iraq and Afghanistan, because Iraq has more than 250 billion barrels of oil reserve, and Afghanistan is used to build the giant oil pipeline which transports oil from the Caspian Sea to the Arabian Sea, a project that was rejected by the Taliban government in 2001 when the Bush

administration suggested it. The government used the military might of the United States of America to occupy, not intervene in, Iraq and Afghanistan. Both countries provided huge opportunity for oil corporations to make super-profits, and these corporations do make super-profits as a result of high oil prices generated by these two wars. But the military occupation of these small countries requires significant increases in military spending, which the Bush administration did not calculate properly as it was thought that the military occupation of these countries was a cake-walk. But the military expenditures also benefited the military-industrial complex, as most of the spending was directed to purchase weapons and military equipment. This increased military spending generated a huge budget deficit; and the increased oil prices, due to the expectations of the possibility of oil shortage as a result of wars, led to higher domestic prices and cost of production. Profits declined, so were employment and investment. Both generated a higher inflation rate. The Fed, trying to defend the interest of the financiers, increased the short-term interest rates (or the Federal funds rates) to control inflation. This combination

Table 1. Important economic indicators for the American economy.

Year	2001	2002	2003	2004	2005	2006	2007	2008
Indicators								
Rate of unemployment	4.7	5.8	6.0	5.5	5.1	4.6	4.6	5.6
Rate of inflation	2.8	1.6	2.3	2.7	3.4	3.2	2.8	3.84
Rate of productivity	2.5	4.1	3.7	2.8	1.8	1.0	1.4	2.5
Growth								
Rate of GDP	0.8	1.6	2.5	3.6	2.9	2.8	2.0	1.07
Growth								
Growth of weekly	-0.1	1.3	0.0	-0.4	-0.6	1.1	0.9	-1.8
Compensation								
Non-financial profit	245.5	332.3	356.4	490.7	526.9	629.7	547.0	510.5
After tax (\$billion)								
Military spending(\$ billion)	290.2	331.9	387.2	436.5	474.1	499.3	529.8	594.7
Total government	1863.2	2011.2	2160.1	2293.0	2472.2	2655.4	2730.2	29978.7
spending (\$billion)								

Sources: Economic report of the President, 2009, various tables. Some growth rates are calculated by the author.

(of high interest rates, of high oil prices, and of a higher unemployment rate) generated a breakdown in the housing sector and squeezed the American people financially. Consequently, the economic crisis (or the Great Recession) in the American economy had occurred.

Section two of this paper provides the theoretical framework for analyzing the economic condition, and section three brings facts supporting the proposed analysis. These facts cover the dominant triangle: militarism, oil corporations, and the Fed. Clearly, these facts support the analysis that this dominant triangle is responsible for the recent Great Recession of the American economy. The last section is devoted to a summary and conclusions.

THE BAISC THEORITICAL FRAMEWORK

This section is based on work developed in Mouhammed (2008). Essentially, this theoretical framework is grounded in Veblen's and Mitchell's theories of the business cycle. Veblen provides an analysis explaining a recession according to the principles of increasing costs of production and decreasing revenues, or profit squeeze. In contrast, an economic expansion is explained by increasing revenues and decreasing costs.

For an economic expansion (or prosperity), Veblen suggests various causes for the reduction of the output cost. Veblen (1923: 97) contends, a "ceaseless advance of the mechanical technology has...the effect of lowering the production cost of the necessary equipment, as also the (physical) cost at which raw materials may be had." This technological change which is manifested in

massive investment spending is able to produce capital goods and raw materials at low prices. For example, it has been reported that available technology can drill oil form mountain areas such as Colorado at a very low cost per barrel. Many machines and several types of equipment can be produced at a lower cost of production. This reduction in prices of capital goods and raw materials generates a lower cost of production for business enterprises. Consequently, profitability will increase, so will investment and employment.

