



214 Massachusetts Avenue, NE • Washington DC 20002 • (202) 546-4400 • heritage.org

CONGRESSIONAL TESTIMONY

Discussion of the Costs of the Iraq War

**Testimony before
Joint Economic Committee
United States Senate**

June 12, 2008

**William W. Beach
Director, Center for Data Analysis
Domestic Policy Studies
The Heritage Foundation**

Testimony

My name is William W. Beach. I am the Director of the Center for Data Analysis at The Heritage Foundation. The views I express in this testimony are my own, and should not be construed as representing any official position of The Heritage Foundation.

Mr. Chairman and members of the Joint Economic Committee, I do not present myself this morning as an expert on the battlefronts in the global war on terror. Others are here today or have testified before you who wear the badges of experts in the wars in Iraq and Afghanistan. I like most citizens have my views on those and related conflicts, but those views are not what moved me to accept this committee's invitation to testify today.

Rather, I present myself as an economist who has followed the debate over the cost of the global war on terror and now is worried that this discussion, like so many others, has become a victim of the increasingly bitter partisanship surrounding this war. Citizens assume that those analysts who argue about the costs of the war in Iraq and Afghanistan nevertheless use the standard analytical tools for assessing the value of public outlays. They assume that serious analysts will seek the truth and avoid temptations to score political points by exaggerating their evidence or assuming away data that moves against their argument. They believe that a reasonable range of estimates exist that permit them, the sovereign power in our system of government, to make the necessary decisions about continuing or abandoning the Iraqi phase of this conflict.

Those assumptions are increasingly unfounded. Some of the recent estimates violate the fundamental rules for comparative cost analysis. In addition, these estimates take a generally worst case view and fail to take into account important offsetting factors. Moreover, the relentless drive to make the costs as large as reasonably possible leads analysts into a series of errors about how the war in Iraq has affected the US and world economies. Taken together, these breakdowns in analysis produce war related costs that are too high and, worse, delay the resolution of America's future role in Iraq and Afghanistan.

My testimony briefly touches on three topics in the cost debate: 1) the frequent absence of an appropriate cost/benefit analysis, 2) the costs of the Iraqi conflict and the tendency of some leading cost analysts to ignore offsetting factors and to exaggerate the long-term war-related outlays of the federal government, and 3) the effect of the war on world oil prices and macroeconomic performance.

Cost/Benefit Analysis

If there is anything as settled in economics as, say, the theoretical structures of supply and demand it would be analyzing costs in terms of foregone opportunities. Economists have long understood that economic cost differs significantly from the concept of cost used by accountants, and they have lectured to generations of undergraduate economics students that the difference is crucial to understanding economic activity.

Briefly, economists think about cost as a part of the broader discussion of choice. People choose to spend their money in one way rather than another because the chosen

way produces better benefits than they way not chosen. We forego certain opportunities in favor of others in order to obtain benefits that are better than others.

This approach to costs means that not all costs are created equal. Suppose that two activities both had the same accounting cost of \$100. From an accounting viewpoint, both costs are identical and choosing one or the other makes no difference. However, imagine that spending \$100 one way saves your daughter's life and spending it the other way lets you repaint your kitchen. The first expenditure probably reduces the cost of \$100 to nearly nothing, since the benefit is so overwhelmingly great. The second \$100 expenditure probably costs more than \$100 amount because you will likely add the pain of your own labor to the cost of the paint.

It is particularly important to use the economic concept of cost rather than the accounting concept when evaluating the spending for a war. It is highly unlikely that the public would support a massive buildup of military forces and equipment during times of perfect international peace. Clearly, those are times to spend the same amount of money on education, health care, or other domestic priorities. However, a country reacts totally differently when those domestic priorities are endangered by foreign aggression. When attacked or threatened with violence, it makes sense to spend on significant sums on defense.

It also makes sense to evaluate ongoing defense or war fighting costs in terms of the benefits of security. Clearly, if the costs approximate the benefits, then such a dreadful thing as war has an economic justification. If not, then citizens will vote to end the conflict.

I hope I'm not belaboring these points, but the absence of these considerations in the recently published book by Joseph Stiglitz and Linda Bilmes¹ (Stiglitz and Bilmes) requires that they be made. Let me illustrate why.

Stiglitz and Bilmes present two sets of cost estimates, one called best case and one they call realistic-moderate. In table 4.1 of their book, the military outlays under these two scenarios are summed up:²

Table 1
Principal Cost Components
From Stiglitz and Bilmes

Federal Government Outlay	Best Case (In Billions)	Realistic- Moderate (In Billions)
Total Operations to Date	\$646	\$646
Future Operations	521	913
Future Veterans' Costs	422	717
Other Military Costs/	132	404

¹ Joseph E. Stiglitz and Linda J. Bilmes, *The Three Trillion Dollar War: The True Cost of the Iraq Conflict* (New York: W. W. Norton & Company, 2008).

² Ibid, p. 112.

