

DEFENCE RESOURCES

ECONOMICS OF ARMED CONFLICT

BRNO

2020

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LEARNING OUTPUTS

Students will know:

- Basic definition and typology of armed conflicts

Students will be able to:

- Express economic and methodological Framework for impact evaluation of armed conflicts

Students will capable of:

- discussion of basic problems which are connected with economic and politic level of armed conflict

ECONOMICS OF ARMED CONFLICT

KEY TERMS

Armed Conflict, Rebellion, Insurgency, War, Costs and benefits of armed conflicts, Economic framework of armed conflict, visible and hidden causes of armed conflict.

INTRODUCTION

Governments spend large amounts of money in fighting armed conflicts, but until recently, these expenditures have not been subject to rigorous analysis. The reason is obvious: during an armed conflict, the priority is to win. No one wants to second-guess the generals on how money should be spent. After a war, the issue of whether the money was well spent is of interest to historians; public attention is focused on more pressing issues, including dealing with the aftermath of the war.

The armed conflict is obviously costly and has economic consequence; therefore, it should have always been of at least some interest to economists. Nevertheless, interest in the costs of conflict as a mainstream policy concern and as an issue worthy of study by economists has been rather recent. With the exception of a literature relating military expenditures to economic growth (for an overview, see Ram, 1995), virtually all research on the consequences and costs of conflict has been published over the past decade. Even in this short period, the literature has grown considerably and the pace of research is gaining momentum.¹

Armed conflicts are costly. Estimating the costs of armed conflicts is one of the contributions which economists can make to the overall assessment of any country involvement in a military conflict. The final decision will reflect complex military and political judgements and will be further influenced by legal and ethical issues. Nonetheless, there are no ‘free lunches.’ **War involves the use of scarce resources** which have **alternative uses**, especially for social welfare programmes (eg. schools; hospitals; care for the elderly). The scale of any country involvement in armed conflict will **reflect its ability and willingness to pay the price of such a conflict**.

¹ For example, the work of Bilmes and Stiglitz deals with the costs of the Iraq war and, in addition, the costs of the Afghanistan wars. With all the caveats that one can apply, their current estimate of the cost of the two wars falls between 4 and 6 trillion dollars.

Typically, **decisions about war are based on military and political judgements**, with the economic dimension ignored. In some cases, when a nation's survival is threatened (eg. UK in 1940), it might be willing to pay any price to defeat an aggressor. Other types of conflict might be subject to budget constraints, although at the outset of any military conflict, the magnitude of any such constraints is never apparent. In democracies, the electorate will eventually express their views on their willingness to continue paying for a conflict (eg USA in Vietnam). Even here, voting arrangements are only crude mechanisms for expressing voter preferences on a single issue such as war with Iraq.

Inevitably and understandably, debates about armed conflict are highly emotional. Military personnel and civilians will be killed and injured; houses, buildings, roads, bridges and a nation's communications infrastructure will be destroyed and damaged. Faced with such costs, there are incentives to **search for alternative, less costly and more attractive solutions**. Here, the options include **diplomacy, international pressure, sanctions and, in the case of Iraq, the return of UN weapons inspectors**. Against such a background, it might be concluded that economists have little contribution to make to the analysis of military conflict. **Such a conclusion would be misleading and wrong.**

1 DEFINITION AND TYPOLOGY OF ARMED CONFLICT

An **armed conflict** is a contested incompatibility that concerns government and/or territory where the use of armed force between two parties, of which at least one is the government of a state, results in at least **25 battle-related deaths** in **one calendar year**.

“Armed conflict” is also referred to as “state-based conflict”, as opposed to “non-state conflict”, in which none of the warring parties is a government.

