

## Chapter 6

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# Hidden Wounds and Accounting Tricks

## Disguising the True Costs

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All public policy choices—including war making—involve a tradeoff of costs and benefits. It may be impossible to place a price on the expected benefits—such as “democracy” and “freedom.” But costs can be estimated and quantified.

Those willing to undertake a war are always those who are most optimistic about the benefits and most likely to underestimate true costs. Accordingly, one should always subject the claims of war advocates to severe scrutiny, forcing them to lay out different scenarios, with probabilities associated with each. Only that will give a sense of how high the costs could be. In the case of Iraq, not only did its advocates underestimate the true costs, but they have

attempted to keep down the apparent costs of the war in order to make it more politically palatable. In doing so, they may have increased the real costs.

In January 2006 we estimated the total costs of the war at \$1 trillion to \$2 trillion. We argued that those estimates were conservative, and subsequent events have supported those claims: costs have continued to increase far faster than we projected. We now estimate that the total cost of the conflict will exceed \$3 trillion.

Here we review the lessons of the Iraq war that relate to the economic and financial costs and how we account for them. Some of those lessons are standard lessons of economics that have been ignored in the important area of defense economics. Some of the lessons are old lessons of war. And some of the lessons are new lessons to be learned from the tragic experience in Iraq.

### Lesson 1: The True Cost of the War in Both Blood and Treasure Must Not Be Hidden from View

By fighting the war with an all-volunteer army bolstered by thousands of contractors, the administration has been able to make the cost in blood seem like a financial cost—how much soldiers and contractors are paid. And then by borrowing the money to wage it, the United States has been able to hide this financial cost—which is deferred and passed on to the next generation.

The Iraq war has, in a sense, been financed entirely by borrowing. Taxes have not been raised to pay for it—in fact, taxes on the rich have actually fallen. Deficit spending gives the illusion that the laws of economics can be repealed and that there are no economic trade-offs—that we can have both guns and butter. Of course, the laws of economics have not been repealed. The costs of the war are just postponed, possibly to another generation.

Much of the discussion in the remainder of this chapter is directed at understanding the techniques by which this is done, the motives for doing so, and the consequences. It is hoped that these understandings will reduce the scope for the deliberate manipulation of information concerning the anticipated and ongoing costs of war.

### Lesson 2: Volunteer Armies in Societies with High Levels of Inequality May Be Especially Conducive to Undertaking Risky Wars

When those fighting in the military do not come from the decision-making elites of society, the costs of any conflict may not be fully understood and

fully taken into account when decisions are made. One might be able to rationalize such behavior by saying that the individuals chose to serve in the armed forces. But frequently the young men and women did not fully understand the nature of the contracts into which they were entering; many, if not most, did not understand that their deployments could be extended involuntarily.<sup>1</sup> That is especially true in the case of those in the National Guard, few of whom believed they would become frontline troops in a foreign war. If the private sector engaged in similar recruiting activities, they might be called to account for deceptive practices. At the very minimum, so long as we continue to maintain a voluntary army, those signing up should be made fully aware of all the risks (including the risk of not being able to leave the military at the time specified by the contract).

### Lesson 3: The Costs of War Continue Long After Combat Has Ceased, but These Costs Are Hidden by the Government's "Cash" Accounting System

In most areas of public policy, actions taken today have costs and benefits that last long into the future. The decision to go to war is no different. It entails a commitment not only to pay the daily costs of battlefield operations but to provide long-term medical and disability care to wounded soldiers; to replace depleted military equipment; and to recruit, equip, and train a large number of new soldiers to replace soldiers and officers lost by the military as a result of death, injury, or decisions not to reenlist.

Because of the way the U.S. government reports expenditures, the costs of the war as reported are extremely misleading. The government uses "cash" accounting—a method that recognizes only the expenditures actually spent each year. By contrast, all publicly traded companies—no matter how small—must use "accrual" accounting. Under these rules, costs already incurred but not yet paid must be reported. For example, a business that promises to pay a fixed pension to its workers has to report that liability in its accounts. In addition, accrual accounting requires that capital equipment (computers, vehicles, buildings) be depreciated over its economic life.

