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## Uncovering the Costs of the Iraq War

FRED E. FOLDVARY<sup>1</sup>

### ABSTRACT

**A KEY BENEFIT OF STUDYING ECONOMICS IS TO BETTER SEE THE REALITY** beneath appearances. Two simple examples are often taught in economics courses. One is the difference between accounting profit and economic profit, the real gain being the economic profit, which subtracts from revenue not just the explicit costs recorded by accountants but the implicit opportunity costs of the owner's labor and asset yields. A second example is the difference between nominal and real interest rates, the latter being adjusted for inflation. Note that the adjective "economic" represents reality, in contrast to possibly deceptive reports and accounts.

Although we can dispute questions about the costs and benefits of war with respect to the moral, political, and security consequences, our viewpoints should be informed by the real economic costs. In their excellent book on the war in Iraq, Joseph Stiglitz and Linda Bilmes have done what economists are supposed to do: bring to light the economic reality. Regardless of one's assessment of the big questions, they provide us with the data and analysis of the war's real costs.

The three trillion dollars stated in the title is the cost only to the United States, excluding Iraq and the rest of the world. (Impacts abroad are discussed in a separate chapter.) The three trillion dollars figure calculates the direct spending on the war in Iraq (how much money has been appropriated for the war in Iraq) plus the indirect costs, starting with the 2003 invasion. The U.S. government's reported cost is the superficial appearance. Stiglitz and Bilmes go beyond that number to also reveal the implicit costs, including liabilities that will bear on future accounts.

The estimated liabilities of the Iraq war depends on the expected future course of the conflict. The authors provide two estimates, a "realistic-moderate"

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<sup>1</sup> Lecturer in Economics, Santa Clara University, Santa Clara, CA 95053.

case and a “best” case for a “rosy scenario for the wind-down of the war” (131). The explicit realistic-moderate budgetary costs calculated by the authors total \$2.655 trillion, with the best case cost of \$1.754 trillion (57). The realistic-moderate total cost of caring for veterans is put at \$717 billion, with the best case at \$422. For the costs of lost lives, the authors use the “value of a statistical life” of \$7.2 million (95), which puts the additional social economic costs at \$415 billion realistic-moderate and \$295 best case. The total budgetary plus social costs are thus \$2.016 trillion best case and \$3.095 realistic-moderate (112). The total macroeconomic cost is \$1.9 trillion realistic-moderate and \$263 billion best case, which includes the oil price impact of \$800 billion realistic-moderate and \$263 best case. The total budgetary, social, and macroeconomic costs come to \$4.995 trillion realistic-moderate and \$2.279 trillion best case (130), not including interest on the extra debt.

The authors note that even the direct cost of the war is difficult to calculate. During past conflicts, the Pentagon usually established a separate account to keep track of operation funds. However, no such distinct account exists for the war in Iraq. As the authors state, “War and baseline funds are mixed in the same accounts” (9).

That the authors had to dig into the details of the federal budget to extract the data points to another serious issue, the sloppy accounting practices of the federal government. The government’s accounting is so shoddy, say Stiglitz and Bilmes, that the Securities and Exchange Commission would prosecute any private firm with such a mess. The federal government uses cash accounting, which by ignoring liabilities, makes the costs appear to be much lower than they are. (However, the federal government does publish the *Financial Report of the United States Government*, showing its financial position using accrual accounting.) Even worse, the government has not made it easy to obtain figures; the uncovering of some of the data required the use of the Freedom of Information Act by veterans’ organizations.

Another factor distracting the public away from understanding the direct cost of the war is that the military operations have been almost entirely funded via a series of “emergency” supplemental spending bills totaling in the hundreds of billions. This budget gimmick makes it possible to avoid painful budget choices since “emergency spending” is exempt from the budget caps designed to set an upper limit on government spending.

The professional budget staff in Congress is therefore unable to do its usual thorough review of the numbers, and there has been little Congressional oversight, since emergency spending takes place mainly outside of the regular budget process. Congress is not blameless in this process, as it has used the war to attach special and local interest spending to war bills with minimal scrutiny, despite the legal requirement to separate war spending from regular defense appropriations. The corruption is spread throughout the government.

Stiglitz and Bilmes show that many billions of dollars have been misdirected and wasted. The waste itself increased the costs and exacerbated hardships of the troops and of the Iraqi people. An example they provide is the \$18.4 billion that Congress approved for the reconstruction of Iraq. Rather than being spent for the intended purpose, the money was held up as the Department of Defense squabbled with Congress on how to allocate it, and then when it was spent a year later, because of escalated violence, the funds were spent on security instead. The administration sought to keep accounting costs low at the beginning of the war, which not only postponed the payments to the future, but made the ultimate costs much greater.

