

## How Did the U.S. Government Annihilate \$1 Trillion of American Wealth?

by [Michael S. Rozeff](#)

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Ask Paul Wolfowitz, Richard Perle, and William Kristol. Ask Colin Powell and Condoleezza Rice and Dick Cheney and George Bush. Ask the American Congress. They not only know how to extinguish vast amounts of American wealth, they have done it by attacking Iraq. Of this there is little doubt. They get A+ in destruction of wealth. They are fully qualified to teach a course in any university on the annihilation of wealth.

Sad to say, they are not the only rulers and would-be rulers in many lands, past, present and future, who have been, are now, and will be *summa cum laude* at *Terminator* College. But we are Americans, and these are our homegrown leaders. They are ours, and we are theirs. They have pressed the buttons of war and can press them again. The bombs they have launched at our well-being deserve our immediate attention. Every American deserves to know what the price of terrorist reduction in Iraq is.

Ask not what your leaders can do *for* the country; ask what they can do *to* the country. Ask what they already have done to the country. Ask how many more Saddams they'd like to take out. Ask what removing one Saddam has cost.

Sad to say, I do not refer to the lives lost, the bodies wounded, and the minds scarred. As each day passes, these relentlessly add still more to the toll of damage done. I refer to the dollars and cents values that are

reflected in markets for securities.

On the eve of the Iraq War that officially began on March 19, 2003 but had actually been fired up two years earlier with aerial bombardments, three researchers produced a paper estimating that the stock market had already priced in the upcoming war with a decline of 15 percent in value. [Leigh, Wolfers, and Zitzewitz](#) provided evidence that \$1.1 trillion in value had been shaved off the S&P 500 stocks because of the Iraq War.

On September 30, 2002, [Gary North](#) wrote: "War is bad for stock market performance unless the war is clearly going to be short-lived. War transfers purchasing power from private consumer markets to weapons markets." He criticized Lawrence Lindsay's view that regime change in Iraq would drive down oil prices and be good for the economy. (Mr. Lindsay was President Bush's senior economic advisor.) North added: "The invasion may very well drive up the price of oil because of the fear of regional de-stabilization."

The cost forecasts of Lindsay or any politician who favors war or any other government program whatever can always safely be tossed aside. A politician has no incentive to reveal the truth about costs, except that falsehoods might lower his chance of re-election. By the time elections roll around, the past words of incumbents are mostly drowned in a sea of noise, rhetoric, and memory loss. The middle-of-the-road apathetic voter pays little attention to promises broken or forecasts wildly violated. Given these facts, politicians have an incentive to play down and conceal the costs of any program.

Salmon P. Chase, who was Lincoln's Secretary of the Treasury, estimated the dollar cost (to the North) of the War Between the States at \$240 million. Excluding pensions, the government's own [estimate in 1879](#) was that the war cost the North about \$4 billion. Chase was only off by a factor of 17. Estimates of Vietnam war costs were underestimated by orders of magnitude because the planners did not foresee the war's length, among other things.

On the eve of the Iraq War, [Lew Rockwell](#) demolished "the longstanding canard that war is good for the economy," pointing out that war "destroys capital, in the same sense that all government spending destroys capital. It removes resources from where they are productive – within the market economy – and places them in the hands of

bureaucrats..." He observed that "The prospect of war is inhibiting recovery. The stock market is now at 1998 levels, with five years of increased valuations wiped out."

How right both North and Rockwell were. Wars have to be paid for. They *are* paid for through taxes and borrowing that leads to future taxes. The taxes are direct reductions of the wealth of citizens. Having less to spend, they purchase less. This shows up in lower revenues to the sellers of products, such as corporations. This, in turn, shows up in decreases in the values of these companies. The value declines show up primarily as declines in the values of the stocks of these corporations. This means that war and its accompanying taxes make stock prices decline. It means that the size of the war costs can be measured by looking at the size of the declines in stock prices.

What needs to be understood, emphasized, and underscored, what needs to be seen as clearly as possible, are the reality and the mind-boggling size of the wealth destruction that our leaders have caused Americans to bear. It is not believable that most Americans, presented with a choice between spending one trillion dollars or achieving the current status in Iraq, would have chosen to spend that sum. One trillion dollars is 100 million \$10,000 bills. It is not believable that 100,000,000 families would have willingly given up \$10,000 each for the results so far achieved by the Iraq War. I wonder if 10 million or even 1 million families would have given up half that amount.