The introduction of new technologies, besides the increases in production, will reduce demand for labor and wages (Veblen, 1923: 220, 287). Veblen (1923: 200) thinks that the business community intends "to buy the industrial man-power as cheap as may be, and to sell the means of living ...as dear as may be." This statement clearly means that profit is augmented by lowering wages and squeezing workers. Moreover, lower wages during the initial expansionary phase of the business cycle are associated with increased productivity which reduces the cost of labor per unit of output and increases profits.

The condition of increased productivity and of decreased wages implies a lower share of labor in the Gross Domestic Product (GDP) and a higher inequality in income distribution in favor of the business community, or the absentee owners. This inequality is associated with a level of output that cannot be sold domestically, as working people have less income to spend. Therefore, a tendency to go global is imperative for capitalism, and capitalist governments accommodate the requirements for such a tendency. For example, the military power of a nation and patriotism are used to support the global penetration of capital. Going globally will enable capitalists to find markets for selling products and services.

Foreign markets are able to provide cheaper sources of workers and raw materials. These foreign markets also provide opportunities for capitalists to invest their excess capital for higher rates of profits relative to the rates of return on domestic investments. Veblen (1934: 378-79) states:

“Investment is made in the foreign country to get a higher rate of profits than at home; which draws a part of the available means of industry out of the country; which advances the rate of profits in the country, or keeps up the rate on home investments, by keeping the productivity of the country’s industry down; which enhances or keep up prices and the cost of living”

Obviously, higher rates of returns on exported capital and cheaper prices of inputs will cut production cost and will generate more profits; consequently, the economic boom continues.

Mitchell (1941) and Mouhammed (2008) provide other sources reducing the cost of production during the early phase of the economic expansion such as lower interest rates by the banking system and lower taxes by the government. Other sources of cost reduction come from lower administrative cost and rents. If insurance premium and health-care cost are low, then capitalists and people will be able to cut their costs as well.

On the revenue side, Veblen (1923: 287) argues that the fundamental objective of business enterprises is “to increase their sales without lowering prices”. Sales can be augmented by several methods. Salesmanship (marketing) which consists of advertising and personal bargaining according to Veblen (1923: 311) is used to increase sales and revenues. In fact, this method emphasizes the importance of the business field of marketing.

The introduction of new technology requires more investments by various firms to adopt the new technology. This new demand will increase revenues of the innovating firms. The new technology can also be used to produce new products. If these products are successful in the market place, they will generate higher revenues for the producers. In the long run, the new technology may be able to augment labor productivity, which will increase demand for labor and reduce the rate unemployment. Hence, business revenues will increase, as those employed workers spend their incomes. Simply, successful innovations increase profits, investments, employment, and income.

Debt is needed for generating higher demands and prices, because it provides funds for business enterprises to borrow to invest and to expand operations. Similarly, consumers can obtain some credits to spend for consumption items. The increased consumption spending will stimulate producers to produce more output to

accommodate the growing demand. Consequently, induced investments will be materialized, and many industries producing capital goods will have new demand for machines and equipment. It follows that central banks or the Federal Reserve (Fed) in the United States of America must stand ready to accommodate the economy with sufficient amount of liquidity represented by a higher supply of money in order for the economy to function properly. Indeed, money is indispensable for greasing the wheels.

Credits and salesmanship can generate more profits. Veblen (1923: 400) correctly thinks that profit “is widened by raising the level of sales-price; both by efficient salesmanship in the merchandising trade and by a continued expansion of the outstanding volume of purchasing-power through a continued creation of credit.” When profits are widening, employment and income will rise, and the economy is prospering. Governments can obtain more tax revenues from people, as prosperity continues.

Government can increase business revenues as well. Government enhances “prices by contributing to the security” (Veblen, 1923: 400). Veblen (1904: 250-256, 1923, 34-5, 398-411) thinks that security is maintained by spending on police and military; both of these wasteful expenditures generate a higher level of aggregate demand that enhances prices and revenues in the short-run. In the long-run, however, Veblen thinks that spending on military will generate disastrous consequences.

