

“War at Any Cost? The Total Economic Costs of the War Beyond the Federal Budget”

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Thank you for this opportunity to discuss with you the economic costs of the Iraq War. March 19 marks the fifth anniversary of what was supposed to be a short venture to save the world from the threat of weapons of mass destruction—which simply weren’t there. It is now the second longest war in America’s history, and, after the all-encompassing World War II, the second most costly, even after adjusting for inflation. In terms of costs per troop, it is by far the costliest—some eight times as expensive as World War II.

A War for Democracy

Before turning to the costs *beyond* the Federal Budget, I want to make three prefatory remarks. We went to war to fight for democracy; but democracy is more than just periodic elections. It involves broader notions of democratic accountability. Citizens have the right to know what they are spending their hard earned dollars on. They have a right to know what their government is doing and the consequences of its actions. Over the past two years, I have worked with a colleague at Harvard, Linda Bilmes, to estimate the full costs of the Iraq war. We published our initial study in January 2006, and I would like that paper to be entered into the record. We published a second study, concerning the costs of providing medical care and disability benefits to our returning veterans, in January 2007. I would ask for that to also be entered into the record. We have now published a book, *The Three Trillion Dollar War*, which estimates the true costs of the war, the veterans’ costs, and the impact on the U.S. economy. I want to point out that it required an enormous amount of work to write our book. We should not have needed to write it, and when we came to write it, it should have been a far easier task. The Administration and Congress should have provided these numbers to the American people. Five years after the beginning of this war, you should not be funding this war with emergency appropriations, which escape the normal budget scrutiny. We should not have had to resort to the Freedom of Information Act to find out how many Americans have been injured in this war. This Administration has said that it will provide everything that our troops need. We should not have had to use the Freedom of Information Act to discover that more than three years ago, senior officers in the Marines were already sending urgent requests for MRAPs—which would have saved the lives of a large fraction of those killed if we had provided them at that time.

The Soaring Budgetary Costs

The second remark is that the budgetary costs themselves have been enormous—far, far larger than the some \$50 billion that the Administration estimated at the beginning of the war. We are now spending that amount in operations every three months. But the costs to the Federal Budget are far larger than the day-to-day operational costs. The war has

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raised overall military costs: we have to pay more to recruit and retain our troops, and even with these increased expenditures, standards for recruits have had to be lowered. It will be costly to restore our military to its pre-war standing, both in terms of personnel and materiel. There are costs hidden in other parts of the budget—not only are the direct costs of the contractors high, especially as a result of single source contracting and low levels of oversight (the defense contractors and oil companies have been the only true winners in this war, evidenced by what has happened to their stock prices), but we are also paying for the contractors' insurance for death benefits and disability. Even with these high insurance premiums, remarkably the government often winds up paying the benefits as well. In our calculations, we have not included the full costs of these, simply because it is impossible for ordinary citizens to find out what they are.

The most important costs that go well beyond the operational costs are the expenditures required to provide health care and disability for returning veterans. These are likely to be very, very high, and we will be paying these bills for decades to come. Almost 40% of the nearly 700,000 troops who fought in the one month long Gulf War have become eligible for disability benefits, and we are paying more than \$4 billion a year for disability benefits from that short war. Imagine, then, what a war that will almost surely involve more than 2 million troops and will almost surely last more than six or seven years will cost. Already, we are seeing large numbers of returning veterans showing up at VA hospitals for treatment, large numbers applying for disability, and large numbers with severe psychological problems. These problems increase disproportionately with every tour of duty and with longer tours of duty; and with more than one-third of our men and women being asked to do two or three tours of duty, the numbers will almost surely mount. While in previous wars, the ratio of injured to fatalities was 2.5 to 1, in this war it is 7 to 1, and if we include those that have to be medically evacuated because of what are classified as non-hostile accidents or illnesses, the ratio soars to 15 to 1. Many of the injuries are horrific and will require a lifetime of care. It is a testimony to modern medicine—though clearly we could have done a lot more to spare our troops than we did. Most of the costs will be borne by the VA, but there will be a burden on our social security system as well. We have estimated the total costs (in present discounted value terms) in what we call our “realistic” (but still highly conservative) scenario as \$630 billion.

Bills we will be paying for decades

My third prefatory remark is this: we will be facing these budgetary costs for decades to come. Even the CBO methodology, which looks ten years into the future, is too short-sighted for these liabilities which we have incurred. In the case of World War II veterans, VA expenditures peaked more than four decades after the cessation of hostilities. Furthermore, because the Administration actually cut taxes as we went to war, when we were already running huge deficits, this war has, effectively, been entirely financed by deficits. The national debt has increased by some \$2.5 trillion since the beginning of the war, and of this, almost \$1 trillion is due directly to the war itself. But the meter is still ticking. By 2017, we estimate that the national debt will have increased, just because of the war, by some \$2 trillion.