1.1 The separate elements of the definition are operationalized as follows

- a) **Use of armed force:** use of arms in order to promote the parties’ general position in the conflict, resulting in deaths. Arms: any material means, e.g. manufactured weapons but also sticks, stones, fire, water, etc.
- b) **25 deaths:** a minimum of 25 battle-related deaths per year and per incompatibility.
- c) **Party:** a government of a state or any opposition organization or alliance of opposition organizations.
 - Government: the party controlling the capital of the state.
 - Opposition organization: any non-governmental group of people having announced a name for their group and using armed force.
- d) **State:** a state is
 - an internationally recognized sovereign government controlling a specified territory, or
 - an internationally unrecognized government controlling a specified territory whose sovereignty is not disputed by another internationally recognized sovereign government previously controlling the same territory.
- e) **Incompatibility concerning government and/or territory** the incompatibility, as stated by the parties, must concern government and/or territory.
 - Incompatibility: the stated generally incompatible positions.
 - Incompatibility concerning government: incompatibility concerning type of political system, the replacement of the central government or the change of its composition.
 - Incompatibility concerning territory: incompatibility concerning the status of a territory, e.g. the change of the state in control of a certain territory (interstate conflict), secession or autonomy (intrastate conflict).

1.2 Classification of armed conflict

For Classification of armed conflict is possible to use following criterions:

Area

- Local conflict
- Regional conflict
- Global conflict

Time

- Short conflict
- Lengthy conflict

Intensity

- Limited conflict
- Total conflict

Methods

- Regular conflict
- Irregular conflict

Extent of loss

- Small armed conflict (25 losses during year and 1000 casualties on the whole)
- Medium armed conflict (from 25 to 1000 casualties per year and 1000 casualties on the whole)
- War (more than 1000 casualties in every year of conflicts)

FOR BETTER UNDERSTANDING PROBLEM



Nowadays armed conflict databases exist and provide deep insight into problem of armed conflict description and definition. Researchers can use following sources of information:

ARMED CONFLICT DATABASE: MONITORING CONFLICTS WORLDWIDE

Armed Conflict Database: Monitoring Conflicts Worldwide. Accessible on: <https://acd.iiss.org/>

Figure 1 Description of webpages: Armed Conflict Database: Monitoring Conflicts Worldwide