In the Iraq war, there are two large accrued liabilities in the form of health care costs and future disability payments to veterans. These two items—in today's dollars—mean an additional \$300 to \$550 billion, depending on how long the war lasts and how many veterans claim the benefits to which they are entitled. In other words, this hidden cost could well equal the total reported cost of combat operations to date.

In addition, fierce combat operations have dramatically reduced the economic life of military equipment. In an accrual accounting system, the auditors would insist on a large increase in depreciation costs as planes, tanks, helicopters, and so forth are rapidly worn out and written off. And even that might underestimate the true cost if new military hardware is more expensive than the old. But none of these costs appear in the government's accounts until the bills are actually paid.

It is also becoming apparent that the length and ferocity of the Iraq war will require a substantial expenditure to "reset" the military in the form of recruiting, training, and restoring full military strength and morale to a force worn down by prolonged deployments. A prolonged and expensive exercise of this type was necessary after Vietnam.

All these costs are large and very real. There is no chance the government will refuse care for veterans, at least officially, or decline to replace worn-out helicopters. But in the cash-based accounting system, they simply don't show up yet. The result is that the total budgetary costs of the war are completely underestimated. The public and Congress often seem to be basing their cost-benefit calculations on the widely reported amount of \$500 billion. But this figure reflects just the running costs of the war. The true budgetary costs—costs that the government has already accrued but not yet paid—are more than double and possibly triple that amount. They are presented in Table 6.1.

### Lesson 4: Even the Ongoing Costs of War Have Been Chronically Underestimated

Before the Iraq war started, then Defense Secretary Donald Rumsfeld predicted that the war would cost \$60 billion. In a taped interview he dismissed as "baloney" an estimate by Lawrence Lindsay, head of the National Economic Council, that it might total \$200 billion.<sup>2</sup> Deputy Secretary Paul Wolfowitz even went so far as to suggest that the postwar reconstruction would pay for itself through increased oil revenues.

Not only were the original estimates incorrect, but throughout the conflict, the Pentagon has failed to anticipate the continual increase in the monthly cost. The cash cost directly attributable to the war alone has risen from \$4.4 billion per month in 2003 to nearly \$12 billion per month by 2007.

One difficulty in estimation is that many costs do not rise in a linear fashion according to the number of troops. The worsening security situation means it now costs more to renew contracts with private contractors,

**Table 6.1. Budgetary Only Cost of Operations Iraqi Freedom (OIF) and Enduring Freedom (OEF) (not including economic costs or cost of interest on debt<sup>a</sup>)**

Budgetary Item	U.S. \$ billion
Spent to date (combat operations)	605
Excess increase in defense budget to date <sup>b</sup>	108
Total spent to date	713
Estimated long-term costs:	
Future running costs (including surge) <sup>c</sup>	677
Veterans disability costs <sup>d</sup>	117
Veterans medical costs <sup>e</sup>	260
Veterans Social Security Disability pay <sup>f</sup>	35
Military equipment replenishment <sup>g</sup>	67
Military reset costs <sup>h</sup>	89
Total Budgetary Only Cost Estimate	2.0 Trillion

a. Interest on the debt is estimated to cost an additional \$200 to \$600 billion, depending on borrowing rates and repayment schedule. These costs are considered "transfer payments" and therefore typically are not included in economic estimates, though they represent another cash cost that the U.S. government must pay out of its annual budget.

b. Since 2002, the Defense budget that is not directly related to OIF/OEF has risen by a cumulative amount of \$325 billion. Comparing this to the rate of annual increase over the preceding two decades, we would have expected this increase to be only \$217 billion. We estimate that this additional increase of \$108 billion is attributable to costs that are indirectly related to the war operations, including the cost of additional recruiters, recruiting advertising and development, additional procurement, training, support operations, contracting personnel, and other costs. We have not included further projections for this cost. As just one example, the war has made it much more difficult for the military to recruit, forcing it to pay large bonuses.