There has been much discussion of unfunded entitlements in recent years. This war has created a new unfunded entitlement—future benefits of Iraqi veterans—that may total a half a trillion dollars or more. But this is an entitlement which they have earned, and from which we should not, we cannot walk away. What we should do, now, is to recognize the financial obligations that we have incurred, that we are incurring today, and that we will incur before this War is over, and fully fund them. These obligations are much like deferred compensation: we require private firms to fully fund such obligations, and for good reason. There should not be a double standard.

When, of course, we add together all of these costs of the war, we are talking about *budgetary* impacts that are not just \$12 billion a month (or \$16 billion if we include Afghanistan), but greater than that by at least 40%. Our full cost of the war—our \$3 trillion dollar tally—is twice the direct operational budget. We should remember that every month we stay in Iraq and Afghanistan is really costing us some \$22 billion; every year, more than \$250 billion. In another two years, the tally will exceed another half trillion.

Micro-economic costs

The focus of my remarks today, however, is on the large costs that go beyond these budgetary costs. We classify these into two categories, micro-economic costs (to individuals, especially to the troops that have served us so well and their families, and to firms) and macro-economic costs (to our overall economy, today and into the future).

We have consistently understaffed, underinvested in, and underfunded the medical and disability programs that serve our veterans. As a result, our servicemen and women returning from the battlefield in Iraq often face a new battle—with the bureaucracy to get the benefits to which they are entitled and which they deserve. When they cannot get the health care to which they are entitled, or they have to wait months just to schedule an appointment to see a VA doctor, those who are fortunate enough to have families who can afford to do so, pay for it on their own. This doesn't diminish the cost to society; it just shifts the burden from the federal budget to these people who have already sacrificed so much.

There are other ways in which the costs to society exceed the costs to the budget, often by considerable amounts. When the government evaluates whether a safety regulation is worth instituting, it balances the costs with the benefits, that is, the savings in lives; as unpleasant as it may seem, it places a dollar value on people's lives, which includes the loss in output. The typical numbers, called the value of statistical lives, are \$7 to \$8 million. But to the budget, the cost of the life of a troop is only the \$500,000 death benefit. I have already noted that in this war, we have been penny wise and pound foolish—a little extra spending earlier on would have made the war, in the short run, seem more costly, but it would have saved us billions in the long run. But the billions that it would have saved the budget pale in comparison to what it would have meant to those who have died unnecessarily or who face a lifetime with disabilities far worse than

needed to have been the case. I am not a lawyer, but I do know this: any private employer who had acted in this way, with consequences as serious, would be liable for a suit for gross negligence.

There are other costs: for instance, the Dole-Shalala Commission estimated that in one of five families with a seriously disabled veteran, someone in the family has to give up their job to provide the necessary care.

Some of the costs are hard to quantify, but nonetheless real: Reservists and members of the National Guard who are forced to serve in Iraq find their lives and careers interrupted. Their employers lose the services of these often highly valued employees.

Economists emphasize the concept of *opportunity costs*. Resources devoted to the war could have been used for other purposes. One of the main responsibilities of the National Guard is to serve as a *first responder* in times of an emergency; their services are invaluable, and when they are not available—because they are in Iraq—everyone suffers when an emergency occurs. We saw that so clearly in Hurricane Katrina.

More broadly, we are today less equipped to handle a variety of challenges that might arise. If we are lucky, we may muddle through. We may not be so lucky. Already, one of the opportunity costs is apparent: while we were focusing on the weapons of mass destruction that did not exist in Iraq—and that we should have known did not exist—a new country joined the Nuclear Club.

Our country and our businesses are suffering due to America's changed standing in the eyes of the world because of the war and the way it has been conducted, as shown in survey after survey. These surveys show a clear relation between attitudes towards America more generally and attitudes towards American businesses. In many quarters, the supposed war for democracy has even given democracy a bad name.

I have, so far, emphasized the direct economic costs as well as the *opportunity costs*—the diversion of funds that could have been used in so many other and better ways. I would be remiss, however, if I did not note that there are other costs: in the long run, the squandering of America's leadership role in the international community, the diversion of attention from critical global issues, including issues like global warming and nuclear proliferation in North Korea—that simply won't go away on their own, and that cannot simply wait to be addressed—may represent the largest and most longstanding legacy of this unfortunate war.²

² This is a point that even conservative commentators have emphasized. Anne Applebaum, for instance, noted that “Countries that would once have supported American foreign policy on principle, simply out of solidarity or friendship, will now have to be cajoled, or paid, to join us. Count that—along with the lives of soldiers and civilians, the dollars and equipment—as another cost of the war.” Anne Applebaum, “Why They Don't Like Us,” *Washington Post*, October 2, 2007, p. A19.