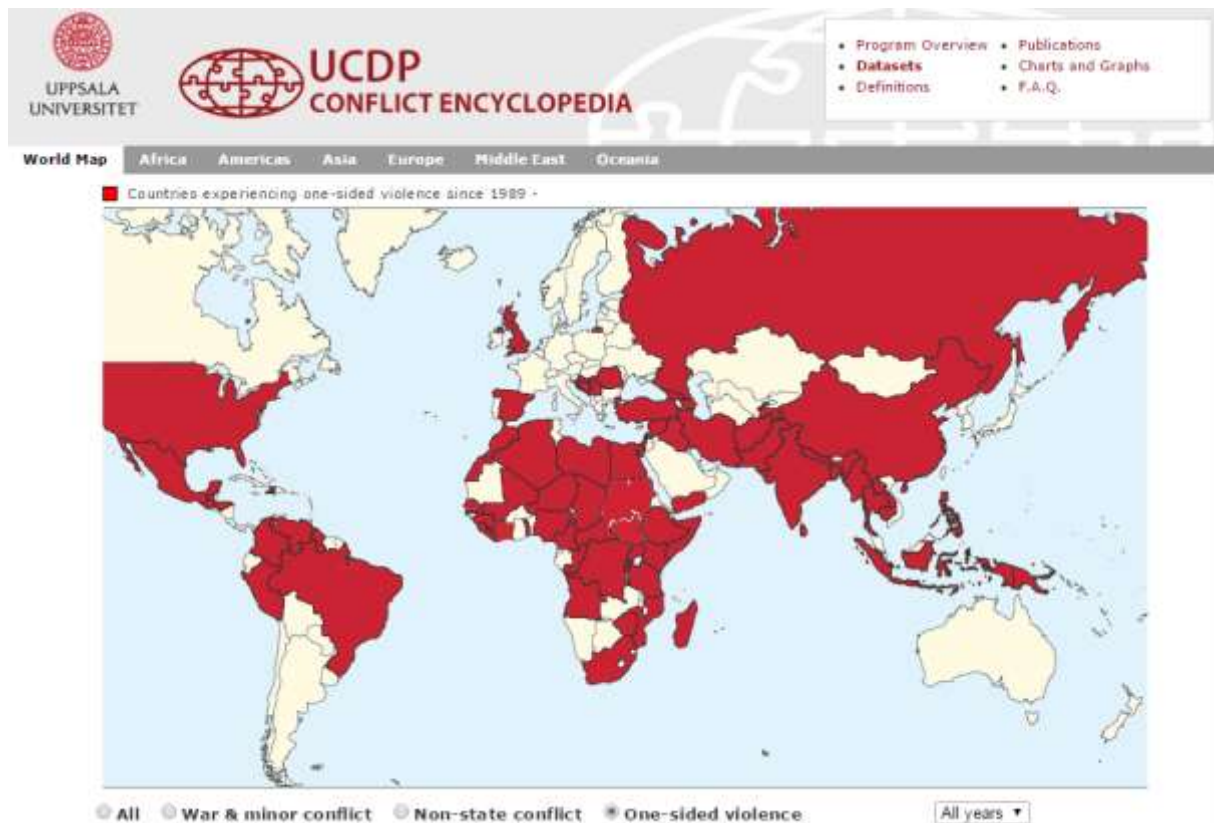


Source: *Armed Conflict Database: Monitoring Conflicts Worldwide* accessible on: <https://acd.iiss.org/>

UPPSALA CONFLICT DATA PROGRAM

Uppsala Conflict Data Program. Accessible on:
<http://www.pcr.uu.se/research/UCDP/>

Figure 2 Description of webpages: Uppsala Conflict Data Program.



Source:

The Uppsala Conflict Data Program (UCDP) has recorded ongoing violent conflicts since the 1970s. The data provided is one of the most accurate and well-used data-sources on global armed conflicts and its definition of armed conflict is becoming a standard in how conflicts are systematically defined and studied.

2 BASIC PROBLEMS CONNECTED WITH ECONOMIC ASPECTS OF ARMED CONFLICT

The horrors of war trouble mankind for ages. We are entitled to put a question. What is the war like? We can characterize the war and armed conflict relatively simply.

- a) Wars and conflict are unpredictable
- b) Wars and armed conflict are expensive
- c) Wars and conflicts are uncomfortable

2.1 Wars and conflict are unpredictable

The causes of their outbreaks are often hidden for common man. But in fact, only **two main reasons** exist.

Two main reasons exist:

- **Firstly**, it is a desire of the profit.
- **Secondly**, it is a desire of the domination and hegemony.

In first time this reasons were described by Arthur Cecil Pigou in the beginning last century.

2.2 Wars and armed conflict are expensive

The costs of wars and armed conflicts **are tremendous**. We can show the following evidence.

- **The WWII** cost about 2896,3 billion in today's dollars.
- **The Korean war** cost about 335,9 billion in today's dollars.
- **The Vietnam war** cost between 1.5% and 2% of GDP each year during the eight years of major American commitment, or about \$600 billion in today's dollars.
- **The liberation of Kuwait** in 1991 cost the equivalent, of 1% of the GDP of the time, or about \$80 billion in today's dollars.
- **The Iraq conflict** has cost till now about \$707 billion dollars.
- **The Afghanistan** conflict has cost till now about \$233 billion dollars.

We can compare these costs of war in Iraq and Afghanistan to the cost of

- **14,904,312** Elementary School **Teachers** for One Year or
- 7,057,801 Affordable **Housing Units**

2.3 Wars and Conflicts are Uncomfortable

Evidence exists:

- **Firstly**, there is a consumption of scarce resources.
- **Secondly**, the final costs of conflicts are unknown and any estimates are too inaccurate.
- **Thirdly**, conflict costs finding is process of estimates.

2.4 Wars Are Expensive and Costs are Unpredictable

The costs of war are always **much more than anticipated**, while the benefits are much less. We can point out an experience with the estimates of following cases of war costs.

Case of North-South War

- **Lincoln's Secretary of the Treasury** estimated that the direct cost of the war to the North would be **\$240 million**, which amounted to about 7 percent of annual GDP at that time.
- The actual cost to the **North** turned out to be **\$3,200 million**, or about 13 times the original estimated cost.
- The cost to the **South** was much greater, for most of its capital stock was destroyed and **output per worker was depressed for nearly a century**.