c. Future running costs based on continued U.S. presence in the Iraq theater through 2010 (minimum) and 2015 (maximum), using CBO projections for troop deployment levels, including the minimum surge in troops of 6 months. Note that some recent discussions have talked about the possibility of a permanent presence in Iraq, along the lines of that in Korea. The upper bound on the costs could thus be substantially higher than the costs in Table 6.1.

d. Bilmes, Linda, "Soldiers Returning from Iraq and Afghanistan: The Long-term Cost of Providing Veterans Disability and Medical Care," Kennedy School of Government Working Paper, January 2007.

e. *Ibid.*, minimum cost adjusted for CBO estimates that average cost of treatment per veteran equals \$2600/per annum, based on 2006 VA budget submission.

f. Estimate based on 12,219 soldiers listed by DOD as "wounded, not returned," who are likely eligible for Social Security Disability pay in addition to disability benefits from the Veterans Benefits Administration; using an average benefit of \$900 per month, and assuming that 50% of those eligible eventually apply.

g. Cost of replacing military hardware and equipment that is being used up at an average of 6 times the peacetime rate; and depreciation of stock; including replacement of \$24 billion worth of National Guard equipment.

h. This refers to the costs of returning the military forces to their pre-war strength, including demobilization costs, additional training costs, re-equipping mobile ready stocks, and cost of retraining and replenishing prewar strength of Reserves and National Guards.

who face increased security costs and must pay their workers higher wages to compensate for the increased danger. In addition, an increasing reliance on Reservists and the National Guard (who now make up some 40 percent of the forces in Iraq and Afghanistan) pushes up direct costs: for example, the government must pay reservists a full-time annual wage, combat pay, and bonuses, instead of paying for one weekend per month. (Using them as soldiers in these theaters also increases the indirect costs to the economy, because reservists are no longer available to their employers to perform their regular civilian jobs.)

This chronic underestimation has continued throughout this war. In January 2007, the administration estimated that it would cost \$5.6 billion to deploy an additional 21,000 troops for the proposed "surge" in troop levels. But this estimate referred only to the cost of deploying combat troops for four months. According to an April 2007 study by the nonpartisan Congressional Budget Office (CBO), the surge would also require deployment of 15,000–28,000 combat support troops, which would raise the cost to at least \$11 billion (for four months). The costs would rise to \$27 to \$49 billion if the surge continued for twelve to twenty-four months as it has now.<sup>3</sup> Even that CBO estimate did not take into account any of the long-term costs for veterans and replacement equipment described above. Nor did it include the implications of the surge (which CBO pointed out in a separate report)—the reduced availability of U.S. troop brigades for other potential conflicts for a period well beyond the actual deployment.<sup>4</sup>

### Lesson 5: When the War Is Unpopular, There Is an Incentive to Use Budgetary Tricks to Hide the Total Cost

The administration has employed a number of tactics to avoid accountability and shield war costs from proper congressional oversight. The first has been the unprecedented use of "emergency supplemental" budget authority to provide funding for the ongoing operations of the war. This authority exists in order to provide funding for unforeseen emergencies (i.e., Hurricane Katrina) or new programs enacted during the fiscal year. Therefore, the only appropriate use of emergency funding would have been the original legislation authorizing the war in 2003.<sup>5</sup>

But the administration proposed, and Congress approved (almost unanimously), a series of eleven subsequent supplemental appropriations between the years of 2003 and 2006, totaling some \$479 billion in funding for Operations Iraqi Freedom, Enduring Freedom, and Noble Eagle.<sup>6</sup>

This method of funding had several negative effects. First, it enabled the United States to hide the cost of the war, because the funds did not compete head-on with regular appropriations for other governmental functions. Had the administration been forced to include the \$89 billion per year in regular appropriations, the costs would have been more transparent, and the trade-offs obvious: it would be clear that if taxes were not raised or other expenditures cut, the deficit would have soared even higher.