Macro-economic costs

Finally, I want to turn to the macro-economic costs. First, I want to dispel a widespread misconception that wars are good for the economy—a misconception that arose from the role that World War II played in helping the US emerge from the Great Depression. But at least since Keynes, we know how to maintain the economy at or near full employment in far better ways; there are ways of spending money that stimulate the economy in the short run while at the same time leaving it stronger for the long run. This war has been especially bad for the economy. Some of the costs are becoming apparent only now; others we will face for years to come.

There are four major categories of macro-economic impacts. The first is through the war's effect on oil prices. Before the war, five years ago, the price of oil was under \$25 a barrel. As you know, now it has hit \$100 a barrel. Before the war, future markets expected the \$25 price to persist for at least a decade. Yes, there would be increased demands from China and India; but in well-functioning markets, supply responds to meet new demands. With large supplies and low extraction costs in the Middle East, markets expected production would increase in tandem with demand. The war changed this equation. How much of the increased price should be blamed on the War? In our book, we have taken a very conservative position—that only \$5 to \$10 of the increase is due to the war, and that the price increase will last for only 7 to 8 years. We think those assumptions are unrealistically conservative. For instance, futures markets today expect that the price will remain in excess of \$80 for at least the next decade. We chose to be excessively conservative, simply because we did not want to have an unnecessary squabble: as it was, even with these very conservative estimates, the costs of the war are vastly higher than its advocates were willing to admit. (Even the CBO, at the time we did our earlier study in 2006, was projecting that the total cost of the war would amount to only a half trillion dollars, still ten times greater than the Administration had estimated at the beginning of the war. Our objective was the more modest one of trying to get people to realize that this war was going to be far more expensive than that.)

Money spent to buy oil is money not available to be spent here in the U.S. It's as simple as that. Lower aggregate demand leads, through a multiplier, to lower national income.

The second impact arises from the fact that Iraq expenditures do not stimulate the economy in the short run as much as expenditures on, say, infrastructure or education that are so badly needed here at home. A dollar spent to hire a Nepalese contractor—or even an Iraqi—in Iraq does not have the first round, second round, or nth round impacts that a dollar spent here does.

The third impact is that both directly, and indirectly, through the mounting deficits, Iraq expenditures are crowding out investments that would have increased America's productivity in the future.

The mounting Iraqi war debt has meant that we have had to borrow more and more money from abroad—America as a country is far more indebted to others than it was five

years ago. We and our children will be paying interest on this debt. The fact that we borrowed rather than paid the bills as they came due does not mean that the war was for free; it only postponed the payments. The payments we will have to make to service this debt will lower the standard of living of Americans from what it otherwise would have been—an outcome which is particularly harsh, given that median American income today is lower than it was five years ago (which is simply to say that, adjusting for inflation, most Americans are worse off now than they were five years ago). This was true even before America went into its current downturn.

It should have come as no surprise that, when America's great financial institutions, Citibank and Merrill Lynch, needed money quickly, there were no pools of liquid cash available here. High oil prices and high national savings in China and elsewhere have created huge pools of wealth outside the United States, and it was to these that our financial institutions had to turn. It is, and should be, a cause of concern.

Until recently, it was a surprise to some that, in spite of these obvious ways in which the Iraq war was weakening the American economy, the economy seemed as strong as it did. Was there something, after all, to the old adage about wars being good for the economy? To me, and to other serious students of the American economy, there was, however, an obvious answer. These weaknesses were being hidden, just as much of the other costs of the war were being hidden from easy view. The exposure of these weaknesses was, it seemed to me, just around the corner—perhaps even more than the long vaunted victory that remained elusively just around the corner. The macro-economic effects were being hidden by loose monetary policy, a flood of liquidity, and lax regulation. These allowed household savings rates to plummet to zero, the lowest levels since the great Depression, and fed a housing bubble, allowing hundreds of billions of dollars to be taken out in mortgage equity withdrawals that increased the irresponsible consumption boom. As I once put it somewhat graphically, the subprime mortgages and lending programs with slogans like “qualified at birth” meant that easy credit was available for anyone this side of being on a life support system. Our financial institutions and credit rating agencies came to believe in financial alchemy, that these toxic mortgages could somehow be converted into AAA assets. We were living on borrowed money and borrowed time. There had to come a day of reckoning, and it has now arrived. The games we played—which for a time allowed us to hide the true costs of the Iraq war—are now over. And, just as our troops paid a high price for our penny wise pound foolish policies, so too will our economy.

The cost to the economy of this downturn will be enormous. We do not know, of course, how long or how deep the downturn will be, but it is likely to be worse than any we have experienced in the last quarter of a century. Even if growth this year is 0.8% (as the IMF forecasts), and next year growth starts to resuscitate, to 2%, and in 2010 returns to its potential growth of, say, 3.5% (a quicker recovery than most would expect), the total lost output over those three years—the discrepancy between the economy's actual output and its potential—will amount to some one and a half trillion dollars.