Case of Vietnam War

- In recent times, the costs of the **Vietnam War** *were grossly underestimated* even as the buildup occurred.
- The original budget projection in early 1966 underestimated the cost for the subsequent fiscal year by **\$10 billion**, or about **1½ percent of GDP**.
- In assuming that the war would end by June 1967, the Pentagon underestimated the total cost of the war **by around 90 percent**.
- The war in fact dragged on until 1973, and the total direct cost was in the range of **\$110 billion to \$150 billion**.
- The indirect costs were more difficult to gauge but comprised **inflation and economic instability, civil unrest**, and, some have argued, **a growing disenchantment with authority and government in the United States**.

Case of Iraq and Afghanistan War

- First government estimates oscillated between **\$30 billion to \$60 billion** dollars.
- **Laurence B. Lindsey** (former adviser of President Bush jr.) predicted Iraq War Would Cost **\$100 Billion to \$200 Billion** dollars in 2002. The fact of the matter is less than three months later he was out of the White House.
- In 2008 Joseph Stiglitz and Linda Bilmes came to the conclusion that costs of Iraq war will hit the record level of **three trillion dollars**.
- In 2010 Joseph Stiglitz and Linda Bilmes made correction their estimates, **total costs of Iraq and Afghanistan conflicts** finally reach nearly level between **4 and 6 trillion dollars** with high probability.

3 AN ECONOMIC FRAMEWORK FOR EVALUATING CONFLICT

Economists assess conflict in terms of its likely costs and benefits to the adversaries. On this basis and from the any state's perspective, there will be **direct military costs as well as costs imposed on the civilian economy and such costs might be short and long-term**. Much depends on the scenarios assumed, all of which will be characterised by uncertainty. Whichever conflict with any country will incur military costs over its duration followed in the longer-run by possible extra costs to the defence budget as the state government adjusts its defence policy and faces a possible increased threat from potential danger.²

Conflict will also involve short-run costs for some state civilian economy, reflected in possible higher oil prices, impacts on such sectors as the airline industry, foreign tourism and share prices, a loss of investor confidence, as well as a possible recession in the world economy. Some sectors will benefit, such as defence industries (eg. orders for ammunition and missiles). In the longer-run, there might be implications for the level of public spending on social welfare programmes. Or, state might contribute to a foreign aid programme designed to re-build the economy after war damage. These types of military and civil costs will be borne by all the parties in any conflict. Table X shows such a cost-benefit framework.

Table 1 Cost-Benefit Framework

Country	Military Costs	Civilian Costs	Benefits
UK			
USA			
Other Allies			
Iraq			

Sources:

Whilst Table X presents an attractive framework for assessing any state involvement in a military conflict with any country, placing numbers into the various boxes is far more difficult. Policy-makers will be required to make judgements about the possible benefits to the state and the valuation to be placed on such benefits. For example, it might be argued that a successful military conflict leading to destruction of unfriendly states's nuclear, chemical and biological weapons and a 'desirable' regime change will lead to peace and stability in the certain territory and in the world and those benefits for some state citizens will be realised over a number of years. Alternatively, the estimated costs to the state of the conflict provide an indication of the *minimum valuation* which must be placed on the likely benefits to the state from any military action.

² For example, the 2002 UK defence department "Comprehensive Spending Review" announced planned increases in real defence spending of 1.2% per year between 2003 and 2006, some of which was to meet the new threats from international terrorism. Or, in the long run, the UK (and the EU) might be involved in providing a peace-keeping force in Iraq to provide 'stability' following any regime change (cf. Afghanistan).

For example, if it costs the UK, say, £2 billion, then the UK must value the benefits from the conflict at £2 billion or more to make it a 'worthwhile' action.

Estimating the costs of any conflict is also difficult. Estimates and outturns are likely to differ.