The authors contend that another source of waste is the contracting out of many of the tasks. Contracting can be cost effective if it is done by comparative bidding—though cost effectiveness might not be a good if the endeavor isn't. At any rate, the Bush administration, in a hurry to conduct the operations, has often used “sole-source bidding.” With cost-plus contracts, the incentive is to incur costs. Even if this was unavoidable at the beginning of the war, justification is lacking for the multi-year contracts that have been awarded.

The authors note various opportunity costs of the war in Iraq, where the funds could have been better utilized. The trillions spent in Iraq could have been spent to reduce the federal debt, provide tax cuts, provide domestic government services, or enhance efforts in Afghanistan, where it might have prevented the resurgence of the Taliban. With the lack of honest and proper accounting, the incompetence, the political games, and opportunity costs, Stiglitz and Bilmes state that “For students of ‘government failure,’ the Iraq war is a case study” (xix).

Once Stiglitz and Bilmes add up all these costs, they end up with a much higher number than the one generally reported by the administration. The authors contend that as a total real amount, the Iraq war has already cost the US economy more than any other war except for World War II. (The authors, however, do not calculate the costs as a fraction of GDP.) They report the cost of World War II in 2007 dollars at \$5 trillion, so, as it continues, the absolute costs (rather than relative to GDP) of the Iraq war could surpass World War II. They report the cost per troop (soldier) for the Iraq war at four times the \$100,000 cost per troop of World War II (which, one should add, could be justified as substituting technologically advanced capital goods and human capital for troop numbers).

With respect to public policy and public choice, the authors observe that typical Americans have not personally felt or observed the huge costs of the war. The personal costs at present are concentrated in the military and its contractors, and their families. But since the federal budget was already in deficit when the war began, the extra costs to the budget have been borrowed, much from abroad. The financial costs are potential liabilities on taxpayers (and possibly on the holders of treasury bonds if greater inflation reduces the real debt), but it has not yet resulted in a loss of personal treasure except in higher prices.

The costs of war in terms of resources always impact people living in the present day. The guns of war have a present-day opportunity cost of fewer civilian goods produced. As we teach our students in the production possibilities graph, more guns implies less butter. The opportunity cost includes less domestic investment in capital goods and technology, which then reduces future growth and living standards. But the typical person does not observe these costs, as they are hidden in higher prices and would-have-been life improvements, as resources get pulled away from civilian production by the government's bidding higher prices to hire the labor and materials, or as government orders members of the national guard to vacate their civilian jobs and shift over to military service, which then increases costs as these workers get replaced.

Nevertheless, the financial costs of a war are shifted to future generations when the funds are borrowed. This raises the issue of the best policy for financing wars: by taxes or debt? In their proposals for reform, Stiglitz and Bilmes favor taxation, echoing the thought of Adam Smith in the *Wealth of Nations*. Smith wrote that the citizens are much less likely to approve a war if it is financed by taxes rather than by debt: "when war comes," governments are unwilling "to increase their revenue in proportion to the increases in their expence. They are unwilling, for fear of offending the people... who would soon be disgusted with the war... The facility of borrowing delivers them from the embarrassment which this fear ... would otherwise occasion" (Smith 1776, 919). Moreover, "Were the expence of war to be defrayed always by a revenue raised within the year, the taxes ... would last no longer than the war... Wars would in general be more speedily concluded and less wantonly undertaken" (925-6).

Better knowledge of the costs is vital to the public's attitude towards the war. The cost per U.S. household is over \$100 per month for the Iraq war (35). Even if they are not being taxed to pay for the war, if the public knew the costs, opposition would be substantially greater. And if they were asked whether they would pay \$100 per month to pay for it, a massive rejection of the war would not be surprising. Stiglitz and Bilmes have thus not just engaged in an academic exercise but have provided the public the means to better judge the costs and benefits of the war.

An economic analysis of the war has to consider counterfactual alternatives. What would likely have happened had the U.S. government not invaded Iraq? The authors consider the case of continued enforcement of the no-fly zones and other pre-war measures, but one should also consider that the pre-war trade restrictions on Iraq were weakening, the oil-for-food program was being exploited by the Iraqi regime for its own gains, and possibly the Iraqi regime would have restored its oil revenues and weapons programs and continued to promote attacks on Israel. Moreover, Iraq is no longer a military threat to its neighbors. The authors might have done more counterfactual analysis, as there may well have been alternatives to war for dealing with these issues.

Stiglitz and Bilmes claim that the war in Iraq has contributed to the rise in the price of oil. They note that the price of oil began to surge just as the war began, and rose beyond the range indicated by futures markets. Their estimate for the price increase is \$5 to \$10 per barrel, which was dwarfed by the increase in the price in 2008, after their book was written. Most likely the price of oil would have gone up substantially even in the absence of the Iraq war, but indeed by reducing production in Iraq and with the demand for fuel by the military in Iraq, the war in Iraq did indeed contribute to the price increase.

