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The True Cost of the War in Iraq: Implications for the Global Economy

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Chair: Dr John Llewellyn, Senior Economic Policy Advisor, Lehman Brothers and Council Member, Chatham House

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John Llewellyn:

It is my great pleasure to introduce today's speaker, Joseph Stiglitz. Joe has had, as most of you will know, a long and distinguished career as an economist. Joe is currently University Professor at Columbia Business School. From 1970 to 2000 he was Chief Economist and Senior-Vice President at the World Bank. In 2001 he was awarded the Nobel Prize in Economics. But those are just three little extracts from what has already been a most impressive career and I would direct those of you who would like to know more about Joe's fascinating career to date to his autobiography on the Nobel Prize website, nobelprize.org.

Joe is also a most prolific writer and his most recent book is *The Three Trillion Dollar War: The True Cost of the War in Iraq*. It is on that subject that he is going to speak to us today and it is on sale here in the building today.

Joseph Stiglitz:

Thank you very much for this opportunity to talk to you about this book.

When the Bush Administration went to war in Iraq, it did not focus very much obviously on the cost. Larry Lindsey, the chief economic advisor, said that the cost was going to be between $100 billion and $200 billion and for that slight moment of quasi-honesty he was fired. Rumsfeld responded and said: Baloney. The number that the Administration came out with was $50 billion to $60 billion.

In this book we calculate that the cost is more like $3 trillion. It is a big discrepancy – the same kind of discrepancy as here in Britain. The Blair government put aside about 1 billion pounds; we estimate that the cost to the UK is at least 20 billion pounds. A smaller order of magnitude of mistake than in the United States but still a big difference.

I began working on this project in a research paper for the American Economics Association and Economists for Peace and Security as an exercise in the economics of the public sector. We knew that budgetary numbers often differ from true overall economic costs and I wanted to know what the true economic costs were. As it turned out, the project became a kind of investigative journalism, sleuth/detective work that made it far more interesting. When we were writing the book we worried if anybody would be interested in reading a book of accounting and as it turns out there are an awful lot of things that we discovered in the process that really says a great deal about government. At the end we talk about some reform issues, issues of how we exit from this mess, that I think address a broader range of issues.

Just to give you a couple of examples, we had to on a number of occasions resort to the Freedom of Information Act to get the information that we needed. On a website the government talks about the number of people who have been injured in the war. It turns out that the true number of those injured is over twice the number they admit to and we used the Freedom of Information Act to find out that the ratio of injuries to fatalities, which in a normal war is about 2:1, in this war they admitted to 7:1 but the true number is about 15:1. That is part of why this war is going to be so costly. The upfront costs have turned out to be much higher than $50 billion; it turns out we are now spending every three months $50 billion. But the downstream costs in terms of disabilities and health care costs is going to be enormous.

We should have been aware of this because the short first Gulf War that lasted just thirty days, we thought was a war for free – that is to say, it was paid for by Kuwait and Saudi Arabia. It was not of course a war for free, because somebody else paid for it. It turned out not to be a war for free – that short war, the United States is now paying $4 billion a year in disability. Thirty-nine per cent of those who fought in that short war have become eligible for disability. We estimate that the number of those who are fighting, some 2 million who are fighting in this war, will wind up disabled. What we already know is that those who are applying for disability have many more disabilities than those in the previous war. The previous war averaged 3 to 1; here we are talking about 3 to 5 disabilities each.

As we went through the calculations we deliberately were very conservative. At the time we wrote our first paper in January 2006, the number that the government owned up to had increased tenfold from $50 billion to around $500 billion. But our estimate at the time was between $1 trillion and $2 trillion. But one of the tasks when you face numbers that large is: how can you make them credible? So we did not want a dispute about nitpicking over one number or another, so as we went through each of the items we were consistently very conservative. The same thing is true in these numbers. When we say $3 trillion – that is a very conservative number. The true costs are likely to be much larger than that.

Let me very quickly go through how you come up with a number like this – some of the arithmetic. The way you build up an analysis of this kind is to go through systematically the various kinds of costs and add them up. It is actually conceptually not that difficult.

The first are the direct operation costs, the costs that are already running at $12 billion a month for Iraq and another $4 billion for Afghanistan.