Experience at estimating the costs of major new weapons programmes shows that they are characterised by cost overruns, delays and poor reliability. **Estimating the military costs of conflict are even more problematic and uncertain.** There is much experience of false hopes about wars which are expected to be 'over by tomorrow' and conflicts which produce unexpected outcomes. Similarly, estimating the civilian costs of any conflict need to allow for the 'counter-factual': what would have happened in the absence of the conflict? For example, would the economy and the airline industry have experienced a recession without the conflict?

In estimating the military costs of conflict, the focus need to be on the additional costs incurred by the defence budget as a result of the conflict. The UK makes annual payments for its Armed Forces of some £30 billion (resource basis), so any conflict with Iraq needs to estimate the additional costs which will arise. These include the extra use of ammunition and missiles, the extra wear and tear on equipment, the additional costs of transporting forces and of accommodating them in the Gulf. There are possible losses of equipment and their replacement. However, if the lost equipment is surplus to requirements, then it will not be replaced and should not be included as a cost (ie. it is a sunk cost).

There will also be human capital losses in the form deaths and injuries to military personnel. Here, there are issues about the valuation of human capital losses where the economic valuation would be based on **estimates of the lost future earnings stream.** For example, for the US involvement in the Vietnam War, it was estimated that by the early 1970s, the total value of the human capital losses from the War were **some \$6 to \$12 billion** (1968 prices: Kiker and Birkeli, 1972). In contrast, for the Gulf War, it was estimated that for the USA, the human capital costs of the War were small when compared to civilian life. By remaining in the USA, more young people would have died as civilians from accidents, suicides and homicides: hence, the surprising conclusion that young people "...were much safer in combat than in civilian life" (Wolfson and Smith, 1993, p 301).

4 THE CLASSIFICATION OF CONFLICT COSTS AND BENEFITS

Quantification of the benefits of war is difficult. How does one ascertain the value of increased security, or even ascertain the extent to which security is increased?

The costs of war are more than just the dollars spent; it includes deaths, injuries, and destruction, along with unintended consequences that **go on** for decades. There are a lot of criteria to classification of armed conflicts costs.³ The most suitable criterion is dividing on direct and indirect:

4.1 Benefits of armed conflicts

The armed conflict in Iraq and Afghanistan were in part directed against complex organizations that locate in nation-states, rather than purely against the nation-states themselves. Consequently two issues assumed paramount importance in these conflicts.

Stiglitz and Bilmes stated, that:

a) Securing territory may not necessarily result in greater security: threat diversion versus threat destruction. The Obama Administration, in its decision to extend the conflict in Afghanistan, focused on the importance of denying Al Qaeda a safe haven from which to train and fight. George W. Bush had argued for the initial invasion of Afghanistan and the war in Iraq on similar grounds.

Preventing a particular piece of territory from being used for such purposes only enhances security if there are no other pieces of territory from which such hostile actions can be undertaken. Al Qaeda has been called a “protean” enemy⁴. It has cells in many countries, and it has the ability to move its base of operations into Pakistan, Yemen, Somalia, or reconstitute itself in any of a host of failed states around the globe.⁵ It would not be sustainable – in human resources or funding – for the US to pursue a strategy of chasing terrorists from place to place indefinitely. This simply emphasizes that one needs to take a global perspective in assessing impacts on security.

b) Endogeneity of forces in opposition. A traditional war calculus involves counting how many of the enemies’ troops one has killed or injured sufficiently that they are removed from the battlefield (or how many tanks and other materiel one has destroyed). The classical enemy has

³ There is a huge literature, where authors delimits costs and benefits of conflict different way. For example: SKÖNS, Elisabeth. *The costs of armed conflict*. International Task Force on Global Public Goods [online]. c 2003, last revision 23. 8. 2006 [cit.2007-01-25] Available on: <<http://www.gpgtaskforce.org/>>; BROWN, Michael E., ROSECRANCE, Richard, N. *The Costs of Conflict: Prevention and Cure in the Global Arena*. [online]. c1999, last revision 7.5. 2003 [cit.2007-01-10] Available on <<http://www.wilsoncenter.org/>>; NORDHAUS, William D. *The Economic Consequences of a War with Iraq*. [online]. c1998, last revision 5.1.2005 [cit.2007-01-11] Available on: <<http://www.econ.yale.edu/~nordhaus/>>.