More importantly, using the emergency funding route allowed the administration to submit hastily assembled funding requests instead of following the annual budget process. The result was that the very people within the government whose job it is to analyze budget requests—budget analysts in the Office of Management and Budget, as well as congressional budget analysts—were prevented from doing so. Their lack of involvement in the budgetary process for the war was one of the factors that led to cost overruns in contractor operations, overpayments to Halliburton, and confusion over funding.<sup>7</sup>

A second important budgetary “trick” has been to shift some of the costs from “war” to general military appropriations. Between 2002 and 2007, the military budget outside of expenditures for Iraq and Afghanistan has increased by \$325 billion. Of this amount, about \$115 billion, or one-third of the total, cannot be attributed to ordinary increases in personnel, procurement, and inflation or otherwise attributed directly to the war on terrorism. The U.S. government is not spending substantially more money on developing new weapons systems. Overall defense spending since the beginning of the war has increased much faster than would be predicted by its average annual increase over the past thirty years. Arguably, most of this increase in spending is related in one way or another to the wars in Iraq and Afghanistan.

A third technique has been to defer spending on maintenance and replacement of equipment until after the war is over. This lowers the apparent cost of the war, and allows costs to be deferred and shifted into the general defense budget. An example is the situation facing the Air Force fleet, which is older than ever and wearing out faster because of heavy use in Iraq and Afghanistan. The Air Force now spends 87 percent more on maintenance for a fleet of warplanes than it did ten years ago, due to a larger number of missions, harsh flying conditions, and the age of the planes (twenty-four years old, compared with twenty-one years old in 2001).<sup>8</sup> The Air Force is seeking to purchase new aircraft to lower the average age of its fleet to fifteen years, at a cost of some \$400 billion over the next two decades. But this long-term cost of the war is disguised as ordinary military replenishment.

## Lesson 6: The Use of Contractors Disguises the True Number of Military Assigned to the War Theater

The use of contractors drives up short-term costs, since contractors are frequently paid more than military personnel.<sup>9</sup> Why do it? First and most important, using contractors makes it possible to hold down the headline number of troops deployed in the field. Second, the military is already struggling to keep up with its recruitment goals and is being obliged to spend considerably more (in the form of signing bonuses and incentives) to attract and retain soldiers. Third, contractors have no entitlement to long-term medical and disability benefits from the government. Finally, the use of private contractors may increase the constituency for war by expanding the number of people who benefit from it.

There are good reasons that countries do not privatize their military. The general theory of privatization outlines the conditions under which privatization of a traditionally provided public service is desirable.<sup>10</sup> It makes sense for governments to privatize steel mills; it may even make sense to privatize natural monopolies like electricity or gas, provided adequate regulatory frameworks are put into place. It does not make sense to privatize the military.

Part of the argument for privatization is that it encourages customer responsiveness. The makers of steel can enhance their profits by producing steel products that are more to the liking of their customers, of higher quality and greater reliability. But those who interact with the military contractors typically do not do so voluntarily; there is no market where they can choose to be interrogated by a contractor from the United States or by some other provider. Indeed, the incentives are perverse. The incentives of the contractor are to minimize costs, and those incentives do not take into account the broad range of public objectives of the United States.

To cite one obvious example: in the aftermath of the war, the United States had a strong incentive to restore the economy of Iraq, which entailed creating jobs as rapidly as possible. Young, unemployed, armed men can be (literally) explosive. The U.S. government should have done everything possible to ensure that Iraqis had a direct economic interest in the success of the occupation and that they were convinced it would be successful. But the contractors' interests were in minimizing costs. Thus if Nepalese workers were cheaper than Iraqi workers, Nepalese workers were hired. Not only did that engender resentment (especially when it was believed that at least some of those practices were being paid for by Iraqi oil money), but also spending money on those from outside the country did not create the multiplier effects that could have helped engender growth.

## Lesson 7: The Attempt to Keep Budget Costs in Check May Simply Lead to a Substantial Increase in the Discrepancy Between Budgetary and Social Costs

Budgetary costs represent only part of the total costs of war to society.

Consider, for example, a veteran who is 100 percent disabled. He or she will receive about \$44,000 in annual benefits from the Veterans Administration (VA), and additional benefits of perhaps \$15,000 to \$25,000 from Social Security disability pay.<sup>11</sup> But that does not take into account the often substantial health care costs borne by the individual and his family in caring for him; nor does it fully compensate for pain and suffering for the veteran and his family or the loss of economic value caused by the disability.

