A Global Affairs Commentary

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The Economic Costs of Going to War with Iraq

By Miriam Pemberton

I want to begin with two caveats. The first is that if attacking Iraq clearly fell into the category of a just war, we should of course spend whatever it would take to wage it. Providing for the common defense is our government's first mandate. But by my reckoning our government has not remotely made the case that this would in fact be a just war. I'll just mention quickly a couple of reasons, which the president's speech yesterday at the UN did not change.

Most fundamental is of course the fact that Iraq has not attacked us, and there is no credible evidence that it is collaborating with al Qaeda, which has. The administration's attempts to establish such a linkage have not been convincing. A couple of weeks ago Secretary Rumsfeld announced a few sightings of suspected al Qaeda members in Iraq. Well, this was northern Iraq, which is under the protection of U.S. warplanes from the Iraqi government. And if the presence of suspected al Qaeda members were reason enough to attack, we should be bombing Germany, and ourselves. Second, in addition to distracting from the pursuit of al Qaeda, an attack on Iraq shows real promise as a recruiting tool for more terrorists. An excessive, intrusive response by the world's superpower in the Middle East helps them make their case for resistance by any available means.

In the absence of a clear case for starting this war, then, we need to consider the ways in which starting it might conflict with our government's second mandate, which is to promote the general welfare. To the extent that an attack would have the effect of weakening an already shaky economy, it would undermine the welfare of all of us. So as we debate this profoundly serious question, the issue of the economic cost of going to war needs to be included in our deliberations.

My second caveat is that no one can say for sure what these costs will be. Wars never go according to war plans. And in this case the complex and far-reaching repercussions of—to pick one thing out of a hat—a destabilized Middle East, can be partially predicted but not foreseen. So mostly we are groping for the best calculus of risks. But I will try to distinguish between what we know for sure at this point and what is likely enough that it should worry us.

One thing we know is that fears that the U.S. might go ahead with an attack on Iraq have already begun to affect oil prices. Oil is already trading close to an 18-month high of $30 a barrel. Ten months ago, the price was half that. So the war fever premium has already been high. And every time a U.S. official comes out and says something that suggests an attack is actually imminent, or even is in fact likely to happen at all, oil prices spike. Vice President Cheney made the first of two such speeches on August 26th, for example, and by the end of the day, the price of each barrel sold on the U.S. market had jumped sixty-five cents.

Following the last U.S. invasion of Iraq, oil prices doubled, and stayed high for the better part of a year. A repeat would create ripple effects throughout our economy. Estimates by Wall Street analysts indicate that a ten dollar per barrel rise in oil prices—half the amount of the last Gulf War effect—would over a year's time reduce U.S. GDP growth by about half a percent, and add nearly one percent to inflation.

The economic drag from these oil price shocks is being felt most strongly across the transportation sectors that grease our economy's wheels, and is adding friction to these wheels, an effect that is of course being passed on to consumers. In the airline sector alone, the nine major U.S. carriers have lost $7.3 billion in the past year, and one of them has been propelled into bankruptcy. This is despite the bailout package passed after 9-11 totaling $5 billion in direct

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federal aid and $10 billion in loan guarantees. Most analysts expect that a U.S. attack on Iraq could send the price of oil beyond $50 a barrel. In that event, we will probably be bailing out all our airlines.

There are always some winners in war—the defense industry is obviously riding high. But there are also many losers, as international trade in general becomes constricted. Tourism is the world's largest industry; experts estimate that it employs about 10% of the world's workforce. The last Gulf War actually depressed tourism in places as far from the Middle East as Costa Rica and East Africa.

The U.S. is trying to prepare for a disruption of its own supplies by adding to its Strategic Petroleum Reserve. Its target goal is to cover U.S. import needs for about 60 days. But this short-term cushion won't help the rest of the world, or do anything to restrain prices.

And given the current fragile condition of the global economy, higher oil prices could mean the difference between modest growth and a full-blown recession.

Growth deceleration in the American economy is already underway: the first-quarter annualized rate of 5% had by the second quarter dropped to 1.1%. It would be a mistake, of course to blame all our economic bad news on the September 11 attacks. But as one writer for the London Times put it, what can be said with certainty is that al Qaeda struck the U.S. and world economies at an exquisitely vulnerable time, when such factors as corporate accountability scandals, oil price rises from the explosion of violence in Israel-Palestine, and the tanking of the dot-coms had done their damage. 9-11 only exacerbated the loss of investor confidence and depressed investment, which have in turn raised the cost of capital and reduced the prospects for long-term productivity growth.