Revenues can be augmented by merger and consolidation (Veblen, 1904: 240-244, 1923: 337). Merger and consolidation, while they eliminate some producers, do increase profitability and revenues as they increase prices and cut costs as a result of eliminating duplicated economic activities. Many redundant costly operations are eliminated and most likely during mergers firms can augment their market oligopolistic and monopolistic power by charging higher prices for their products. Thus, profits are increasing.

Globalization increases revenues by finding markets for products and services. Veblen (1923: 287) points out that imperialism enlarges markets for domestic products by establishing a system of colonies. In other words, colonies represent increases in demand curves for products, which will increase revenues. Various important economic resources are obtained from these colonies which actually create a self-contained Imperial State. Veblen (1915: 184) explains:

“By the acquisition of colonies, it has been hoped the raw materials of industry could in great part, perhaps in the end exclusively, be drawn from these dependencies; so making the Empire independent of foreign nations for its supply of the materials of its industry, at the same time that the same colonies would afford a

market for wrought goods. The aim has been to achieve an industrially self-contained Imperial State”

Hence, the country's exports will increase. A reduction in the exchange rate of the domestic currency can also stimulate the exports of the country, as it makes the exports of the country cheaper in foreign countries. Exports of the United States of America can also be increased if the importing countries reduce their tariffs on American exports. It is also true that as foreign countries become prosperous, their purchases (imports) from the United States of America will rise.

Essentially, for Veblen (1923: 393), the basic point is:

“The earnings of enterprise and invested capital are always eventually to be drawn from the margin of sales-price over production-cost, it is incumbent on all business management to curtail production-cost so far as may be.”

Simply, entrepreneurs have to reduce all elements of cost in order to be efficient and have to find ways for increasing revenues. The difference between high revenues and low costs is high profits which are used for augmenting investment, employment, and income. These indicators will in turn increase government tax revenues.

Usually, as the economy prospers due to increased profits and capital accumulation, firms demand more workers and raw materials. Logically, money wages and prices of materials will rise. During this period productivity slows down and the labor cost per unit of output will be rising. It is also true that as prosperity continues, demand for capital funds will be rising. Hence, the interest rate will be increasing. Mitchell (1941) and Schumpeter (1934), the best authorities of the business cycle, correctly think that increased interest rates will kill the expansionary process the economy generates, because rising interest rates mean higher cost for many firms and consumers.

That is to say, if the elements of cost such as wages (and a reduction in labor productivity), interest payments, rents, and prices of intermediate (material) inputs increase and revenues decline, then earnings and profits are squeezed. Stock market will collapse. Consequently, consumption and investment expenditures will decline, which will affect negatively all economic and financial indicators of the economy.

EVIDENCE

We can use the previous theoretical framework to explain the evolution of the faltering condition of the American economy, which has been generated by the dominant triangle of three important institutions: Militarism, oil corporations, and the financiers. The higher-plane

American capitalism tried to expand its domination on the globe for more profits, power, and hegemony. In order to accomplish these goals, the system must have a military force that is able to submit other nations, particularly the small defenseless nations. A complementary important factor to militarism is patriotism, because patriotism creates cohesive bond between people and government for achieving some national goals.

AL-Qaeda which is a terrorist organization attacked the United States of America on September 11, 2001. The Bush administration, I argue, capitalized on the terrorist attack by occupying Iraq after Afghanistan. Iraq had no terrorists but has more than 250 billion barrels of oil reserve. When the country was occupied, oil corporations controlled the oil reserve. The control of oil wealth was thought to achieve three goals. The first goal is the high profits that American oil corporations will generate, and the second goal is the huge market and profits that the military-industrial complex will obtain. The third goal is the enhanced position of the United States to control other non-oil countries such as India, China, and even Europe.