⁴ Jessica Stern, “The Protean Enemy”, *Foreign Affairs*, 82(4): pp. 27-40 July/August 2003.

⁵ There is an analogy in anti-crime efforts. For example, placing more policemen in one suburb can reduce crime in that suburb; but the criminals may simply find other equally satisfactory places, from their perspective, to operate. The Colombian government’s successful anti-drug effort has led to growth of drug cartels in other countries, such as Mexico – because the underlying demand for drugs in the developed world has not been reduced.

a fixed capacity, so it is reasonable to think that if we destroy 30% of his capacity, his strength diminishes relative to our strength.

But these more recent conflicts are of an entirely different nature. Most of the “enemy” is not conscripts, but volunteers. The way the war is waged may affect the supply of such volunteers as well as the material support given to the opposition by the host population.

In such conflicts, ensuring economic stability -, including employment opportunities for those who fought in the conflict- may be critical in bringing the war to a resolution. For example during Malaysia’s 12 year battle against a fierce insurgency, the government succeeded only after it adopted a strategy of economic security and development known as “KESBAN”.⁶ The focus on strengthening governance, training the military, providing employment in rural areas (where insurgent recruits were drawn from), and providing social services eventually choked the insurgency and led to sustained economic growth. This has been a major issue in Iraq, where millions of men, mostly Sunnis, were left without a livelihood following the US invasion and the decision by L. Paul Bremer, the U.S. administrator of Iraq, to outlaw the Baath Party and dissolve Iraq’s 500,000-member military.⁷

Whenever one country invades and occupies another one, the occupier risks uniting the enemy population in the name of patriotism—even if the government that has been removed is widely disliked. Under such circumstances, winning the hearts and minds of the local population is both more important and more difficult. The two main strategies deployed can be thought of as the “carrot” and the “stick”. The carrot in this case, is to persuade the populace that life would be genuinely better under the new regime supported by the invading power. The stick approach is to persuade the populace that, in any case, the invader and his allies will win, and therefore it is rational and in their best self-interest for the populace to cast their lot in with them--in other words, to make the population fear the consequences of opposing the invader.

⁶ KESBAN is the local acronym for “Security and Development”, a strategy adopted by the Malaysian military and other government agencies during the 1970s to combat the communist insurgency.

⁷ In May 2003, two months after the US invasion, Bremer dismissed all senior members from their government posts and dissolved Iraq’s military. In November 2003, Bremer established a Supreme National Debaathification Commission to root out senior Baathists from Iraqi ministries. All military officers above the rank of colonel were barred from returning to work, as were all 100,000 members of Iraq’s various intelligence services. The Debaathification Commission was officially disbanded in 2004, but internal Iraqi politics kept an effective ban in place for years afterwards.

4.2 Costs of armed conflicts

4.1 Direct (military) costs

- deployment,
- extra pay/allowances,
- fuel,
- ammunition,
- costs of replacing equipment,
- value of human life / human losses.

4.2 Indirect (economic) cost

- higher oil prices,
- possible recession effects
- budged reallocation
- increasing public deficit and public debt – crowding out effect,
- **social problem** (unemployment of war veterans, family break up),
- health problem (mental and physical disorders /for example see Chart X).

Support for offensive wars wears thin, especially when they are not ended quickly.

For contemporary studies which deal with armed conflict costs problem is common the problem of terms heterogeneity and variety. There is not common unifying terms device. The certain way, how to deal with the problem of delimitation and description of armed conflicts costs, is usage of cost-benefit analysis methodology. By way of this type economic analysis we will able to assess potential costs and benefits of the all possible solution of conflicts among states and evaluate separate costs of expressed alternatives (Abstract approach show Table 2).