Adjustments		
Total Budgetary Costs	\$1,721	\$2,680

Assuming for a moment that each of these costs estimates is reasonable (which is an assumption I'm unwilling to support except for this illustration), then the US will spend between \$1.7 and \$2.7 trillion dollars on the war in Iraq. This sounds to anyone like a very large amount, especially when we think about how much good these same sums would do to rebuild our highways, provide low-income health insurance, and so forth. However, these are presented by the authors as accounting costs, not economic costs.

If Stiglitz and Bilmes had presented their readers with economic costs, they would have provided a context of competing benefits, one of which would be the safety of the United States from violence. I don't know how they would have chosen to do this, but one approach immediately comes to mind: comparing these military costs to the economic damage done by a series of 9/11 size events.

Some analysts have estimated that the attacks of September 11, 2001 reduced US economic activity by about \$225 billion over the next 12 months. Let's assume that our enemy would have visited one such attack on the US for each of the next six years (2003 through 2008) had we not taken the battle to the enemy's prime territory. If we increase that \$225 billion by two percent per year to account for overall growth in the economy, then the sum over the period of avoided major terrorist attacks would be \$1,673 billion, or \$48 billion less than the estimate of current and future outlays under the best case scenario. If we believe the counterfactual—that we avoided major terrorist attacks by fighting the enemy abroad—then I would imagine most people would approve of expenditures of this amount. On the other hand, costs exceed benefits by \$1,007 billion under the realistic-moderate scenario...a relatively clear signal that outlays of this magnitude may not be justified.

However the authors had decided to present the economic costs, they should have done so. Simply presenting accounting costs deceives readers who are untrained in cost analysis and presents obstacles to the ongoing debate over Iraq rather than data to inform our choices.

The Cost of the War in Iraq

There are a number of leading cost estimates for the war in Iraq. I follow the methodology contained in a widely circulated working paper from the National Bureau for Economic Research by Steven Davis, Kevin Murphy, and Robert Topel, all from the University of Chicago.³ Davis, Murphy and Topel began their work in 2003 as the debate over containment or regime change reached a high point. Their original 2003 essay presented estimates that the long-run costs of containing Saddam's regime were nearly as large as the forecasted costs of military intervention and regime change. They significantly updated their work in 2006.

³ Steven J. Davis, Kevin M. Murphy and Robert H. Topel, "War in Iraq versus Containment", Working Paper 12092, National Bureau of Economic Research (March, 2006).

Their work provides a tightly documented foundation for inflation adjusted annual cost estimates of the major moving pieces in the Iraq cost debate. In the table below, I have assumed that combat operations associated with the occupation of Iraq continue at a diminished rate through calendar year 2012, after which the U.S. and allied forces adopt a regional military posture on a level with the pre-war containment efforts. Any number of alternative assumptions could have been made, including immediate withdrawal or occupation lasting beyond 2012. However, many observers think that the Iraqi domestic situation will sufficiently stabilize between now and 2012 that U.S. occupation forces will withdraw to a regional military platform.

Given that, something like the following costs stemming from the Iraqi theater are likely.

Principal Cost Category (Billions of 2003 Dollars)	10-year Cost In the Iraq Theater
Major combat operations	\$63
Warfare associated with occupation	848
Economic cost of fatalities and casualties	137
Reconstruction, humanitarian assistance	95
Total, 2003 through 2012	\$1,143

As of March of this year, the Congress had appropriated about \$845 billion for military operations, reconstruction, embassy costs, enhanced security at U.S. bases, and foreign aid programs in Iraq and Afghanistan. Due to the increase in military personnel and operations since the surge, the “burn rate” in Iraq has increased from \$4.4 billion per month in 2003 to \$12.5 today. However, the benefits of the current increase in activity are present across a wide spectrum of metrics, particularly in the decline in battle related casualties.

Some critics, such as Stiglitz and Bilmes, expand these war fighting estimates by ignoring the improvements of 2007 and 2008. Pre-surge cost ratios are extended into the distant future, casualty rates continue at pre-surge levels, and long-term outlays for Veteran Administration programs blossom by the expansion of the base.

For example, the monthly average casualty rate in 2007 stood at 75, but that rate fell during the last three months of the year to an average of 33. During the early months of 2008, the monthly casualty rate was half that of 2007, at 40 per month. Stiglitz and

⁴ Based on estimates contained in Tables 2, 7, 9 and 10 of Davis, et al.

Bilmes, however, assume that the "...rate of death and injuries per soldier continues unchanged..." over their forecast period.⁵

These higher than supportable estimates of casualties produce a larger base for VA outlays than it appears will be the case. Furthermore, Stiglitz and Bilmes assume that the utilization rates for veterans of Operation Iraqi Freedom will be the same as that by veterans of Desert Storm. Obviously, that assumption has very little evidence to support it, since utilization levels are yet to be established for OIF vets. Moreover, one wonders whether the special circumstances that afflicted Desert Storm troops makes their utilization profiles unique. We have yet to fully trace the full medical effects of exposure to burning petroleum that so famously confronted our military during the first Gulf war.

