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**Before the Joint Economic Committee of the United States Congress**

**THE COSTS OF THE IRAQ WAR**

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Mr. Chairman and Members of the Joint Economic Committee,

It is a great pleasure for me to appear before this Committee once again, and especially so because the topic you have chosen to consider today — the cost of the Iraq War — is of great importance to our country. This hearing also is particularly timely, because next month will mark the beginning of the fifth year of that war. What was originally expected to be a short and cheap military exercise has become the second longest war in American history (Vietnam being the longest) and the second most expensive (World War II having been considerably more costly).

Now is a good time for a deeply divided nation to develop a better understanding of the costs of this war and to use that information — factoring in a variety of other national security considerations as well, of course — to determine whether these costs are still worth paying. And if they are considered worth paying, we need to consider how to cover the costs in a way that is fiscally responsible and that will put America's longer-term finances on a stronger footing.

To be sure, the decision on whether, and at what level, to continue the American military presence in Iraq is *not* primarily an economic one — nor should it be. It must depend heavily on a range of considerations that relate to the positive or negative consequences of changes in troop levels (or of the in-country mission of our troops) for US national security and for the future stability of Iraq and the Middle East. It must also factor in other important considerations such as whether political reconciliation and stabilization in Iraq are moving forward rapidly enough, and whether or not the continued loss of life and the injuries suffered by Americans are worth the outcomes we seek. Whatever the case, the Congress should use this period to consider — in as non-partisan a way as possible — how in the future this country can avoid the mistakes that have been made in the funding of this conflict.

**LACK OF A CANDID NATIONAL DEBATE ON WAR COSTS**

Democracies function best when policies are based on the informed consent of the governed. And here I emphasize the word *informed*. In most wars there is a tendency to underestimate the cost at the outset — in part because of wishful thinking that they will be short and cheap and in part because leaders often cannot immediately judge at the outset. That was certainly true in Civil War, World War I and the Vietnam War. But there was generally a very candid, open and

robust debate in the Congress and among the American people about how to pay for a war once its costs became apparent — and in some cases even in anticipation of rising costs.

During this war there has been a surprising absence of vigorous public or Congressional debate over war costs and how to pay them. In large measure that is because this war represents only a small portion of American GDP — roughly one percent annually in direct budgetary terms — compared to World War II (around 40% at its peak) the Korean War (around 15%) and Vietnam (around 10%). So paying for the current war has not *appeared* to impose large *visible* costs on the American economy — although, as I shall later point out, that is a deceptive illusion.

Also, in other wars higher taxes, and elevated borrowing that pushed up interest rates, forced Americans to come to grips with the price of the war and political leaders to feel a greater sense of accountability about war costs. This war so far has seen taxes lowered and has had no impact on interest rates; for the better part of the war the Federal Reserve was cutting rates and long term bond rates were quite stable.

Moreover, the fact that this war has been financed almost entirely by using “emergency budget supplementals” that circumvent the normal budget process has meant that the executive branch and the Congress have skirted the issue of tradeoffs in the budget. Thus a great deal of unnecessary and non-essential spending, including climbing numbers of “earmarks,” has occurred even as the cost of the war has increased — a development that never before occurred in American wartime history.

Normally when America goes to war, non-essential spending programs are reduced to make room in the budget for the higher costs of the war. Individual programs that benefit specific constituencies are sacrificed for the common good. FDR himself slashed or removed from the budget entirely many of his pet New Deal programs to pay for World War II. And taxes have *never* been cut during a major American war; for example, President Eisenhower adamantly resisted pressure from Senate Republicans for a tax cut during the Korean War.

## PAYING FOR PAST WARS — COMPARED TO THIS ONE

One month after the attack on Pearl Harbor plunged America into World War II, President Roosevelt appeared before Congress to deliver his 1942 State of the Union Address. He was straightforward about the massive expenses the war would require. “War,” he said, “costs money. That means taxes and bonds and bonds and taxes. It means cutting luxuries and other non essentials.”