Costs need to be compared to benefits, and some pro-war voices have argued that the previous Iraqi regime would have become a greater threat to its neighbors. Stiglitz and Bilmes argue that the Iraq war “has not increased stability and security in the Middle East. It has not reduced the threat of terrorism” (128). They also note a global opposition to U.S. unilateralism, and the sentiment by many Muslims that the United States is acting against Islam. While one can dispute such arguments, the pro-war case also needs better grounding, as it often seems to presume that the benefits are infinite, worth any cost.

Stiglitz and Bilmes discuss various costs and issues for exiting Iraq, but do not mention the possibility of a plebiscite. If most Iraqis wish American forces to leave, a plebiscite would provide the U.S. government with political cover for an exit. If the vote were in favor of U.S. troops staying for the time being, it could blunt the Iraqi rebel attacks. Perhaps both the opponents and supporters of the war avoid talk of a plebiscite because the results could go against them.

There is also a useful chapter on “Learning from Our Mistakes: Reforms for the Future.” The first proposed reform is that wars not be funded through emergency supplemental appropriations after the beginning of the war. They should have gone further and proposed this as a Constitutional amendment, rather than a statute which could be more easily amended later.

As one would expect, some of their proposals seek better accounting methods. On the fiscal side, Stiglitz and Bilmes’s reform #9 is in accord with Adam Smith, proposing that the costs of a war lasting more than one year should be borne by the current taxpayers. However, they say this should be with “a war surtax” (197). But an increase in marginal income tax rates would cause a greater than proportional increase in the excess burden of the tax, increasing the economic cost by significantly more than the tax cost. Given a war expense, why not at least mention, as Smith did, the tax on land value or ground rent, which has little or no deadweight loss? (Perhaps they should read my “Plea to Public Economists” which appeared in this journal in 2005).

A further strength of the book is its appendices, which treat the evolving Department of Defense web sites as well as their methodologies. The book has copious notes and an index.

Stiglitz and Bilmes have done a superb job in documenting and analyzing the economic costs of the Iraq war. The book would have been even better if they

had included the literature on the costs of war, particularly the classical liberal thought that opposed war. For example, John Denson's *The Costs of War: America's Pyrrhic Victories* examines the costs as well as the misleading rationales for America's past wars. The authors could also have broadened the work by placing the war in Iraq in the broader context of American foreign policy.

Some past statements on war resonate today in the context of the past cold war and the current war on terror as well the shooting wars in Iraq and Afghanistan. In discussing the anti-colonial thought of John Mill, Edmund Silberner (1972, 44) states, "Nowhere, perhaps, has fear produced as much harm as in the domain of national security. Bad governments easily persuade their frightened peoples that they can never enjoy enough security."

The classic pithy connection between war and state power was made by Randolph Bourne, an opponent of America's entry into World War I, who was arrested for his stance. A poem by John Dos Passos (1932, 106) has Bourne's ghost crying out, "*War is the health of the state*" (italics in the original), which Bourne had written in an unpublished manuscript called *The State*. This recognition, that war enhances state power, was recognized by James Mill. Silberner (1972, 44-5), discussing Mill, states, "nothing increases more than war the volume of that part of the national wealth which is subject to the authority of the state." (See also Higgs (1987) for the historical inducement to greater power by war).

In classical economic thought, free trade was put forth as the antithesis of colonies and wars to extend and protect colonial territory. Henry George (1886) wrote that free trade has been "the extinguisher of war, the eradicator of prejudice, the diffuser of knowledge" (52).

Adam Smith (1776, 617) thought Great Britain would benefit from granting the American colonies their freedom: "Great Britain would not only be immediately freed from the whole annual expence of the peace establishment of the colonies, but might settle with them such a treaty of commerce as would effectually secure to her a free trade, more advantageous to the great body of the people, though less so to the merchants, than the monopoly which she at present enjoys." The War in Iraq is better understood in the context of this anti-empire thought, as this war can be seen as a continuation of an imperial policy, with overseas wars of choice going back to the Spanish-American War of 1898. In this journal, Christopher Coyne and Steve Davies (2007, 11-15) have offered a 20-point overview of the common public bads of empire, nation building, and the like.

But even absent this context, we can salute Stiglitz and Bilmes for doing the good economic work of taking us beyond the superficial accounts of the war, and thereby helping people better understand the colossal costs of this war.

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ABOUT THE AUTHOR

**Fred Foldvary** teaches economics at Santa Clara University in California. His books include *Soul of Liberty*, *Beyond Neoclassical Economics*, *Public Goods and Private Communities*, *Dictionary of Free-Market Economics*, and (co-edited) *The Half-Life of Policy Rationales: How New Technology Affects Old Policy Issues*. Foldvary's main areas of research include public economics, social ethics, real estate economics, and private communities.

His website is [www.foldvary.net](http://www.foldvary.net); his email is [ffoldvary@scu.edu](mailto:ffoldvary@scu.edu).

[Go to September 2008 Table of Contents with links to articles](#)

[Go to Archive of Watchpad Section](#)