That is, the military occupation of Iraq and the domination of the Middle East would allow the United States of America to control the basic sources of oil the world needs. This control of oil can be used to influence other countries depending on foreign oil for consumption and production. In addition, the Bush administration and other important political leaders thought that the huge profitability of oil corporations and the military industrial complex would enhance the macroeconomic prosperity of the United States of America. In other words, it was thought that what was good for some large corporations it would also be good for prospering the entire American economy. This was the mistake of what is termed the ‘fallacy of composition’. In short, these corporations did generate huge profits, but the American economy went into the Great Recession, because the wars have not gone as was expected and their effects on rising cost and reducing profitability were significant for generating the economic crisis. In other words, wars benefited some corporations but did not benefit the entire American economy. Basically, the three dominant institutions, which are explained below, are the most important component in explaining the Great Recession.

Militarism

President Bush, the Commander in Chief, decided to occupy Iraq militarily, and the U.S forces implemented his decision by invading and occupying the country on April 2003. A month later President Bush declared that the Mission was accomplished. In fact, the war has not been over yet. Ignoring the effects of the war on Iraq because the subject was dealt with in Mouhammed (2008), the war led to huge increases in military spending. The federal government has created large budget deficit (and

national debt) which has become a very important element for generating higher inflation rates. The deliberate increases in government spending on militarism have been responsible for increasing prices of commodities and services that have increased the domestic rate of inflation. The government has been trying to finance the wars in Afghanistan and Iraq through deficit financing or selling government bonds to domestic and foreign purchasers such as China and India, to mention a few. Usually, a war is financed by increasing taxes, but recently this has not been the case, because the Bush administration was reluctant to raise taxes, which was an inconsistent policy with the supply-side economics whose basic element is the reduction of tax rates in order to stimulate business enterprises. Consequently, these two wars have forced the government to increase spending, and the expectations of higher future inflation have become normal.

But the war expenditures (which are estimated on November 13, 2009 to be \$1.6 trillion, ignoring the cost suffered by the Iraqi and the Afghan peoples) benefited directly oil corporations and the military complex. This is because as more bombs are dropped in the Middle East, the demand for weapons and bombs will be increasing. That is to say, the military-industrial complex will obtain higher revenues. By the same token, dropping bombs in the Middle East increase the price of oil, as the oil market and foreign importers expect a possible oil shortage and uncertain conditions. Thus, they are willing to pay high oil prices for future delivery. Clearly, very high revenues and profits will be generated by the oil corporations (and other related industries) and the financiers. The danger of this condition is that these corporations are very powerful and have their supporters every where in the world and will take a defensive position for their profits. They can play a crucial role in perpetuating the military approach to the U.S. foreign policy. That is, these corporations can always influence a democratic government to use bombs and missiles in dealing with foreign conflicts.

Baran and Sweezy (1966: 153), the fathers of the Monthly Marxist School, think that the increased military spending by the United States government has a profound positive impact on the American economy. For example, if economic stagnation is defined in terms of a high rate of unemployment and a low rate of economic growth, then the augmentation of military spending increases the rate of economic growth and reduces the rate of unemployment. They state:

“This massive absorption of surplus in military preparations has been the key fact of postwar American economic history. Some six or seven million workers, more than 9 percent of the labor force, are now dependent for jobs on the arms budget. If military spending were reduced once gain to pre-Second World War proportions, the nation's economy would return to a state of

profound depression, characterized by unemployment rate of 15% and up, such as prevailed during the 1930's”.

Their basic point is that the military-industrial complex has employed millions of workers, and that the military-industrial corporations which are tied to the Pentagon can survive by depending on government military spending regardless of their high cost of production. Many retired officers are working for these corporations and can recommend a variety of weaponry systems to the Pentagon to purchase. These contracts will produce goods and services which will be used in military operations. They have short duration whether they can be destroyed or become obsolete. In either way they will have to be replaced. Thus, government has to finance these purchases, and these military industrial corporations are making their profits. Consequently, if the government orders more weapons and equipment, then more jobs will be created. In addition, these corporations are linked to other industries such as the steel and the computer industries. If they receive more contracts, the steel and other linked industries will produce these goods. In short, the multiplier will work effectively as long as these orders are not outsourced to foreign producers.