Table 2 Abstract framework for assessment of potential solution of problematic regional or international-political relationships

Problem	Alternatives	Cost-benefits framework
Political-economic crisis	Diplomatic talks	<i>Benefits</i> <i>Costs</i>
	Bribery	<i>Benefits</i> <i>Costs</i>
	Isolation	<i>Benefits</i> <i>Costs</i>
	Sanction	<i>Benefits</i> <i>Costs</i>
	Intimidation	<i>Benefits</i> <i>Costs</i>
	Military power usage (Armed conflict)	<i>Benefits</i> <i>Costs</i>

Sources: own

5 PROBLEMS OF ESTIMATING COSTS⁸

The heart of the discussion on benefits is the value of additional security obtained by the war. This is a subject on which reasonable people may disagree, since it requires assumptions (typically unverifiable) about what would have happened in the absence of the conflict. Estimating the cost of the war is easier, although several elements in the cost calculation are highly problematic.

There is no doubt that wars use up resources. The questions are analytical:

- (a) estimating the full magnitude of those resources used and*
- (b) assigning a value to them. Each presents particular difficulties.*

The taxonomy of costs centers on:

- (i) resources spent to date;*
- (ii) resources expected to be spent in the future;*
- (iii) budgetary costs to the government; and*
- (iv) costs borne by the rest of the economy.*

The latter costs are referred to as the economic as opposed to the budgetary costs of the conflict. In terms of the economic costs, there are microeconomic costs—costs borne by particular individuals or firms--and macro-economic costs--impacts on the total economy over and above the sum of the micro costs.

In each step, we have to assess quantities of resources used and “valuations” of these resources.

What makes the exercise especially challenging is that government accounting systems do not document most items in a way that would enable an easy assessment of the resources directly used, or the full budgetary impact. Such problems arise frequently in accounting exercises, as we explain below, but in the case of War Accounting, there is a further problem of transparency. Governments often want to hide the true costs of war from their electorate, especially when the war is unpopular.¹⁶ But the accounting distortions are not all one-sided. Sometimes the defense establishment has an incentive to use war funding to conceal spending for non-war items, in order to obtain extra money for pet projects (in the belief, usually correct, that it is hard for Congress to turn down a request for war funding , or to sort out exactly where military appropriations are spent).⁹ The overall economic costs are typically much larger than the budgetary costs, but there are instances where this is not the case. An example is where payments from the government to the private sector exceed the value of the resources procured.

⁸ This part of study support come from: STIGLITZ Joseph E., BILMES Linda J. Estimating the Costs of War: Methodological Issues, with Applications to Iraq and Afghanistan

⁹ During the years since the US military intervention in Afghanistan, the overall US military base budget increased by a total of \$1 trillion. It was difficult to sort out which of the tens of thousands of items that received funding increases were related, directly or indirectly, to the wars. For example, the cost of TRICARE, the military’s health care plan for the active duty Armed Forces, grew from \$19 billion in 2001 to \$50.7 billion for 2010. This is undoubtedly related to the wars in Iraq and Afghanistan, but it is also due to independent factors such as general health care inflation and advances in battlefield medicine. See discussion of the difficulties of untangling military spending from war spending in the reports by the Congressional Research Service (Belasco 2005, 2006, 2007, 2008, 2010); GAO (September 2005); Wheeler (2007)

In economic parlance, these may be called “transfer payments”¹⁰; in ordinary language, this is called war profiteering. There is evidence of widespread war profiteering during the Iraq years. A number of impartial organizations have documented cases ranging from payment of exorbitant sums for simple tasks such as painting walls and repairing trucks to gross over-payments to contractors such as Halliburton and Blackwater. There have also been numerous cases of outright fraud where the US government has been found to have paid contractors for services that were never provided at all.¹¹

Though such problems arise in all government procurement, there are normally safeguards in place that limit its scale. During the Iraq War, many of these safeguards were suspended or relaxed. The sheer size of the US military operations in Iraq and Afghanistan, (the biggest wartime mobilization since the all-volunteer force was created in 1973) placed a strain on the enlisted force, which led to an unprecedented reliance on paid private contractors.

Contractors were employed to provide many functions that are typically considered inherently governmental, such as prisoner interrogations and the widespread use of armed security guards. Controversy over the latter peaked in Iraq when private security guards killed or wounded 34 Iraqi civilians in 2007 at Nisur Square in Baghdad¹².