Higher taxes as well as cuts in luxuries and non-essential spending have been hallmarks of fiscal policy during every major war in which the U.S. has engaged — until now. The Iraq War has been paid for in a very different way. As noted above, it is the first war during which taxes have been *cut* and non-essential government spending has *increased*, and quite *substantially* at that. This has meant that the *bond* part of FDR’s equation (i.e. federal borrowing) has been the *sole* source of funding for the costs of this War. This has made it easier for Americans to avoid coming to grips with the cost of the war, because no popular programs were cut and no taxes were levied — no economic inconvenience to them.

By the end of FY 2008, the Iraq War will have cost \$608 billion in *direct* budgetary appropriations, plus another and far larger set of costs that are not directly in the budget. These have been described in a Joint Economic Committee Report entitled “War at Any Price?”

released in November 2007, and in my friend and co-panelist Joe Stiglitz's recent book entitled *The Three Trillion Dollar War*. This \$608 billion figure also does not include the interest that has been paid on funds previously borrowed to cover the costs of the war since 2003 (which itself must be borrowed). That brings total borrowing for the war close to \$650 billion dollars. [The direct costs of the War in Afghanistan for the U.S. come to around \$200 billion so far, although I do not include them in this analysis, even though many of the same considerations apply; but that war is dissimilar in one major respect, because it was and is a "war of necessity," and there is far greater foreign engagement.]

The Iraq War differs from other major American wars of the past in yet one more respect as well: a substantial portion of the money borrowed to pay for it (roughly 40%) comes from abroad. That has been the case on only one other American War — the Revolution, when borrowing from France and the Netherlands proved critical to the success of the Continental Army.

I make these points of differentiation between this war and past wars because it is important to understand the unique character of the funding of this war and to put it in historical perspective. The methods by which American wars have been paid for since 1776 are described in greater detail in a book I have written recently called *The Price of Liberty: Paying for Americas Wars from the Revolution to the War on Terror*. There is merit in studying how presidents and Congresses have paid for wars in the past as we attempt to put the policies used to pay for this war in historical context — and seek to do a better job in the future.

#### ABSENCE OF SHARED SACRIFICE

There is another point of history worth emphasizing: war financing is *not* simply about money. Clearly wars, as FDR emphasized, cost a lot of money. But throughout history national leaders also have recognized the importance of conducting war financing in ways that connect Americans at home to the armed forces abroad, demonstrating that as American forces are making sacrifices on the battlefield — and many thousands of them are making major sacrifices every single day during this war — the American people are making sacrifices in their behalf at home. Woodrow Wilson's Treasury Secretary, William Gibbs McAdoo, stated during the early months of World War I that "a man who could not serve in the trenches of France might never the less serve in the financial trenches at home" by buying war bonds (called Liberty Bonds). He coined the term "capitalizing patriotism" to emphasize that patriotism required all Americans to make financial sacrifices to support the nation's troops when they were at war, putting their lives at risk. He did not see this as a partisan measure — but as one of support for American troops.

FDR was even more blunt, emphasizing the need for shared sacrifice. "Battles are not won," he stated, "by soldiers or sailors who think first of their own safety. And wars are not won by people who are concerned primarily with their own comfort, their own convenience and their own pocketbooks." Yet the American people as a whole have been asked to give up nothing for this war — they have been treated to tax cuts and increases in government programs of various sorts. The only sacrifices are those being made by the troops and their families.

I believe that in the current environment Americans would willingly support enactment of a "tax surcharge for veterans" levied on citizens in the top income bracket. The tax would not be to pay for the war itself — because so many Americans either oppose this war or find it futile and therefore would not, at this point, support a tax that appeared in any way to perpetuate an American presence in Iraq. The tax revenues would go into a fund dedicated *specifically* to

ensure that wounded and disabled veterans receive the highest quality care for as long as they need it, which for many will be their entire lifetimes.

The cost of treating the many thousands of returning men and women who receive various kinds of serious wounds, among which are the much discussed traumatic brain injury (TBI), or are victims of post-traumatic stress disorder (PTSD), will be enormous. These wounds and conditions also take a heavy toll on the families of victims. I believe that even Americans who are bitterly opposed to this war would support such a tax to ensure the provision of lifelong disability and medical care for these veterans; estimates for such costs range into the hundreds of billions of dollars over many decades, especially since disabilities often manifest themselves years after veterans have come home from the battle field.