Many U.S. economists are now revising their growth projections for the near term slightly upward. Having taught a couple of kids to ride a bicycle, though, I liked the explanation I read recently of why an economy is like a bicycle. When it moves fast, it can ride out shocks and stay upright. But when a bicycle, or an economy, is hardly moving, it can be knocked over by even a modest bump in the road. A war with Iraq would be quite a bump.

I'll just offer a few more indicators that war fever is not good for our economic health. The value of the dollar peaked against the euro the day President Bush delivered his "axis of evil" State of the Union address, and has been trending downward ever since.

And of course, large tax cuts combined with military spending increases have turned budget surplus into deficit, just as they did during the Reagan years. The projected deficit for FY 2002—$157 billion—is already well over 1% of GDP. As the deficit grows, increases in the public cost of borrowing will put pressure on long-term interest rates, and crowd out private-sector borrowing. The consumer spending that has been buoyed by extremely low rates—financing purchases like home mortgages and new cars—is likely to dry up fast. All point to slower growth, and may trigger a recession. The Congressional Budget Office projects increases in military spending of $450 billion over the next ten years, based on the President's requests. But their figures don't factor in the cost of a war with Iraq.

The last time we had one, in 1991, direct war costs ran around $80 billion in today's dollars. No one believes that this time it would be that cheap. But of course 80% of the costs of the last Gulf War were borne by our allies. This time it appears that allies will be much harder to come by. The Germans and the Saudis, in particular, were among the largest cash contributors to the last Gulf War, and they have both indicated their opposition to an attack. The scattered expressions of international support for the president's speech at the UN yesterday approved of his working with the UN; no one was promising financial support for a war.

In calculating the potential costs to the U.S. of such a war it is important to remember that putting together the original Gulf War coalition incurred substantial costs all on its own, in the form of financial inducements to join. For example, the U.S. had to give Turkey about $5 billion in debt forgiveness and other financial benefits to secure their reluctant support for the war. This time the reluctance is much more internationally widespread, and overcoming it is likely to be much more expensive. Yesterday the Turkish prime minister described the possibility of an attack as "a sword hanging over our heads." Turkey, he said, "is at the forefront of countries that will be negatively affected by military action."

In addition to these direct and indirect costs of waging the war itself, we need to factor into our calculations the protracted military presence, lasting years, not months, that must certainly follow it. Scott Feil, a retired colonel and expert on post-conflict reconstruction, estimates that a force of 75,000 would be necessary during the first year, at a direct cost of $16.5 billion. Former national security

adviser Sandy Berger recently testified that rebuilding the Iraqi economy would cost between $50 and $150 billion. Given the U.S.' recent track record, in Kosovo and Afghanistan, for example, it is unlikely that we would take on the whole bill for Iraqi economic reconstruction. But somebody will need to pay it. Colonel Feil assumes that the U.S. would take on responsibility for some humanitarian emergency relief, and some of the costs of transitional administration, civil service, and other components of reconstruction. He estimates these at $15-25 billion over the next decade.

And none of these estimates tries to factor in the dangers of a wider war. The worries that are already affecting oil prices relate not primarily to Iraq itself as an exporter, but to the likelihood that a war with Iraq could easily destabilize the entire Middle East, propelling a wave of revolutions in politically precarious regimes throughout the Arab world. Any subset of this scenario would begin to jeopardize oil exports of almost 20 million barrels a day, which is just about equal to the whole of U.S. daily consumption, and more than a quarter of the daily consumption around the globe. The disruption of supply could come either from political decisions by the region's leaders or from the destruction of infrastructure. As the prospect of either of these effects becomes more likely, oil markets will react.

Saudi Arabia is both the largest producer and exporter, and the most politically vulnerable. Internal instability alone could depress Saudi production. The Iranian revolution of 1979 cut production in half, to 3 million barrels, where it has stayed. We all worried that the last Gulf War would have a domino effect on the governments in the region, and this didn't happen. But several of them, Jordan and Saudi Arabia at the top of the list, are weaker now than they were then. Iraqi aggression against Kuwait created broad regional support for an armed response, and this support does not now exist. And, it should be added, the 1991 war had destabilizing effects that simply took a long time to incubate and come to light. The U.S. bases in Saudi Arabia became the focal point for the resentment that resulted in the attacks of 9-11.

When we have not been attacked, when the other justifications the administration has offered for going to war are as murky as they are, when there is much dissension within the government and in particular within the military about the wisdom of an attack, and when the idea of attacking has virtually no support from our allies, then it makes sense for Congress and the American people to take these economic costs into special consideration. The preponderance of evidence suggests that if we start this war we will be endangering our economic health.

(Miriam Pemberton <miriam@ips-dc.org> is Peace and Security Editor for Foreign Policy In Focus, and delivered this testimony before Congress on September 13, 2002.)