Then there are the costs that are hidden elsewhere in the Defense Department budget. Since the beginning of the war cumulatively the Defense Department expenditures have gone up $500 billion. It is not like there has been any new enemy. We are spending a little bit for the war on terrorism in terms of ports and things like that but it is a miniscule amount. So the question is, where is the money going? Some of it is going for weapons that do not work against enemies that do not exist – we know that. Another way of putting it is corporate welfare for defence contractors. That is part of it. But part of it is clearly related to the war itself. We have asked the same small group of people to do all the fighting. We have not had a draft. Those in the Army thought they signed up for a three-year tour of duty and are told: no, you did not read the fine print. If a private employer had put those things in the fine print he would be in jail, but the government had what they call stop-loss provisions – which is just a euphemism to say even though your contract is over you have to stay fighting. The people who signed up for the National Guard, who thought they were there for crises like Hurricane Katrina, were told: no, you thought you were going to be dealing with the National Guard; you are actually international fighters. So when Hurricane Katrina came they were not there to help out in that crisis.

The net effect of this is, not surprisingly, we have had to pay higher enlistment and reenlistment bonuses and raise salaries. Even doing that, we have only succeeded in fulfilling the enlistment targets by lowering standards. The fraction of people who are high school graduates has gone down; the fraction of people who are convicted felons and admitted into our Army has gone up. When you think about a war that is intended to win the hearts and minds of people, these are not necessarily the best-prepared people to win that particular war.

A little digression here. One of the things, as we were writing the book, that kept us going is that every few days we came across another scandal. Something would be unbelievable, and you would check it and say: it is still unbelievable. This is an example. We pay these enlistment bonuses, often to very poor people, for signing up for three years. What happens if in the first month of that three-year tour of duty they get blown up, injured, so they cannot go back to fighting? The US government demands they pay back the reenlistment bonus. After all, they signed up for three years and they only served one month. As I say, I had the same disbelief – but it is true. I could go on but that just illustrates the nature of why we are going to have a harder time going forward. Who wants to work for an employer like that? Those are some of the costs we will be paying for years to come.

So that is the second item: you look for military expenditures that are not labelled Iraq. Then of course there are the military expenditures going forward. We use various scenarios provided by the CBO and the Department of Defense. Those are the direct expenditures.

But a lot of what we are talking about are the other expenditures that have not been talked about. The most important of those expenditures are the expenditures, again in a military sense, for what is called the reset of the military. The fact is that equipment has been depreciating far faster than we have been replacing it – it is called deferred maintenance. One of the reasons that the cost of the war per month has gone up from $4 billion to $12 billion is that you can defer maintenance only for so long. At the beginning of the war they thought it was only going to be a few-years war and they passed the cost down to after the war. Now after five years you cannot do that anymore and so some of that deferred maintenance we are now paying, but there is still more and more deferred maintenance. So there is a huge cost of bills that will have to be paid to reset the Army.

Just to put this in perspective, 19 March marks the fifth anniversary of the war. It is now the second-longest war in America's history, after the Vietnam War, and the second most costly war in terms of the upfront operational cost, after World War II (obviously an all-encompassing war).

So that is first, future costs – the military costs, the costs of bringing equipment back, the demobilisation costs. But the most important future cost outside the military is the cost of disability, the health care costs I referred to earlier, that we estimate in excess of $600 billion. That is conservative. All the expectations are that it will be much greater. Already from the 700,000 plus veterans that have returned, over 260,000 have visited VA hospitals; 100,000 have been diagnosed with serious psychiatric problems; 52,000 are suffering from PTSD. So this has been a very hard war on those fighting.

We know that things are going to be getting worse because particularly in the psychological area those who serve two, three or four tours of duty are more than proportionately likely to wind up with serious psychological problems, and those with those two, three or four duties are not yet back. So we can anticipate much more serious problems down the line.

There are lots of costs that are outside of the Department of Defense and Veterans Affairs. The most important is Social Security, which is already in very difficult economic circumstances. It pays disability no matter how people get disabled. So this large number of people – 40% – coming back with disability will get Social Security benefits.