Baran and Sweezy point out correctly that these military industrial corporations have become vested interests and very powerful. Many politicians do not vote against new increases in military spending, because they know that the new spending will benefit the military corporations. Simply, the well-known justifications for new expenditures are to fight communism or to defend the nation's national security. In Baran's time the justifications were wars on communism. Currently, the justifications are wars on terrorism. Both justifications (Baran and Sweezy, 1966: 165) make “competition with private enterprise ... largely or even wholly absent”. Capitalists support military spending because it keeps their domination and power. For example, government spending on education, which is non-military spending, will enhance people education, productivity, and income redistribution. These educated people will demand higher wage rates and reasonable working conditions. Usually, capitalists are neither interested in paying higher wages nor are in favor of income redistribution. In contrast, military spending does not increase all people's education and productivity, nor will redistribute income for the educated people.

Baran's and Sweezy's analysis of the role of military spending is correct in the short run. Veblen and Mitchell also think that during this period spending on national security can increase aggregate demand and prospers some industries. This spending provides a push to help the American economy to move out of a recession. But over a long period of time, the military spending is a disaster, and it can be stated that Baran's and Sweezy's analysis is deficient. Veblen himself thinks that a war can

disintegrate an economy and increases inflation and the interest rate, which impede private investment and consumption expenditures and disturb the credit market.

Following Veblen's contribution Melman (1965) thinks that spending on military (and the war economy) is wasteful, because it creates misuse of human and physical economics resources, because they are channeled out of productive employment into unproductive employment. Consequently, Melman (1965) concludes that military spending leaves the economy without economic inputs, leading to economic stagnation, a conclusion which is at odd with Baran's and Sweezy's proposition. This military spending will be inflationary as well. Statistically, Szymaniski (1973), whose study was original and penetrating, tested Baran's hypothesis for 18 capitalist countries and found that military spending produces stagnation, or low rate of economic growth, but it does reduce the rate of unemployment.

Historically, the military spending on the Vietnam War did not generate prosperity for the American economy. During the 1970s the economy had experienced several recessions which created more economic and social problems for business enterprises and people. Businesses had to pay higher costs for labor and inputs used in the production process. People did not have sufficient income to purchase goods and services. Government did not have sufficient funds to spend on education, health care, and the infrastructure. In addition, the value of the dollar was on the decline due to the increased spending to maintain the military bases and troops in foreign countries.

The war economy of the 1970s generated budget deficit and a high rate of inflation. The cost of doing business increased, which reduced profitability. Investment spending declined and the rate of unemployment rose. The high rates of unemployment and inflation created what has been termed stagflation. It is reasonable to state too that during that stagnation period the military-industrial complex made huge profits out of the military spending on the Vietnam War. Due to this war and the Arab Oil embargo, the economy was stagnating and never recovered until 1985. Although many economists argue that President Reagan's supply-side economics (tax cut, deregulations, and massive military spending) was responsible for the recovery, the mere fact is that the Iraq-Iran War contributed significantly for the economic recovery, because the war reduced the price of barrel of oil to about \$7.00.

Domination of world oil

The occupation of Iraq provides the United States of America with absolute control on the Iraqi oil, which provides a basic opportunity for oil companies to raise prices and to make huge profits at the expense of the American and other peoples. The Iraqi oil was taken out of the world oil market. Before the occupation of the

country, Iraq was able to produce about three million barrels of oil a day. This shortage of oil and the threat of bombing the Iranian nuclear facilities pushed the price of oil upward. On March 2007, oil prices reached \$112 a barrel and moved further upward to \$147.00 a barrel on July 2008. These increases in oil prices augmented the cost of production of many industries using oil as a basic input (such as the airline, auto, and food, to mention a few) for their operations. In fact, the American auto industry was cutting production, because people were switching towards small efficient foreign cars. These increases in oil prices had also deteriorated people's real income such that sales of department stores declined by 15 percent during the first quarter of 2008. Some of them were even going out of business such as Wilson. Once these industries' profits were affected negatively, other related industries suffered as well, a situation that culminated in a severe crisis in the economic activity. Furthermore, on the average, an American spent annually more than \$3000 on oil, and the high cost of oil absorbed a reasonable percentage of consumer's income, which deprived other industries from obtaining advantages of consumers' spending. In other words, demand for oil is inelastic, and when the price of oil goes up, total expenditures on oil will mount. But total expenditures on non-oil products will decline.