Where does this \$1 trillion figure come from, and how can we be sure that it is accurate? The answers involve new but straightforward ideas and applications of finance.

Leigh, Wolfers and Zitzewitz (LWZ) made their wealth destruction estimates by using a then-existing Saddam Security futures contract trading at [TradeSports.com](http://TradeSports.com). These securities, which traded between 18,000–31,000 contracts a month, were contingent upon the ouster of Saddam by future dates. This was a market in the prediction that Saddam would be removed from office. In other words, the contract traded in the prediction of another Iraq War.

For those who are unfamiliar with betting, stock, prediction, and futures markets, the pertinent facts are these. Speculative markets in general, whether they be horse races, bets on crop yields, futures markets in gold, or stock markets all allow individuals to trade upon and profit from

information they might have about future events and outcomes. Individuals then have incentives to seek, collect, interpret and trade upon relevant information. The traders who are better at these activities tend to make money, while the worse speculators lose. Prices then come to reflect the best information known by the most successful traders.

Because market prices aggregate diverse bits of information, the trading process causes speculative prices to forecast the future more accurately than other methods such as asking experts or taking polls. The Iowa Electronic Markets trade in bets on election outcomes, for example. They regularly beat voting polls. Studies of odds at horse races also show that they accurately forecast the chances of horses winning.

Many investors do not appreciate the fact that markets are forward-looking. Prices today impound forecasts of what might occur in the future. They "discount" the future. Over 100 years ago, Charles H. Dow (of Dow-Jones fame) in his book *Scientific Stock Speculation* wrote:

"The best way of reading the market is to read from the standpoint of values. [The market] represents a serious, well-considered effort on the part of far-sighted and well-informed men to adjust prices to such values as exist or which are expected to exist in the not too remote future...The thought with great operators is whether the value of property which they propose to buy will lead investors and speculators six months hence to take stock at figures ten to twenty points above present prices.

"In reading the market, therefore, the main point is to discover what a stock can be expected to be worth three months hence and then to see whether manipulators or investors are advancing the price of the stock toward those figures...To know values is to comprehend the meaning of movements in the market."

Dow's comments unlock one of the major secrets of the stock market. Those "in the know" buy at wholesale with the intent of selling at retail "six months hence," or at some point in the future. That point is when the good news that they anticipated is made public. At that point, public buying enters and takes the stock off the speculators' hands. This is why stocks very often sell off on the announcement of (anticipated) good news. Conversely, if bad news is anticipated, the speculators sell short. When and if the bad news materializes and the public sells, the speculators can buy (cover their short sales) at lower prices and profit. This is why stocks sometimes rally on the announcement of bad news.

Please note. Speculative operations are far from foolproof.

LWZ compared the Saddam Security with oil prices and found that a 10 percentage point rise in the chance of ouster corresponded to a \$1 rise in oil prices. That meant that ouster implied a \$10 oil price rise. Similarly, they found that a 10 percentage point rise in Saddam's ouster chance lowered the S&P 500 index by 1.5 percent, implying that his ouster would lower prices by 15 percent, which translated into a \$1.1 trillion loss to shareholders.

William D. [Nordhaus](#), a professor at Bush's alma mater, estimated in October of 2002 that the war would cost anywhere from \$121 billion to \$1.6 trillion. He used a variety of economic estimates. At present, estimates of Congressional appropriations for the Iraq War are running about \$231 billion.

Because of the market's ability to discount the future, much of the impact of the Iraq War on stock market values occurred prior to the war's beginning. The pre-war time frame is when LWZ analyzed the Saddam Security and the S&P 500. This is when statements and actions by politicians and the government began to tip off shrewd speculators to a war in the making. This is the period when Washington insiders who possessed inside political information, unavailable to the public, could speculate in their private accounts. Knowing more surely than anyone else that a war was about to occur, they could more confidently build larger positions in assets destined to increase in price such as defense stocks or gold. They could buy put options in order to bet on declines in stock prices.