Another troubling omission from Stiglitz and Bilmes analysis is an estimate of the post-military economic contributions of injured veterans. Clearly, not every survivor will live his or her adult life under the full-time care of the VA. Indeed, trauma medicine on the battle field has advanced so much since the Vietnam era (and indeed since the first Gulf War) that many of those injured have a better chance of economically productive lives than the predecessors. Dr. Atul Gawande published a fascinating description of field trauma techniques in the *New England Journal of Medicine*.⁶ He reminds us of how much more likely it is today that a wounded soldier will survive and do so in a fashion as to return to a modicum of normal health. In the Korean, Vietnam, and first Gulf war, about 24 percent of wounded soldiers died. Dr. Gawande reports that the early days of the Iraq war saw that ratio drop to 10 percent. Certainly that percentage has risen as the conflict intensified after 2005, but it remains below the recent historical levels.

Finally, Stiglitz and Bilmes add to the cost of the Iraq war between \$250 and \$375 billion to rebuild the armed forces and return our military to "full strength." Even this seemingly reasonable addition to costs falls prey to the tendency to exaggerate. Most certainly counted in this estimate are normal procurement outlays to replace fully depreciated military equipment and infrastructure. They could be on similarly shaky grounds by assuming that the personnel side will need to grow beyond normal replacement over the next decade. It may be that the government decides to increase the size of our military forces, but tracing this back to the Iraq war assumes that the war itself prompted an intentional downsizing of forces that must be rectified following withdrawal. This, like their procurement assumption, is highly questionable.

What about the Increasing Cost of Oil

Critics of the Iraq war point to the increasing price of petroleum as a clear cost of the conflict. Indeed, the leading critics extend this observation to argue that the leading economies of the world have all performed well below potential since the war began and oil supplies were disrupted. There are so many wrong with this argument that one hardly knows where to start, but let me supply a short note.

World oil supplies today are very tight. Current estimates are that the daily difference between supply and demand is a mere 750,000 barrels. This slim margin, however, is not due to the Iraq war. Rather it is due to the explosion in demand for

⁵ Stiglitz and Bilmes, p. 40-41 and 86-87.

⁶ Atul Gawande, "Casualties of War—Military Care for the Wounded in Iraq and Afghanistan," *New England Journal of Medicine*, 351:24 (December 9, 2004).

petroleum from the developing economies of Asia and from ours and Europe's above average economic growth of the past four years. Iraq still exports less than its pre-war potential: indeed exports remain about 25 percent below that level. But, other suppliers, including the OPEC leaders, have more than made up for Iraq's missing supplies.

However, most of the critics do not point to supply as much as they point to price. War in Iraq has been the assumed boogey man in oil futures markets, relentlessly driving up the benchmark crude prices. However, the history of oil prices doesn't appear to support that story.

Well before the war, during the period 1997 through 2000, oil prices as measured by the benchmark U.S. index (West Texas Intermediate at Cushing, Oklahoma) rose three times the long-run rate of growth over the period 1965 through 2008. From 2002 through 2006, West Texas Intermediate grew by 2.5 times the long-run rate. However, since February of 2007, WTI has been growing by 13 times the long-run rate. Doubtless one day we will know what has caused this latest and very visible surge in petroleum price. One suspect, however, clearly will not be in that line-up, and that's the war in Iraq.

Conclusion

The strong views surrounding the war in Iraq and particularly its future color the analysis of its costs. Perhaps that is unavoidable. After all, forecasts require assumptions, and assumptions frequently spring out of beliefs and not science.

Even so, the citizens of this country have before them one of the most important questions that has faced them in several generations: whether to declare this war a mistake from the start that deserves a swift conclusion or to persist in the Middle East by continuing to bring the Global War on Terror to the enemy's territory.

However one feels about the justification for the war, its costs play a role in making this decision. The importance of this question means that those who do the work of accounting for the conflict's fiscal and economic effects must treat the public with respect and prepare their analyses with the highest professional standards fully in view.

The Heritage Foundation is a public policy, research, and educational organization operating under Section 501(C)(3). It is privately supported, and receives no funds from any government at any level, nor does it perform any government or other contract work.

The Heritage Foundation is the most broadly supported think tank in the United States. During 2007, it had nearly 330,000 individual, foundation, and corporate supporters representing every state in the U.S. Its 2007 income came from the following sources:

Individuals	46%
Foundations	22%
Corporations	3%
Investment Income	28%
Publication Sales and Other	0%

The top five corporate givers provided The Heritage Foundation with 1.8% of its 2007 income. The Heritage Foundation's books are audited annually by the national accounting firm of McGladrey & Pullen. A list of major donors is available from The Heritage Foundation upon request.

Members of The Heritage Foundation staff testify as individuals discussing their own independent research. The views expressed are their own, and do not reflect an institutional position for The Heritage Foundation or its board of trustees.