In this war, the military compensates families of the deceased by paying \$500,000, including a “death gratuity” and payments from a life insurance policy. But these death benefits are but a fraction of even a narrowly defined economic value of life. In other situations, such as environmental and workplace accidents, the U.S. government estimates that value at more than \$6 million. Compensation is typically far greater when the individual is injured or killed in an ordinary automobile accident or an accident in the private workplace.

Other social costs include the difference in pay between what reservists and National Guard earn in the military and in their ordinary jobs. Although some studies have shown that some individuals earn higher wages in the military, these studies often do not include the full range of economic benefits that accrue to a worker participating in gainful employment in his or her community and almost certainly do not include the loss in first-responder capability to that community caused by deploying the person to Iraq.

The distinction between budgetary and overall costs is not only conceptually important but also quantitatively significant. At the time of our 2006 study, we estimated that the difference represented an additional \$187 billion to \$305 billion in costs to society.

Although ordinarily departments struggle to expand their budgets, in wartime, the Department of Defense may attempt to shift costs to other departments, which obfuscates the overall costs of war. And all government agencies, facing budget restrictions, try to shift costs to later administrations and to the public. For example, if the VA has not planned for the number of returning soldiers who require health care, the cost of additional personnel is borne by the VA, but the personal cost of waiting in a line for hours, facing delays, and traveling hundreds of miles to seek medical care is borne by individuals in society.

## Lesson 8: War Can Have Major Macroeconomic Consequences

World War II, which was widely given credit for having helped the world emerge from the global Depression, led to a widespread view that wars are good for the economy because of the economic stimulus they provide. But there are always ways of providing such a stimulus with better social and long-term economic benefits. Wars should never be justified solely on the basis of their positive economic effects.

No matter what efforts are made to minimize their domestic impact, wars have a large number of potential ramifications. And there are always great uncertainties, which can dampen the economy. The Iraq war posed substantial risks of an increase in the price of oil, given the importance of the Middle East in the supply of oil, the risk of a breakout of civil strife in Iraq, and the risk of a disturbance in one part of the Middle East spreading elsewhere.

Those favoring the war had argued that it was the best way to secure long-term low prices for oil, but they did not plan for a scenario in which instability in the Middle East would deter further investments in the Middle East. Meanwhile, the possibility that peace might break out in the Middle East—leading to prices substantially below current prices—helps explain the lack of substantial investment in medium-cost alternatives (like shale oil and tar sands), at least in the short run. Moreover, the supply curve of oil sometimes exhibits a perverse backward bending shape, as other suppliers (especially governments) feel less compelled to expand production to meet their budgetary needs. These two factors help account for the large increase in the price of oil. Even if we attribute only \$5 to \$10 of the increase in oil prices to the war, we estimate the cost to the U.S. economy resulting from this increase is \$125 to \$450 billion.<sup>12</sup> One might argue that these costs are just redistributive gains to the oil-producing countries at the expense of the oil-using countries. But that is not quite correct: it would have been far more efficient, from a global perspective, to extract oil from the part of the world that has the lowest extraction cost, the Middle East. The war has had a major impact on global economic efficiency.

Wars can, in fact, have significant negative macroeconomic effects relative to any reasonable counterfactual of how the money might otherwise have been spent: When the economy suffers from a deficiency in aggregate demand, the short-term adverse effects arise from two major sources: (1) War expenditures may have lower multipliers than other forms of expenditures; much of the money spent on waging a war ends up literally in the ground, whereas money spent on building schools, roads, and infrastructure

leads to long-term growth and (2) war introduces a wide range of uncertainties, such as the future price of oil; markets dislike uncertainty—and that depresses investment. Wars may also impose a temporary but costly distortion in the allocation of resources, for example, from shifting production into the production of military hardware and finding more labor overseas.<sup>13</sup>

### Lesson 9: Pretending There Are No Macroeconomic Consequences Can Itself Have Major Macroeconomic Consequences

President Lyndon Johnson, like President George W. Bush, wanted to have guns and butter. The result was that inflationary pressures built up; the cost of wringing this inflationary impulse out of the economy was huge. President Bush has been fortunate that at the time the United States went to war, the economy was operating below its potential. Moreover, globalization enables economies to expand consumption without inflation by buying goods abroad, and the United States has been doing that aplenty. Our fiscal deficit has contributed to its trade deficit; its trade deficit means that the United States has become more indebted. The interest on the borrowing looms as a major budgetary cost in years ahead. Increased indebtedness means that the U.S. standard of living will be lower in years ahead than it otherwise would have been, as Americans “ship” goods abroad to repay what they owe.