To check up on LWZ's findings and the estimates of Nordhaus, I use a traditional but different method than theirs. I directly examine the relation between a few key political statements of Bush and his close associates with changes in stock market values. This method is by no means perfect, but it works. When done in more detail, it becomes the "event study" found in many financial studies of the stock market. Jude Wanniski used this method in his book [The Way The World Works](#) in order to argue that the Smoot-Hawley Tariff caused the stock market crash of 1929.

If we look at the behavior of key defense stocks, they show just how early that the market may have begun to get wind of the Iraq War. They also show that what's good for defense stocks is bad for the market in

general, at least in this episode. War was definitely not good for the economy in general.

Lockheed Martin (LMT) hit 16.50 on March 14, 2000, but at that point it made a bottom and began a strong climb that took it to 70 by mid-2002. (By the time that the war actually began in March 2003, LMT was back around 50. It has since rallied back to 64.)

The price patterns of Northrop Grumman (NOC) and General Dynamics (GD) are very like that of LMT. GD reached its low on March 7, 2000 before commencing a rise from 36 to a peak of 111 reached on June 24, 2002. NOC's low was on March 2. LMT peaked out on June 27, 2002 and NOC peaked on June 19, 2002.

In all three cases, the lows of the stocks occurred in early March of 2000. After each stock had more than tripled, each peaked out toward the end of June of 2002. All three have since rallied back to the vicinity of their 2002 high prices.

While defense stocks were rising, the S&P 500 was falling. In fact, the high for the index of over 1550 occurred in the third week of March 2000, in the *same month* when the defense stocks were making their bottoms. What's good for defense stocks was apparently bad for stocks in general. Furthermore, the S&P 500 declined to a bear market low of about 780 in the third week of July 2002, *within a month* of the tops made by the defense stocks.

Why did defense stocks top out in June of 2002? June/July of 2002 is the time frame in which the knowledge of the decision to go to war against Iraq began to be widely disseminated. This was the time when the bad news about the war (and good news for the defense stocks) was coming out publicly, the news that would propel the public to buy defense stocks. This was an opportune time for speculators who had bought earlier in 2000 and 2001 in anticipation of this good news to begin to liquidate their holdings. The defense stocks sold off on their good news.

How do we know that the information about war was spreading at this juncture and becoming publicly available? A cluster of events occurred. On June 1, Bush addressed West Point and announced the preemptive war doctrine. On June 11, Rumsfeld was asked point blank at a [press conference](#): "Are you planning for a new war against them?" Another

question was "Is it true, as we feel, that the purpose of your visit is to gather support to topple Saddam Hussein's regime?" Although he denied this, the questioners made clear that his strong previous statements about Saddam had left the impression that war lay ahead. On June 17, the [New York Times](#) wrote that the Bush administration was codifying the preemption doctrine and that "Iraq is clearly first on the target list." [Reuters on June 20](#), after increased aerial bombardments in Iraq, mentioned "speculation that the United States might be preparing to invade Iraq..." [Richard Haass](#), who was director of policy planning at the State Department, says that he first learned that the war against Iraq was definite in the first week of July: "The moment was the first week of July (2002), when I had a meeting with Condi. I raised this issue about were we really sure that we wanted to put Iraq front and center at this point, given the war on terrorism and other issues. And she said, essentially, that that decision's been made, don't waste your breath. And that was early July." On July 7, the [Guardian](#) reported on U.S. military activity in Jordan. Its headline read: "US to attack Iraq via Jordan."

Why did defense stocks bottom out in March of 2000? How did the market begin to learn that war was more probable? We need to review what Bush and others said and the market's concurrent price action. We recognize that there are innumerable events impinging on stocks, but if we examine enough statements we see a pattern that can be explained by the information in these statements.

On December 2, 1999, candidate Bush said he'd "take 'em out," referring, he clarified, to Saddam Hussein's weapons of mass destruction. The stock market rose about 0.5 percent that day. This goes against our hypothesis.

On February 11, 2000, Bush said "...there won't be any weapons of mass destruction left in Iraq if I'm the commander in chief..." The market closed down about 2 percent that day.

On May 17, 2000, Bush reportedly told a group of Republicans of his intention to take out both Saddam and Iraq. The market closed down about 1 percent that day.

