

The economics of war

Calculating the consequences

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Recent studies suggest that even a successful military campaign in Iraq could carry a hefty price tag

“IT SEEMS likely that Americans are underestimating the economic commitments involved in a war with Iraq,” says William Nordhaus, an economics professor at Yale University. Given all the imponderables surrounding such a war, it is surprising how many experts (like Mr Nordhaus) are trying to work out how much it might cost. After all, it is not clear whether Saddam Hussein's grip will crumble or if he might use weapons of mass destruction. And it is anybody's guess whether OPEC countries will replace any lost Iraqi production—or might slash output in a general Arab boycott.

The findings of the most ambitious effort to date, undertaken by the Centre for Strategic and International Studies, an American think-tank, were unveiled this week in New York. Over the course of the past few months, CSIS has tapped experts from various fields to try and quantify the likely impacts of war. First, the group's military and geopolitical gurus defined four likely military outcomes: no war; a benign war that lasts four to six weeks; a thornier intermediate option that lasts up to three months; and a “worse” case that drags on for as long as six months. The group intentionally set aside still worse possibilities, such as the use of nuclear weapons.

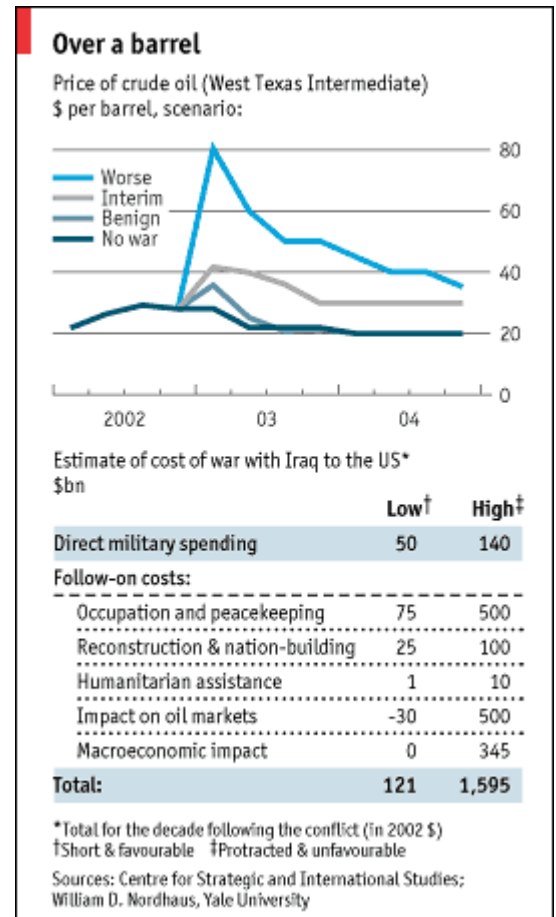
For each of these options, oil-market analysts convened by CSIS speculated over the likely path of oil prices. Their predictions were then fed into macroeconomic models that took into account the positive inputs, such as higher government spending, as well as the negative ones, such as higher inflation. They also factored in the role of market psychology, recalling the experience of the 1970s when oil shocks were accompanied by hoarding and panicky behaviour.

The group reached some striking conclusions. For a start, the no-war scenario is not necessarily the best for the economy. That is because lingering uncertainty about a possible war will continue to depress markets and add a risk premium that boosts oil prices and acts as a drag on growth. At the other extreme, if things turn ugly, the team predicts that oil prices could spike up to \$80 a barrel and, more damaging in economic terms, stay at around \$40 for many months thereafter (see chart).

In the end, though, the group's assessment of the cumulative cost of war to the end of 2004 is not overly alarming: about \$55 billion in the benign scenario, and around \$120 billion in the worse-case scenario. (The higher numbers in the table below are for a whole decade.) The Congressional Budget Office and a committee of the House of Representatives have also done some sums, and both came up with estimates of \$50 billion-60 billion for a shortish war. The Gulf war cost about \$80 billion in today's money, although much of that was recouped by contributions from Saudi Arabia and other allies, which are not likely to be repeated this time. Even so, America can afford all the scenarios.

Some even suggest that the war could be an economic boon. Most wars in America's history have—thanks to massive government spending on defence—tended to stimulate the economy. A notable exception to that, however, was the Gulf war, which was followed by recession. Even so, say some extreme imperialists, if Saddam Hussein is ousted, then America will be able to turn Iraq into its own private pumping-station. Private or not, higher Iraqi output would mean that oil prices would drop for a while and America's economy (along with other oil-consumers') would benefit.

Larry Lindsey, a top economic adviser to President George Bush, made precisely this argument recently: "When there is a regime change in Iraq, you could add 3m-5m barrels of production to world supply...successful prosecution of the war would be good for the economy." The snag in this rosy plan is the dilapidated state of Iraq's petroleum infrastructure: oilmen say it would take 5-10 years for Iraqi output to reach such unprecedented levels (even assuming a post-Saddam Iraq would actually want to flood the world market with oil). Mr Lindsey offered an even more cheerful forecast: he estimated that even a prolonged war would not cost more than \$100 billion-200 billion, or about 1-2% of America's GDP.



What's the worry, then?

Hang on a minute, says Mr Nordhaus, who argues in the latest *New York Review of Books* that none of the recent analyses of war goes far enough. In general terms, he agrees with their estimates for the direct military costs for the various scenarios. But he insists they underestimate the long-term costs to America from an Iraqi war.

He points to the high costs likely to be incurred after a military victory is secured: eg, in peacekeeping,

reconstruction and nation-building. Mr Bush has openly committed America to rebuilding Iraq after ousting Mr Hussein. By examining international experience in post-war Kosovo, East Timor, Haiti and other recent cases, Mr Nordhaus estimates that such non-military costs could reach \$600 billion if a liberated Iraq turns out to be more like the West Bank than Kosovo.

He also worries that an Arab boycott or some other political factor could keep a significant share of OPEC oil off the market for many months. And that, of course, would mean higher oil prices, higher inflation, lost economic output, and so on. All told, Mr Nordhaus thinks that even an Iraqi invasion that went well would probably cost about \$120 billion in today's money over the next decade—and one that went horribly wrong could end up costing a whopping \$1.6 trillion.

The estimators differ in the purpose, methodology and sophistication of their analysis. But, taken together, recent prognoses point to one conclusion: even a short war will prove fairly costly, while a messy one could deal the economy a severe blow. Mr Bush has often stressed the possible price—in terms of national security—of not going to war against Saddam Hussein. These studies suggest that he should start preparing Americans for the economic costs of going to war as well.