It should be noted that the ongoing increases in oil prices had the same role played by the increases in corn prices during the early period of the 1800s. The increased corn prices helped landlords to increase their rents at the expense of capitalists. At that time, capitalists paid higher wages when prices of corn increased. But in recent time capitalists do not compensate workers for the increases in food and material prices: greed. Similarly, the high oil prices were increasing profits of oil corporations at the expense of consumers and other capitalists. Consumers had to reallocate part of their expenditures to purchase oil at the expense of the reduction in their spending on other goods and services. Consumers had to do that, because they were not compensated by the higher oil prices. Many capitalists had to pay higher prices for oil, a situation that increased the production cost and reduced capitalists' returns.

Therefore, the only beneficiary institutions of higher oil prices are foreign oil producers and American oil corporations, and both have generated super profits. For example, Exxon/Mobile generated \$41 billions in revenues during 2007, but these profits did not help the American macro economy to prosper. In fact the danger of this situation easily came when these increases in oil prices generated higher increases in costs of production, which generated cost-push inflation and the Great Recession. At any rate, the military power of the country was used to maximize the profitability of oil corporations and the military complex. Veblen (1934: 432) points out,

"The Republic has come through this era of spiritual dilapidation with an unbalanced budget

and an increased armament by use of which to 'safeguard American Interests'—that is to say, negotiate profitable concessions for American oil companies."

Some representatives of the United States Department did negotiate in 2008 with the new Iraqi government oil contracts for the American oil corporations. Essentially, the Iraqi oil was given to these corporations.

The fed

Due to the expectations of a higher rate of inflation, the Fed had to increase the federal funds rate 17 times between June 2004 and August 2007. The Federal funds rate, which is the rate charged by banks for overnight lending, increased from 1.0 to 5.25%, and these increases were engineered by the Federal Reserve to control the inflation rate. But these increases, given the economic condition, raised the long run interest rate. As it is widely known, the Fed can control the Federal funds rate but cannot control the long run interest rate. The latter is determined by the capital market which consists of private and public financial institutions. The long run rate is based first on the rate quoted by the U.S. Treasury when it issues treasury notes. The federal budget was in deficit, and the government had to borrow. The Treasury does the borrowing when it auctions its papers. This is usually a safety place for lenders to lend their money. So, the U.S. Treasury obtains the funds to finance the budget deficit. If the financial institutions are interested in taking the risk, they can lend their money for a higher long term interest rate, which includes the Treasury rate plus the risk premium. Thus, the long run rate became higher than the short term, and when the Fed increased the short term rate of interest, and the government borrowed more funds, it was likely that the long term interest rate would rise. Stated differently, the financiers do not lend their funds at a low interest rate during inflationary and uncertain environment.

The increases in the interest rates led to several increases in adjustable mortgage rates and had bankrupted many individuals who borrowed funds at these rates. This is because their monthly payments increased tremendously, and many borrowers defaulted. For example, some mortgage monthly payments increased from \$1200 to \$2300, an increase that many borrowers could not afford to pay. In fact, those borrowers may need additional jobs to pay just these marginal increases in the mortgage rate. Following these defaults foreclosure ensued and prices of houses declined to levels such that their market values could not cover their loans. Consequently, financial creditors, banks and other financial institutions have lost trillions of dollars, and the losses will continue. Some people who had equities in their houses lost such equities and will not be able to refinance their homes for obtaining funds to spend for investment and

consumption. That is to say, their wealth effect is eliminated.