## BORROWING FOR THE WAR

I have been asked by the Committee to focus a portion of my remarks on the issue of borrowing for this war — which, sadly, receives little public attention. In all major wars in our past (with the exception of the first Iraq War when President George H.W. Bush, Secretary James Baker and Secretary Nicholas Brady organized massive and direct financial support from America's friends and allies to pay the lion's share of the war), a significant amount of additional federal borrowing has occurred. This is because administrations and Congresses did not want to place the entire burden of the war cost on the current generation of tax payers and sought to spread out the cost over time. Such a policy was prudent, because the nation could not absorb tax increases large enough to pay the full cost of the war during the course of the conflict without crippling the economy. But they also believed that taxes should pay *some portion* of the cost, i.e. that the entire cost burden should *not* be shifted to future generations of taxpayers through borrowing.

So before, or in the early stages of, every major war in the past there was an active debate in the Congress and the Executive branch — and in parallel among the American public — over what proportion of the war should be paid for by taxes and what proportion by borrowing. This was true in the Civil War, in which Secretary Salmon P. Chase informed President Lincoln and the Congress that he proposed to divide up the incremental costs of the war on the basis of 25% taxes and 75% borrowing; Secretary McAdoo set and nearly achieved the goal of paying for one third of World War I through taxes; and Secretary Henry Morgenthau set a goal of paying half the cost of World War II through taxes, although in the final analysis he only got to 45% (a nonetheless impressive feat); President Harry S. Truman aimed to pay almost all of the Korean War through taxes, although he fell short.

The underlying point is that during *all* of these conflicts there was a vigorous national debate on how best to pay the bill — how much current taxpayers should pay and how much should be borrowed and therefore shouldered by future taxpayers through debt service. Usually there were frequent and well attended Congressional hearings on the matter. Sadly, we haven't had that kind of debate regarding this war.

The notion that national security can be paid for "on the cheap" — using borrowed funds alone — is a dangerous one, especially for a nation that is likely to be engaged for several decades in what the Pentagon refers to as the Long War on Terrorism. If that is the case, and there is good reason to believe it is, Americans should be candidly told the costs and exactly how the money will be used. The American public should understand the long term resource requirements not only for the military but also for national intelligence, improved diplomacy, increased foreign assistance, augmented homeland defense, and better support for police, firefighters and public

health authorities. The last of these will also be important if the nation is hit by a pandemic — for which all authorities acknowledge we are grossly ill-prepared.

Funding this war on terror or any other war without presenting Americans with a comprehensive package that relates the various components to the overall goal does not enable the electorate to understand the full costs or consider the most appropriate way of paying them. Once they understand these, they will be better able to decide whether they wish to give up other programs to make room in the budget to cover some of the costs, or pay higher taxes, or borrow more or simply not fund some of these national security items at all.

A robust debate on the topic of war spending (for this or for any other war) and how to allocate the burden between current and future taxpayers is an unambiguously good idea for our democracy, in part because in debating taxes and borrowing for a war, Americans can also debate the wisdom of the war *itself* when it is — as the Iraq War is — a war of choice. It also brings into play the issue of budgetary priorities and trade offs. In debating whether to engage in a “war of choice,” Americans should be cognizant of the important government programs that could be paid for with the resources that would otherwise be devoted to paying for that war. Dwight Eisenhower — certainly no pacifist but a former Supreme Allied Commander — recognized that war diverts resources from other purposes and therefore a decision to enter one should be thoughtfully and carefully taken. He put the tradeoffs as follows: “Every gun that is made, every warship launched, every rocket fired, signifies in the final sense a theft from those who hunger and are not fed, those who are cold and are not clothed.”

The November JEC Report points out that the money spent on the Iraq War during one single day could enroll an additional 58,000 kids in Head Start, make college more affordable for 160,000 low-income students through Pell Grants, hire nearly 11,000 border patrol agents, or put an additional 14,000 police officers on our streets. The large sums so far spent also could have helped to put Social Security and Medicare on a more sustainable basis. And a small fraction of them could have helped to eradicate or contain diseases that devastate the lives of millions in Africa and Asia. But we have had no such debate over what economists call the “opportunity costs” of war spending and thus no such tradeoffs were considered.