On Sept. 29, 2000, the Bush-Cheney Comprehensive Energy Policy referred to ominous Iraqi threats to oil. The market closed down about 1.7 percent that day.

In a debate on October 11, 2000 (after the market close), Bush said that the coalition against Saddam had "fallen apart or it's unraveling..." He said Saddam had better not be developing WMD or there'd "be a consequence..." Bush was at that point in a comfortable lead over Gore. The market fell that day and the next, a total of about 3.6 percent.

In retrospect, the evidence is quite one-sided. During the year 2000, defense stocks were rising as the probability of war against Iraq was rising. The speculation was also a bet that Bush would win the election. Speculation is not a sure thing. According to the [Iowa Electronic Market](#) history, Bush pulled ahead early and, after some wild fluctuations in September in which he was seen as a loser, regained the lead and kept it through the election.

In February of 2001, at the onset of the Bush administration, the pace of public war-relevant statements and activities picked up. We also now know that during this month the administration drafted secret plans for the war and that the National Security Council's first meetings focused on war against Iraq. Therefore, both Washington insiders and speculators attuned to political news were recognizing that war lay ahead. Here's the documentation.

The stock market rose on only 6 trading days in February. It fell on 13. The decline for the month came to about 9.5 percent.

In particular, on Feb. 1 and again on Feb. 4 Powell said Saddam threatened his neighbors with WMD. On February 15, Woolsey said that Iraq may have been involved in the bombing of the World Trade Center. On Feb. 16, both U.S. and British planes attacked Iraqi targets *outside* the no-fly zone. The market dropped about 2.4 percent that day alone. On Feb. 20, Admiral Quigley said that the bombings would continue. The President on Feb. 22 said that he had been spending a lot of time on the Persian Gulf, that Saddam should be peaceful, that the sanctions were not working, and that the bombing was a message to Saddam. Between Feb. 15 and Feb. 23, the market dropped over 6 percent.

Lest the influence of these war-related statements be thought to be coincidence, there were two occasions during this important month and another in March when administration officials made statements that *lowered* the odds of war and on all three occasions the market *rose*. On Feb. 11 with the market closed, Rumsfeld said that Saddam was not a nuclear threat and Powell said Saddam was much weaker. The next day,

stock prices went *up* somewhat over 1 percent. On Feb. 24 (market closed), Powell said that Saddam had no significant WMD capability. The next day of trading saw stock prices rise well over 2 percent. On March 6, Powell said that the sanctions would prevent Saddam from acquiring a WMD capability (implying no war would be necessary). The market rose about 1 percent that day.

If war statements and stock price movements were unrelated, the odds are close to zero that we would observe so many instances when more likely war news appeared with market declines and less likely war news appeared with market rises.

The main alternative to explain the large February decline is economic news. On November 26, 2001, the NBER dated March, 2001 as the crest of a business cycle peak. It is possible that the stock market decline in February of 2001 was partly due to the recession that was starting. However, prices had already moved down from the 1530 level to the 1350 level, a drop of 12 percent, over the prior 5 months. As part of its usual discounting capability, the stock market typically declines in advance of recessions by a few months. Charles Dow in 1900 thought that the market looked ahead 3–6 months. Of course, in the months to follow, defense stocks continued to rise and the stock market continued to decline, even as the recession deepened and war became more likely.

Although the stock market is difficult to interpret because of its forward-looking capacity and the multiplicity of information that affects it, the evidence in this case clearly supports economic logic. War destroys wealth. The Iraq War destroyed immense wealth. The trillion dollar estimate made by Leigh, Wolfers, and Zitzewitz, predicated on a 15 percent drop in the S&P 500 and derived from consideration of futures prices, is supported by my direct examination of stock prices. When Bush the candidate made statements that enhanced the chance of war and when Bush the President and his men made statements, initiated plans, moved troops into Jordan, and bombed outside the no-fly zone, stock prices dropped. Their actions are associated with drops in prices that cumulate to over 15 percent by March 2001.

Our leaders not only annihilated a large portion of Iraq, the Iraqi people, and the Iraqi economy, but they also annihilated American wealth to a surprisingly large degree.

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*Michael S. Rozeff [[send him mail](#)] is the Louis M. Jacobs Professor of Finance at University at Buffalo.*



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