

Prepared statement of Ryan D. Edwards¹ to Reuters on June 20, 2011
“Post-9/11 War Spending, Debt, and the Macroeconomy”

Wars are costly. So far, the United States has spent about \$1.3 trillion in Iraq and Afghanistan. The country spent \$360 billion, or about \$4.5 trillion in today’s dollars, in less than four years during the Second World War. In the seven decades since then, we spent about a third again as much² in compensating and caring for the wounded veterans of that war. Dr. Linda Bilmes of the Harvard Kennedy School currently estimates that over the coming decades, we will need to spend an additional \$600 billion to \$1 trillion caring for the wounded veterans of the current wars in the Middle East.

These costs are large, but to be sure, there are also benefits that can derive from armed conflict. The Civil War, which began 150 years ago this year, resulted in the emancipation, although not the full equality, of 4 million African-American slaves. World War II halted the genocide of the Holocaust and rolled back fascism. The Iraq War removed Saddam Hussein, and the war in Afghanistan ultimately led to the killing of Osama bin Laden and a weakening of al Qaeda.

Decisions to go to war should be made with both costs and benefits in mind. In the research we have conducted as part of the Watson Institute’s Burdens of War project, we have focused primarily on the costs of war for two reasons. First, the history of war cost forecasting and accounting leaves much room for improvement, and Dr. Bilmes and others are continuing to make important new contributions to knowledge and practice in this area. Second, measuring the benefits of war is much more difficult and is a topic that is deserving of future research efforts.

In my contribution to the Burdens of War project, I estimated the costs and benefits of government spending on the wars in Iraq and Afghanistan in a narrowly defined way that I think is useful. Government spending on goods and services raises the nation’s income as measured by Gross Domestic Product or GDP in a direct way by stimulating aggregate demand. But there are costs associated with government spending because it must be financed either by taxes or borrowing. Due to macroeconomic, fiscal, and political events during the past three years, the nation is currently absorbed in a debate about appropriate levels of spending, taxes, and debt. My intention with this paper was to illustrate the multiple macroeconomic effects of deficit spending on the wars in Iraq and Afghanistan, and to provide a comprehensive estimate of its effects on the nation’s finances, and a partial assessment of its effects on our well-being.

The bottom line of my study is that the primary domestic effect of war spending has been to increase our indebtedness. The \$1.3 trillion we have spent to date has probably had a

¹ Assistant Professor of Economics, Queens College, City University of New York, and National Bureau of Economic Research. Mailing Address: Powdermaker 300, 65-30 Kissena Blvd., Flushing, NY 11367. redwards@qc.cuny.edu (718) 997-5189.

² For this and the previous statistic, see Ryan D. Edwards (2010) “U.S. War Costs: Two Parts Temporary, One Part Permanent,” *NBER Working Paper 16108*, Table 2. For WWII, veterans’ benefits were about 30% of the war costs on a present value basis, or 23.5% of the total as shown in the table.

small stimulative effect on annual GDP, perhaps half a percentage point,³ while it has raised our indebtedness by around 15 percent.⁴ On a per-person basis, the additional debt associated with war spending to date, which each living American owes to creditors, is about \$4,000. When debt rises faster than our GDP, as has been the case recently, the government is absorbing private saving that would otherwise be fueling new capital investment, and interest rates tend to rise in response. Although short-term interest rates are currently at historic lows because of the recession, long-term interest rates are probably higher now than they would have been without the wars, by perhaps 35 basis points in 2011. For the average homeowner, that represents roughly \$500 more per year in mortgage interest payments. The burden of servicing all government debt also rises when interest rates are higher.

Recent forecasts by the nonpartisan Congressional Budget Office suggest that war spending and the additional borrowing associated with it are likely to continue through the current decade. As productive capital continues to be crowded out, the small positive effect of war spending on GDP will wane and become negative. Debt and interest rates will continue to rise above what they would be without war spending financed by deficits. The outlook is not rosy.

At the end of World War II, the nation's debt had swelled to more than 100 percent of GDP, a level we have not seen since nor seem destined to breach. But deficit spending on the wars in Iraq and Afghanistan have played a sizeable role in our current fiscal predicament. Debt held by the public has reached 70 percent of GDP, having roughly doubled since 2007, and war spending may be responsible for about 10 percentage points or between one quarter and one third of the increase. As the nation recovers from a protracted recession, we must be careful not to weaken aggregate demand or unsettle markets in the short run. But restoring balance to our long-term fiscal policies should include a reassessment of how we choose to engage in war and how we finance them.

³ See Table 1, column 6, row for 2011. I did not calculate the effect on the unemployment rate in the paper. Okun's Law is an empirical regularity in U.S. data that associates GDP growth with the unemployment rate, with GDP rising by 2 percentage points with each 1 percentage point reduction in unemployment and vice-versa. The relationship is not necessarily causal. Assuming the historical relationship is relevant for this estimate, an increase in GDP of 0.5% would be associated with a reduction in the unemployment rate of 0.25%. This compares with today's unemployment rate of about 9%, up from 4.5 to 5% prior to the recession.

⁴ See Table 2; calculated as either the ratio of debt held by the public in 2011 in the baseline to debt held by the public in 2011 in the counterfactual, or as the ratio of the two Debt/GDP ratios. Then I rounded down to 15 percent.