The question is, have we already counted these costs when we counted the expenditures directly? Is it double counting to count the interest? That is an important technical issue of some complexity. In part, it can be put simply as follows: Is the shadow (or social) price of a dollar to the government greater than 1? Since raising a dollar of tax revenue costs more than a dollar (there is a deadweight loss), the presumption is that a dollar of budgetary expenditures is worth more than a dollar of ordinary consumption. This is reflected, for instance, in the high returns to government investments in research and development. As war costs increased, the government was forced to cut back a variety of expenditures in other areas, including research. These expenditures would (most likely, and on average) have yielded high returns, and hence future gross domestic product is lowered by more than an amount that reflects the interest costs alone.

This is an example of the complexity of cost accounting in second-best economics, when there are distortions. But these second-best considerations can give rise to first-order effects. It would be wrong to ignore these costs.

And, of course, the costs will be larger if we don't recognize them, so that we can take actions to mitigate them, as the Vietnam War under President Johnson illustrates.

### Lesson 10: Those Undertaking a War Face a Well-Known Risk of Extending Commitments When They Should Be Cutting Their Losses

The phenomenon is known as the risk of escalating commitment, and it has several root causes. Economists emphasize that rational decision making should treat “by-gones as by-gones,” or as they put it, sunk costs are sunk, not to be recovered. The standard aphorism puts it: don't let good money chase after bad.

The problem is particularly severe because of asymmetries in loss functions and because those making the decisions do not fully bear the consequences of their mistakes. The probability of salvaging the war in Iraq may be small, but leaders may undertake a strategy with a low probability of military success because the potential gain from saving their reputation is large (whereas if they fail, their reputation will not be much lowered). They do not bear the brunt of the costs (either the economic costs or the costs in lives).

### Lesson 11: The Mistaken Calculations in This War Are Perhaps Greater Than in Previous Ones, Due to a Misunderstanding of Modern Warfare

First, the administration assumed a “partial equilibrium model,” which did not take into account the fact that the supply of those fighting the United States was endogenous.<sup>14</sup> With a fixed supply, killing one enemy reduces the number of enemy soldiers by one. With an elastic supply, killing one enemy could actually increase the number of enemy soldiers. There is a general consensus now that U.S. actions led to an increase in the supply of insurgents.

By using models of behavioral responses that were inappropriate for the situation, the U.S. government miscalculated the consequences of actions and costs. The Bush administration expected that a U.S. presence in Iraq would create incentives for Iraqis to support U.S. efforts, but the presence of American soldiers changed the environment in ways that drove many Iraqis to oppose the United States.

In a rational model, individuals look at their life chances joining the insurgency or supporting the government. That in turn is affected by perceptions of the likely winner and what a “victory” might look like. When the occupation failed to quickly restore the economy, confidence in the occupation’s likely success was lowered. As its failure to restore law and order extended, confidence further eroded. Creating large numbers of unemployed men and not taking actions that would have forestalled access to weapons strengthened the insurgency and made it more effective. Excluding former Baathists from jobs (or even good jobs) meant that these individuals had an incentive not to support a successful new government, but rather to support the insurgency. The larger the number of individuals in the insurgency, the higher the probability of its success, and the more likely it will be successful in attracting new recruits.