Since August 2007, given the Fed started cutting the short term interest rates, the impact of the previous increases in the interest rates on the U.S. economic performance had been disastrous. Higher interest rates created credit crunch. Many bankers developed fear toward lending money to individuals and business firms that were in need of credits for consumption and investments. Consumer confidence was very weak in September 2007 and February 2008 (about 78 percent) because of the housing market, the increased oil prices, and the tightened credit market. Many home owners had been facing foreclosure, and others had already left their houses. Simply, the increased interest rates created a financial burden on many individuals and business enterprises, and at a minimum they increased the rate of unemployment. This is because they reduced the growth rate of consumption expenditures and contributing significantly to the reduction of private domestic investments which had already declined due to the collapse of the housing market. Once the growth rate of consumption expenditures declined, retailers were affected negatively.

Despite the early increases in interest rates, the dollar continued to decline against the euro and other leading currencies, and this decline had been intensified since August 2007 when the Fed cut the short term interest rate. This decline increased U.S. exports and reduced imports, a situation that reduced the deficit in the U.S. international trade balance and increased domestic prices. Higher prices of U.S. imports do eventually contributed for increasing the rate of inflation. Other countries exporting goods and services to the United States of America were affected negatively, as their exported goods and services became expensive in the U.S. economy. Hence, their economies suffered from a reduction in export revenues and a rise in the rate of unemployment. The declining dollar also increased profitability in dollar values when profits generated globally were converted from other expensive currencies to the dollar, a situation that made the stock market looks more reasonable.

The danger of the declining value of the dollar, however, is that many countries and investors holding dollars may be forced to dump (or switch from) the dollars collectively for other alternative currencies; consequently, the dollar will collapse and other leading currencies will be appreciated. In other words, investors had to diversify their portfolios for higher returns by holding less amount of dollars, and this behavior was exacerbated when bad news were coming about losses reported by large financial institutions, higher oil prices, and the collapse of the housing market.

Not surprisingly, there is a strong linkage between deficit spending, inflation, and the declining value of the dollar. When the Fed finances the government for its spending, the money supply will be increasing, because new

high-powered money is injected in the economy. The increased money supply (or the deliberate reduction in the interest rate) will push agents to hold the desired amount of money and spend the excess for purchasing domestic and foreign goods, services, and assets. More spending increases the inflation rate and affects the exchange rate of the dollar. As more dollars are dumped in the world market, the exchange rate of the dollar against leading currencies such as the British pound and the euro will decline. When the exchange rate of the dollar falls, oil prices (determined in dollar) rise, for oil producers are not willing to sacrifice part of their revenues for the decline in the exchange rate of the dollar

The lethal combination

Essentially, the wars along with the military spending and the budget deficit generated high increases in oil prices and inflation which forced the Fed to increase the short-term rate of interest. These increases generated a higher cost of production for the entire economy, which was associated with continued increases in costs of health-care and education. As a result of these higher costs, profits declined. Consequently, investments and employment collapsed. So, higher interest rates, higher oil prices, and higher inflation and unemployment rates coupled with a slowdown in productivity reduced consumption and investment expenditures, given the high exports and government spending which affected the aggregate demand of the economy positively. In other words, the decline in the aggregate supply was larger than the increase in the aggregate demand. Hence, the Great Recession occurred.

The Bush administration and the Fed were heavily depending on a policy outcome that the increase in the aggregate demand would be larger than the decrease in the aggregate supply, and consequently, a high rate of inflation with a high growth rate of GDP could be achieved. In a global economy this case is unlikely to occur. The magnification effect of the increased government spending and exports could not be kept internally. This outcome weakened the multiplier effect. Second, the dollar continued falling and the cost of imports was rising, creating a very high rate of inflation. If the Fed did not increase the Federal funds rate after June 2004, a high rate of inflation could have been created and the economy would have been collapsed before December, 2007.