The broader implications of paying for the war entirely by increasing the federal debt are inter-generational. Borrowing to pay the full cost of the war passes the cost wholly to future taxpayers. The JEC Report calculates that by the end of FY 2008 the additional federal debt resulting from the war will total \$660 billion — and that this figure will grow to \$1.7 trillion by the end of 2017. It further points out that within the coming year the debt service cost for Iraq War spending alone will exceed federal spending for education and health research.

Again, the point is that there are major *tradeoffs* here. Is the continued cost of the Iraq War worth the commitment of resources that potentially could be used otherwise for national social programs or to shore up homeland security or for other purposes? Or, if we do wish to pursue the war at current troop levels — or bring troop levels down to a Korean War-like presence as suggested by Secretary Gates, or engage in a sharp drawdown as recommended by the House Plan — are we willing to give up other programs that are now being funded to pay the costs? These questions cannot be decided here, but what can be agreed on is that a vigorous debate should be held about national priorities and tradeoffs for the use of federal budgetary resources before any new decisions are taken about whether to undertake a war of choice. It may well be that we will undertake such a war after all the considerations are aired, but at least then Americans will understand the resource implications of the decision, and recognize that certain things must be given up to pay the price of that war. And even in a war of necessity, resource

decisions need to be taken in the context of a transparent dialogue about the optimum way to pay the bill.

There is also the issue of the degree to which borrowing for the war draws money away from productive investment. (Of course, it is worth noting that higher taxes would do that too, but I will focus in the borrowing side of the equation here.) It is difficult to know precisely the degree to which money *not* borrowed by the federal government to pay for the war would have gone into *productive* private sector investment as opposed to one-shot consumption. Presumably less federal borrowing for the war would have lowered the cost of capital and thus encouraged some additional private sector investment — although there is little evidence in recent years that the cost of capital was an inhibiting factor in capital investment in the United States. So it is difficult to measure with any precision how much private investment was *actually* displaced by federal borrowing for the war. Conceivably, the major impact of less federal borrowing and thus a lower cost of capital could simply have been to encourage even more consumer borrowing (which was already enormous) — and that would have contributed little to national productivity.

More troubling is that borrowing for war, or for any other current purpose for that matter, will impose a large debt burden on future generations at a time when federal borrowing in the future will climb dramatically to pay for the skyrocketing costs of social security and health care for the aged and the poor. These vital but costly programs will put enormous stress on the federal budget in coming decades, causing an additional increase in borrowing and/or taxes — or cuts in other programs. Placing added burdens on federal finances by accumulating additional war debt now simply makes the management of this problem more difficult. In his celebrated Farewell Address, President Washington enjoined Congress and his fellow citizens to “discharge the debts which unavoidable wars may have occasioned, not ungenerously throwing upon posterity the burdens we ourselves ought to bear.”

But it is not simply war debt that is the problem. Our analysts at Goldman Sachs anticipate that overall federal borrowing over the next ten years will amount to over three trillion dollars — so there are other fiscal issues at play here besides the war. There has been a general absence of fiscal discipline in Washington for nearly a decade. War costs would not have added to federal debt to the degree that they have if non-essential programs had been cut and earmarking been better contained — or if taxes had been raised to pay for even a portion of the added costs of America’s military efforts in Iraq.

A century and a half after President Washington’s Farewell Address, President Eisenhower gave his own Farewell Address in which he counseled Americans “to avoid the impulse to live only for today, plundering for our own ease and convenience the precious resources of tomorrow” and to avoid “mortgaging the material assets of our grandchildren...” And yet we seem to have heeded neither of these calls in recent years. That is *not* the fault of the war but of a less than rigorous process of budgeting and resource allocation in Washington — and a seeming indifference to that by Americans in general.

Finally, as noted above, because roughly 40% of all Treasury securities are sold abroad, that portion of war borrowing is financed by China, Japan, the Middle East and Western Europe. Thus, Americans are accumulating large interest and debt repayment obligations to a number of other nations because of our budget deficits. After the US had accumulated debts to France and the Netherlands during the Revolution, Treasury Secretary Hamilton and the Federalists, followed by the Jeffersonian Republicans, insisted that they be paid down promptly to preserve American creditworthiness.