But it turns out – another surprising thing as we did the work – the cost of the war appears in lots of other departments. One of them, for instance, is the Labor Department. We have a law that the private contractors be insured for disability and death benefits. In this war, one of the reasons the costs are so high is we have used private contractors more than in any other war. We have semi-privatised the war. A private security guard, for instance, doing the same work as an Army sergeant gets paid $400,000 or more. Originally people said: but you do not have to pay the cost of disability. But it turns out that we require them to have insurance and since nobody will insure it, we pay for the insurance. But then it turns out that there is a little exclusion clause in the insurance policy that says: we do not cover injuries in hostile actions. In Iraq most of the injuries and deaths are hostile actions. So not only do we pay the insurance premium, we wind up paying the benefits as well. Again, it was one of those things that when I first read it, I could not believe it – but it is true.

So there is this first big chunk of budgetary costs and there are lots of other things that are hard to quantify that go beyond this. But then there is the second part, which is the costs to the economy that go beyond the budget. On Thursday there are hearings before the Joint Economic Committee, which I am testifying on in Washington, on these costs that go beyond the budget. There are both microeconomic costs and macroeconomic costs.

The microeconomic costs are pretty straightforward. Some of them are quantifiable, some of them are hard to quantify. For instance, disability pay usually is a fraction of what the individual would have earned had he been not injured. You can see that most clearly in the case of death benefits. If a soldier gets killed the budgetary cost is $500,000. If he had been killed in a random automobile accident, he would get far more than that. The government in fact has a standard way of valuing lives – it is very difficult to value a life. It is an unpleasant task. But the government winds up doing it all the time. We have a safety regulation, and the Bush Administration says this all the time: if you are going to have a safety regulation we want to know what the cost of the regulation is and the benefit. The benefit is the number of people whose lives are going to be saved, and you value those lives. Same thing for an environmental regulation. So it is part of what the government does all the time. They use something called the value of a statistical life. That value is $7 million to $8 million or a little bit more. The UK does it too and the numbers are actually a little bit larger in the UK.

The point is it is more than ten times the value that the soldier's family gets, which is $500,000. That represents a real cost to society, to the family. It is obviously a great underestimate. You cannot value a life but it is at least a lower bound to the economic costs to our society.

Among those families in which somebody is seriously injured, a recent study showed that in one out of five families somebody will have to give up a job to take care of the person. We are talking about people who have serious brain injuries, multiple amputees – they cannot take care of themselves. Somebody is going to have to take care of them. The best case, in many cases they have somebody in the family who can do it with a certain level of care but that means they have to give up a job. That is an economic cost.

So there are all these quantifiable economic costs and there are a whole set of other costs, the opportunity costs that we have not quantified. The consequences of not having the National Guard in New Orleans is just one example. The cost to the United States from the fact that it has become the least popular government in the world as a result of this war. So those numbers are in excess of $300 billion.

Finally there are the macroeconomic costs. In a way, I think a lot of our discussion today will be around that subject. Many people have said there have been two issues in the American campaign: the Iraq war and the economy, a weak economy probably going into recession. But what I have argued is that actually there is only one issue because one of the key reasons the American economy is weak is because of the Iraq war. There are several channels through which this happens.

The first is that the war has led to higher oil prices. At the time we went to war the price of oil was $23-25 a barrel and futures markets expected them to remain at that level. Futures markets understood that China and India were growing, there was a growth in global demand, but they also knew that there was a large reservoir of oil in the Middle East, the lowest-cost provider, and that is where they expected the supply response to come from – the supply response in response to the increased demand. What changed that equation was very simple: the Iraq war. It has made it very difficult to increase the supply in the Middle East. Now as most of you know the price of oil is over $100 a barrel.

To be conservative and to make sure we did not get criticised, we attributed in our $3 trillion number only $5-10 of the difference to the Iraq war. A reasonable number would be at least $35 and probably much more because it is the only big event that you can say happened between 2002-03 and now. Of course there was Hurricane Katrina, that was a little blip. There have been a few other things but the major event is the Iraq war. But as I say, in doing our $3 trillion calculus we only looked at $5-10 of that increase in oil.

Expenditures in Iraq do not stimulate the economy in the short run and do not provide the basis for long-run economic growth. If we spend money for somebody from Nepal to work in Iraq it does not stimulate the American economy in the same way as building a road in America or hiring a teacher in America. It certainly does not increase long-run productivity in the United States.