In any war, there is “collateral damage”—the loss of life and property of innocent bystanders. But the volume of such accidents in Iraq (and increasingly in Afghanistan) has influenced many Iraqis to believe that the United States places a lower value on their lives than it does on American lives. It is easy for the opposition to exploit such perceptions—making it easier for the insurgents to gain members. This general argument is reinforced by the fact that the United States keeps a detailed account of the lives lost among U.S. troops, but it has not acknowledged the best scientific studies of civilian deaths among Iraqi civilians.<sup>15</sup>

These arguments are reinforced by the failure of judicial procedures. If good individuals are treated badly (e.g., tortured), then there is little incentive to be good. One risks being tortured whether one supports the insurgency or not. What may matter is the differential accuracy of the “judicial” system. If they punish only those who are complicitous with the occupation, and Americans punish many who are not complicitous with the insurgency, individuals have an incentive to join the insurgency. (Americans mistakenly thought that punishing those who supported the insurgency would discourage individuals from joining the insurgency, but what matters is both our punishment and their punishment and, most importantly, the accuracy with which punishments are levied.)

There may be a tipping point, such that when that threshold (measured, say, in terms of fraction of the population in the insurgency) is crossed, the equilibrium to which the society converges is not the one in which groups coexist peacefully within a single country.<sup>16</sup>

These conclusions are strengthened once one takes into account certain other “nonrational” behavioral responses. The fact that individuals are willing to commit suicide means that the usual kinds of deterrence (threats) may not only be less effective, but may be counterproductive.<sup>17</sup>

The administration seems to have misunderstood modern warfare in yet another way, by anthropomorphizing the Iraqi government, treating it as if it were a single rational individual. The United States set deadlines and timetables and threatened to withdraw unless Iraq met them. The United States believed that such threats would provide clear incentives for the Iraqi government to act in a concerted way. But the Iraqi government is not monolithic: There were almost surely members of the Iraqi government who wanted the government to fail. If they believed that the United States would carry out its threat, it provided them with increased incentives to engage in delaying tactics. To the extent that the U.S. policies coincided with the interests of one group or another (or were perceived in that way), it would almost inevitably be the case that some group believed that they could cut a better deal if the United States left.

The only reason that such hard talk did not have a more adverse effect was that such threats were not fully credible. Given the problems of escalating commitment, there were good reasons to believe that the administration would not carry out its threats. And because it has demonstrated its ability to resist even enormous electoral pressure, that conviction may be growing. As in Vietnam, the battle to get American troops out becomes one of persuading the electorate that it is too costly to stay. At least some of the groups within Iraq thus have an incentive to escalate the tensions.

### Lesson 12: War Can Bring About Large Changes in the Distribution of Global Income, and These Changes Can Themselves Have Significant Consequences

War, like any other major economic policy, has distributional consequences: There are winners and losers. Within the United States, the two major winners are defense contractors and the oil industry. Globally, the increase in the incomes of oil-producing countries—disproportionately undemocratic governments with high degrees of instability—has contributed to global political and strategic instability.

### Conclusion

Had the war brought stability to and enhanced economic growth in the region, its defenders would contrast the cost of the war with those economic benefits. If the war had brought about a wave of democratic regimes, its defenders could arguably set those political benefits against the economic

costs. As it is, the war has brought increased economic and political instability, which has resulted in reduced growth, sectarian violence, lawlessness, rising abductions, and a deteriorating standard of living for millions of people.

More than 4 million Iraqis have fled their homes since the U.S.-led invasion in 2003, with at least 2 million people estimated to have crossed the border in Syria and elsewhere and 2 million more who are displaced within Iraq and seeking to get out.<sup>18</sup> They include many educated families desperately seeking to earn a livelihood. How do you measure the loss of well-being of so many innocent people? In short, there are many effects of the war that we have not brought into the calculations; we believe that those other effects would increase the total cost even further. But however one brings these various costs and purported benefits into the calculus, it is still the case that both Congress and the public need a more accurate estimate of the true costs of the war than is provided by the administration or is reflected in the government's conventional accounting practices.

There will always be considerable uncertainty about the costs of a war, but the U.S. government has systematically underestimated the cost of the Iraq war. The errors are not just random. We have explored the systematic procedures by which the costs of the war, both in treasure and in lives, both to the budget and to the overall economy, can be—and have been—hidden from the public. Those who would take us into the next war should not be allowed to repeat them.