Reforms

This war has been very costly. We have made many mistakes. Some have been honest errors of judgment. But when there are repeated mistakes of this size, as social scientists, we have to ask, are there some systematic patterns? Also, as policy analysts, we have to ask, are there things that we can do to avoid their repetition? In our book, we set out a list of eighteen recommendations for reform. Here, I want to highlight five.

First, we should not be funding any war years after the beginning through emergency appropriations. If we do, it should be a sign that things are not going as expected, and there should be a detailed, written explanation to Congress. Second, there should be a full, comprehensive, accrual-based consolidated accounting of all the budgetary and non-budgetary national defense costs; with so many of the costs years, even decades, down the line, cash accounting not only fails to provide an accurate picture of the cost but encourages what we have seen: short-sighted decisions to keep today's costs down which simply raise the overall costs. And unless the accounting is comprehensive, it encourages cost shifting. Furthermore, the accounting, particularly of military expenditures, must be auditable, with those in charge held responsible. Congress passed Sarbanes-Oxley to hold private firms accountable; but the Defense Department has not lived up to these same standards. The President has not presented, on a regular basis, an accounting of how much the war in Iraq has cost us. These costs span the Departments of Defense, State, Labor, Veterans Affairs, Energy, Social Security, and other agencies. It is only through hard work that we, and others, have been able to piece together the accounts.

Third, if we think a war is worth fighting, we must force Americans to pay up front and not shift the costs to our children; we cannot pretend that one can have a war for free. We must set aside the money required to pay health care and disability benefits for the returning veterans. We require companies to do this, and we should ask nothing less of ourselves. We cannot let what they receive be hostage to the whims of a future political process, and we should not be creating enormous new unfunded entitlements.

Fourth, we must not place the burden on so few who are asked to do repeated tours of duty. It is unfair, and in the long run, as we have seen, it is costly, not just because of the toll it puts on those put through such repeated stress, but also because it will inevitably make it more difficult and more expensive for the armed forces to recruit in the future.

Fifth, we should be wary of privatizing the military to the extent that we have; it has been expensive, in so many ways. There are some things that should be privatized, but there are some things which should not: this is one area where economic theory and historical experience suggests that we should not. To the extent that private contractors are used, there is a need both for greater reliance on competitive bidding and more oversight; and we need a full accounting of the costs, including those costs taxpayers will pay outside the defense department budget.

Concluding remarks

America is a rich country. The question is not whether we can afford to squander \$3 trillion or \$5 trillion. We can. But our strength will be sapped. We will be less prepared to meet challenges in the future, and there are huge opportunity costs. Some of our children will not have the medical care that should be a right to every citizen born in a country as rich as ours; some will bear the scars for life. We are not investing as we should in technology and science, to make our economy as competitive as it should and needs to be. We worry about the inroads China is making in Africa—but our foreign aid budget in Africa amounts to but a few days fighting in Iraq. With a fraction of the amount spent on this war we could have had a new Marshall plan, which would have done so much to win the hearts and minds of those around the world. We have talked about the huge problem facing our social security system, putting into jeopardy the economic security of our elderly. But for a fraction of the cost of this war, we could have put Social Security on a sound footing for the next half century or more.

Economists are fond of saying that there is no such thing as a free lunch. It is also the case that there is no such thing as a free war. This is not the first time that an Administration tried to enlist support for an unpopular war by trying to hide the true and full costs from the American people. And this is not the first time that America and the American economy have suffered as a result. The inflationary episode that America went through beginning in the late 1960's was at least partly a consequence of President Johnson's failure to own up fully to the costs and adjust other tax and expenditures appropriately. This time, the underlying economic situation is different, and, accordingly, the consequences have been different—but in many ways even more severe.

The budgetary costs of this war have been huge. But the costs that go beyond the budget are at least as large, and the meter is still ticking. Every year of this war has seen the costs rise. But even if the troops stay where they are, two more years will add, conservatively, another \$500 billion to the total tally. No one can know for sure whether, when we depart, things will get better (as more Iraqis seem to believe) or worse. No one can know for sure whether staying an extra two years will make the chaos that might follow less—or greater. But it is your solemn responsibility to make the judgment: is this the *best* way of spending \$500 billion? Is it the best way to strengthen America's capacity to meet future challenges, to promote democracy around the world, to help create the kind of world, here and abroad, that we would like our children to inherit? For too long, this Congress and this Administration has approached the problem by dribs and drabs: a little more today might just do the trick; a little more later will help us turn the proverbial corner. But as the late Senator Dirksen said, "a billion here, a billion there, and pretty soon you're talking about real money." Today, we would have to say, a trillion here, a trillion there, and pretty soon you're talking about real money.

Even a rich country ignores costs of this magnitude at its peril.