This war was financed totally by deficit financing, unlike any other war. Normally when countries go to war they talk about shared sacrifice. As America went to war we lowered the taxes for upper-income Americans. Really very strange behaviour in a context in which we already had a large deficit. The result of that is the deficit has grown. The national debt has grown by almost $1 trillion just because of the war and by 2017 we estimate it will rise by another $1 trillion. That is a lot of money.

These three factors have led to a depressing of the US economy today and weakening the US economy in the future. But as we wrote the book we faced a puzzle: why didn't the American economy seem weaker than it was? A lot of people in 2006-07 said the American economy looked pretty good – what are you complaining about? Well, what we argued was that while these factors were depressing the American economy, the Federal Reserve was flooding the American economy with liquidity, the regulators were looking the other way, money was being lent to anybody this side of a life support system. One of the major American banks, Citibank, which recently got in trouble, had a big ad: 'Qualified at Birth'. The fact that you were alive meant that you were qualified. Obviously some of these people were not qualified to repay the loan – they were qualified to take the money, that's easy.

The result of this was there was a housing bubble and a consumption boom. The savings rate in the United States the last couple years has gone to zero. My predecessor as Chairman of the Council of Economic Advisors once said, 'That which is not sustainable won't be sustained'. That is true. We were living on borrowed money and borrowed time. The main vehicle through which this was done was mortgage equity withdrawal. The worst of those were called sub-prime mortgages. In one year $950 billion were taken out of the mortgage market. People took money out of their house and most of that went into consumption. Just to put this in perspective, we are talking about a stimulus package of $125 billion to $150 billion but what was the real stimulus for the last three years have been these mortgage equity withdrawals on an order of magnitude of $950 billion. You can see it is going to be a hard push for that $150 billion to offset that $950 billion.

That particular game is over. I could go on for a long time about that game but the real important point is that the Fed and the regulators did what they thought they had to do. They were myopic. They said: the economy is weak, we have to keep it going and the way to keep it going, given the limited tools we have, is loose monetary policy and lax regulation. It worked – for a while. So the problems the American economy and eventually the world economy is going to face are because they were trying to hide the cost of the Iraq war. Now those bills are coming due.

We end the book with a discussion of a set of recommendations and an exit strategy. Let me very briefly talk about one of the recommendations and one aspect of the exit strategy.

The recommendations – some of them are obvious. You need full accrual-based accounting. We said we went to war for democracy but democracy is more than just periodic voting. It involves citizens being able to participate in the decisions that affect their lives. Meaningful participation means they have to know what big things like war cost. The Bush Administration tried to hide that cost from the American people. So in a sense they were undermining democracy at home as they allegedly were fighting for democracy abroad. That was one of the motivations for our wanting to write this book.

But you need to have comprehensive accounting because – my Nobel Prize was in the economics of information – information affects decisions. If you have information only about the short-run costs, you try to get those short-run costs down. That is what we did. We could have purchased equipment that would have saved lives in the short run but it would have cost us more in the short run. We will be paying more in the long run but that did not show up in the accounting. So it is important to have comprehensive, accrual-based accounting. Every business beyond a corner grocery store uses accrual accounting; we should be using accrual accounting.

But one of the important points is that war has become too easy for America. We spend one out of two dollars spent over the whole world on defence. It is not clear who we are defending ourselves against with that level of expenditure.

There was no doubt we would defeat their army but it is still not clear whether we can win the peace. So with the abolition of the draft, with the fact that we are paying for the war with borrowed money – Americans think this was a war for free but there is no war for free. At the very least America needs to impose a little bit of self-restraint by saying if we go to war we will at least pay for it. We will at least make the judgment that the war is worth our sacrificing the dollar cost of fighting that war.

On the issue of an exit, there is a lot of debate about what will happen when we leave. Some people say that when we leave there will be chaos. Some people believe that when we leave things will get better. Most Iraqis in the survey say they will get better. But without answering that – that is not the real issue when it comes to the decision about departure. Almost everyone except Senator McCain believes that we will eventually have to leave. He says we may have to be there for a hundred years. But if you take the view that you are going to leave then the issue is one of what economists call inter-temporal decision-making: do we leave now or do we leave later? If you ask it that way then the question is: what do you buy by delay and what do you pay by delay? Spending another two years will cost another half-trillion dollars. You have to make the case that spending another two years will make things that much better or that much less worse to be worth a half-trillion dollars. Unfortunately, none of the discussion about exit has been framed in these terms.

Thank you.