## Notes

1. More than 20,000 U.S. troops have had their deployments extended involuntarily by the use of “stop-loss” policies. More than one-third of the total active fighting force has been ordered to serve second or third deployments. Additionally, reservists are being called up involuntarily. More than 5,000 Army reservists and 2,000 Marine reservists have been ordered back involuntarily since the war began.

2. This interview was shown on the *NewsHour with Jim Lehrer*, May 23, 2007.

3. Letter from CBO director Peter Orszag to Congressman John Spratt, February 1, 2007.

4. “Some Implications of Increasing U.S. Forces in Iraq,” CBO, April 2007.

5. Or expenditures that went beyond levels that could reasonably have been anticipated.

6. Operation Noble Eagle refers to construction of military bases and security enhancement for existing military and governmental installations. It accounts for less than 5 percent of the appropriations to date.

7. For example, the Congressional Research Service has repeatedly complained that it cannot track where funds are being obligated, and has specifically cited \$7 billion in funds that were apparently spent for the war in 2003, even though Congress never authorized this spending (CRS, Amy Belasco, 2005, 2006).

8. General Ronald Keys, head of Air Combat Command, quoted in *Air Force Times*, at a speech at Langley Air Base, Virginia, May 8, 2007.

9. Contractors' wages are typically higher in immediate salaries, but lower in terms of long-term benefits such as disability pay, medical care, and pensions. This increases the short-term cost of the war but may decrease long-term costs compared to those for active-duty forces. However, in many occupations, the military is having to match contractor salary levels in the short term in addition to providing long-term benefits.

10. See David Sappington and J. E. Stiglitz, “Privatization, Information and Incentives,” *Journal of Policy Analysis and Management*, 6, no. 4 (1987): 567–582.

11. Indeed, the Defense Department seldom takes into account the consequences of its actions for the budgets of other departments, such as the Social Security Administration or the Veterans Administration. Not providing adequate body armor may have saved the Department of Defense money, but it clearly increased VA costs for disability and health. None of this is surprising: government agencies often focus on their own costs, not the costs they impose either on the private sector or on other government agencies.

12. Oil prices were \$23 per barrel for several months prior to the U.S. invasion of Iraq in March 2003, and future markets did not anticipate any significant increases. For further discussion, see Bilmes and Stiglitz, *The Economic Costs of the Iraq War: An Appraisal Three Years After the Beginning of the Conflict*, NBER Working Paper, February 2006.

13. Greenwald and Stiglitz have argued, for instance, that the global economy suffered *both* when the price of oil soared in the early 1970s and when the price of oil plummeted in the 1980s. The reason has to do with complex consequences of large shifts in the distribution of income and wealth generated by such large price changes.

14. In partial equilibrium models, the behavior of others (e.g., other firms) is taken as given, unaffected by the action of the firm in question.

15. The British medical journal *Lancet* has published two studies of “excess” deaths of Iraqis (that is, deaths at rates beyond that prevailing before the war) based on statistical techniques. The most recent provides evidence that such deaths exceed half a million. President Bush has only cited studies that offer far lower estimates, in the range of 40,000.

16. Many policies may have served to increase the number of insurgents and their effectiveness, and as that occurred, it increased perceptions of the likeli-



hood of success of the insurgency, reinforcing its success. Among the policies contributing to this outcome were the flawed “judicial” proceedings; the lack of adequate care in avoiding collateral damage; the failure to prevent caches of arms from getting into the hands of insurgents; the de-Baathification program; and the failure to manage the reconstruction in ways that repaired the infrastructure quickly, reduced unemployment, or promoted growth.

17. Rational “game theoretic” models underlay the deterrence strategies of the cold war. It is clear that, for the most part, such models are of little relevance in a world in which one party believes in the virtues of sacrificing his or her life.

18. “Iraqi Refugees in the Syrian Arab Republic: A Field-Based Snapshot,” Ashraf al-Khaklidi, Sophia Hoffman, and Victor Tanner, Brookings-Bern Project Occasional Paper, Brookings Institution, June 11, 2007.