SUMMARY AND CONCLUSIONS

The dominant triangle generated the economic collapse of December, 2007. This triangle consists of three important institutions: militarism and wars; oil corporations, and the Fed which represents the financiers. The federal government made decisions to invade Iraq and

Afghanistan for controlling oil wealth and building the oil pipeline that passes through the northern part of Afghanistan. The government provided the necessary requirements and sufficient military spending to execute these wars, which benefit oil corporations and the military industrial complex. These wars increased oil prices and cost of production, which reduced the profitability of other business enterprises. Consequently, rates of Inflation and unemployment had gone up, which led to the collapse of the housing sector, as people could not pay their monthly mortgages. The American Auto industry was also affected negatively due to the increases in oil prices. Other industries such as the tire and airline industries suffered and their profits and revenues declined. The Fed could not continue providing the economy with the necessary liquidity due to a high rate of inflation. Thus, interest rates or the Federal funds rates, increased seventeen times, which led to higher mortgage rates which in turn affected the housing sector negatively. Collectively, these three institutions generated the Great Recession of December, 2007.

The first conclusion of this paper is that when prices of oil continued to rise and when the government continued increasing spending to finance the wars, prices of intermediate and final goods and services went up. The rate of inflation increased, and the increased cost of production squeezed profits. Many industries suffered huge losses. Investments declined and the rate of unemployment increased. The sum of the rates of inflation and unemployment provided what was called during the 1970s the misery index.

The second conclusion is that when inflation was expected to rise or had risen, the Fed reacted by increasing the short term interest rate, which pushed the adjustable mortgage rates upward and disintegrated the housing sector. People lost their homes, and many financial institutions lost their invested assets in the housing sector. Stock markets collapsed as well. Higher interest rates also created credit crunch and reduced consumption and investment expenditures; consequently, the expansionary economic condition was transformed into a recessionary condition. People and business enterprises could not borrow in this environment, because when they pay their debts in the future and the inflation rate is low, then the real monetary value of their debt payments will be much higher than the value of the borrowed amount of money during high inflation. Similarly, lenders were not able to lend funds at a low interest rate because they expected the inflation rate to rise.

The third basic conclusion, which is a by-product result of the previous conclusions, is that if the United States of America does not change its course of action and transforms its war economy into a peace economy, the problem of the current Great Recession cannot be solved properly and the economic slowdown will continue. The peace economy will force the federal government to reallocate more than half of its military spending (about

\$600 billion) to assist many states that need financial assistance to create jobs. The peace economy will also create certainty and generate stability encouraging the expansion of the real private investment which is the dynamic force for accumulation, employment, and prosperity.

REFERENCES

- Baran PA, Sweezy PM (1966). *Monopoly Capital: An Essay on the American Economic and Social Order*. Monthly Review Press, New York.
- Melman S (1965). *Our Depleted Society*. New York, Dell, pp. 241-272.
- Mitchell WC (1941) *Business Cycles And Their Causes*, University of California Press, Berkeley and Los Angeles, CA.
- Mouhammed A (2003). *An Introduction to Thorstein Economic Theory*. New York: Edwin Mellen, pp.169-184.
- Mouhammed A. (2005). A General Explanation of the American Business Cycle of the 1991-2001. *J. Acad. Bus. Econ.*, 5 (2): 1-12.
- Mouhammed A (2008). Mitchell's Business Crisis in a Globally-linked Capitalist Economy. *J. Am. Acad. Bus. Cambridge*, 12(2): 53-64.
- Mouhammed A (2008). The Explanation of the Current Condition of the American Economy. *Int. J. Acad. Bus. World*, 2(2): 1-8.
- Schumpeter J (1934). *Theory of Economic Development*. Harvard University Press, Cambridge, MA, pp. 213-255.
- Szymanisky A (1073). Military Spending and Economic Stagnation. *Am. J. Sociol.*, 79(1): 1-14.
- Veblen T (1904). *The Theory of Business Enterprise*. New York, Scribners, pp. 240-256.
- Veblen T (1923). Absentee Ownership And Business Enterprise In Recent Times: The Case of America. New York, Huebsch, pp. 311-400.
- Veblen T (1964). *Essays in Our Changing Order*, edited by Leon Ardzrooni. New York, Kelley (Originally published by the Viking press in 1934), pp. 378-379.