That will not happen this time; America's debt to other nations and its continued dependence of their capital will climb dramatically in coming years. To be sure, this country can sustain large foreign obligations today far better than the America of the late 18<sup>th</sup> century, but growing amounts could still present problems. It is worth noting here that while there appears to be consternation among many Americans about this nation's growing dependence on foreign capital, there is little apparent recognition that we Americans have it in *our* power to *reduce* this dependence. We can do so by saving more, running government surpluses, curbing the rate of growth of consumption financed by borrowing, and using less imported oil. So far we are moving in the wrong direction on all four counts (although consumer borrowing now appears to be slowing) and thus will depend increasingly on foreign capital inflows.

It is also worth noting that this dependence constitutes a security vulnerability. Were there to be another catastrophic terrorist attack in the near term, at a time when foreign confidence in American finances is already low due to the crisis in our credit markets and to the expectation of rising federal deficits in coming years, the massive sums of foreign funds that we count on — roughly \$2-3 billion net every working day — could decline precipitously. That would sharply slow an already weak U.S. economy that would have been weakened further by the attack. It is worth recalling that in September 2001 the federal government had been running a budget *surplus* for four years and the nation was only half as dependent on foreign capital as it is today — and we had no credit crisis. At that time foreign capital inflows slowed for a while but resumed quickly, and the dollar proved remarkably resilient. In current circumstances a drop on foreign flows could last longer, push up interest rates due to a fall in available capital, and cause the dollar to plunge.

## CONCLUSIONS

Several lessons can be drawn from the way this war has been paid for:

- 1) *Avoid paying for wars by supplementals.* The process circumvents the need to make budgetary tradeoffs, set resource priorities or sufficiently scrutinize how the funds are being used. Even during the very poorly and non-transparently financed Vietnam War, emergency supplementals were used to finance only about a quarter of the costs. Democratic leaders in the Senate insisted that President Johnson and Defense Secretary McNamara stop using this technique as it was undermining support for their policies in the Congress.
- 2) *Cut way back on earmarks, especially during war.* During wars, such programs divert budgetary funds from higher national priorities. Moreover, they create the notion that America can pay for its national security with no sacrifices — and indeed new programs not on the national priority list can be funded with no heed being paid to the need for even slight national sacrifices.
- 3) *Exercise more rigorous Congressional oversight over war spending.* It is possible that even if the party in control of the White House and the party in control of Congress are the same, there can be rigorous oversight of spending to curb waste. The Truman Commission (formally known as the Special Senate Committee to Investigate the National Defense Program) reportedly saved the American taxpayer an estimated \$15 billion during World War II. As historian David McCullough wrote, "Unquestionably [Truman's] relentless watchdog role ...greatly increased public confidence in how the war was being run." In the future the demands of the country for greater attention to social programs at home will grow, so the military will need to demonstrate that it is using its funds with maximum efficiency and on essential requirements.

4) *Recognize the advantage of coalition diplomacy in paying for a war.* The first Iraq War demonstrated the military and the financial benefits of forging a strong international coalition. That coalition provided additional fighting forces, greater legitimacy for the effort and foreign funds that helped to relieve the burden on the American taxpayer.

5) *Take a long-term look at national finances.* If the US allows its finances to deteriorate in coming years there will be serious consequences for the nation's security and its ability to address growing social needs such as education and health care — as well as to provide for the requirements of what will soon become a rapidly retiring group of 76 million baby boomers. A new administration and a new Congress will need to examine closely the future resource requirements of this nation — including the obligations we are accruing to retirees through Social Security and Medicare — and the likely budgetary resources that will be available to meet them. Congress and the president will need to find ways to ensure that projected outlays and resource availability converge as opposed to diverge — which will be the case absent changes in anticipated spending and revenue trajectories. It is difficult to see how America's growing needs can be met without tax increases, and if they are required, they should be structured in ways that boost growth and savings and are consistent with the longstanding principle on which the income tax was based starting during the Civil War — fairness and progressivity.

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I thank the Committee for giving me the opportunity to testify at this hearing and welcome your questions.