The use of contractors has been costly in many respects. Numerous studies have identified human and budgetary costs. For instance, during the 18-month period from fiscal year 2007 through the first half of 2008, the US spent \$34 billion on almost 57,000 contingency contracts for construction, capacity building, security and a range of support services for US forces in Iraq and Afghanistan¹³. There were in the order of 200,000 contractor personnel working on these activities; and during this period there were at least 455 contractors killed and 15,787 injured¹⁴

The heavy reliance on contractors had other negative consequences. In previous wars, military commanders had been able to relieve the heavy strain of conflict for their troops by temporarily assigning them to lighter support tasks (such as kitchen duty -- the traditional “peeling potatoes”, or deliveries, construction, vehicle repairs or custodial duties).

¹⁰ Transfer payments are simply payments from one party to another; they do not involve the use of resources.

¹¹ Statements by the Department of Defense Deputy Inspector General, the Defense Contract Audit Agency, the Special Inspector General for Iraqi Reconstruction (SIGIR), the Special Inspector General for Afghanistan, the GAO (2008, April 2010, March 2010), and the congressionally mandated bipartisan Commission on Wartime Contracting in Iraq and Afghanistan have all reported widespread profiteering and fraud, involving bribery, kickbacks, conspiracy, awarding of lucrative contracts to relatives, setting up of fraudulent “shell” companies, and other problems. Investigations into fraud in Iraq have led to hundred of indictments and dozens of convictions..

¹² See Commission on Wartime Contracting (2010). Commission Co-chair and then-Congressman Christopher Shays said: “There’s a vigorous debate in policy circles whether or to what extent security can or should be contracted out in combat zones. As we saw, contractor incidents can have a direct and devastating effect on United States objectives and public support for our presence.”

¹³ The Army generally uses two types of contractors to support military operations. They are system contractors and contingency contractors. System contractors typically provide support to specific weapon systems or to specified sets of components. They tend to perform very specific and precisely defined activities, and they serve during both wartime and peacetime. Contingency contractors provide a variety of support services primarily during operations. They usually provide more generic logistics support. The majority of contracts awarded in Iraq and Afghanistan have this designation, including the huge LOGCAP service contracts awarded to Halliburton subsidiary KBR. For data, see GAO (2008).

¹⁴ See GAO reports (2008 and 2010). Note: the US government does not keep track of the number of contractors killed and wounded, so these numbers are based on reports to the Department of Labor (which provides insurance) and is likely to be an underestimate.

This flexibility provided commanders with a tool to help soldiers dealing with stress or who had experienced unusually heavy combat for a long period. But in the Iraq and Afghanistan conflicts, virtually all of these support tasks were carried out by private contractors. This arguably led to the relentless tempo of the wars, and may have contributed to the epidemic of post-traumatic stress disorder which has been observed among returning veterans.

According to the GAO, the US agencies that were managing these contracts (the Departments of Defense, State and USAID) did not have full or reliable data on these contracts. US agencies also relied on secondary contractors to track and monitor the primary contracts – for example, contractors provide quality assurance for the construction projects in Iraq and Afghanistan that are awarded to other contractors by the Air Force. However, the US agencies also lacked information about the secondary contractors who were supposed to be providing oversight.

The reports of the Special Inspector General for Iraqi Reconstruction, the Wartime Contracting Commission, and auditors and inspector generals for the Defense Department, State Department and other US contracting authorities have revealed widespread systemic problems in the way that contracts were drawn up, awarded, implemented, monitored, paid, and audited. A number of factors contributed to these problems, including the US increased reliance on non-competitive bidding, weak internal controls and contractor business systems, weak systems for controlling costs, poor or incompetent oversight, poor communications and knowledge of operating procedures in unfamiliar business markets, security issues and outright negligence – all of which led to rampant abuses and the waste of billions of taxpayer dollars.¹⁵ 24 The US also was not able to oversee \$9.1 billion in funds that it was supposed to be holding in an Iraq Development Fund, in custody for the benefit of Iraqis. These funds (primarily derived from oil revenues) were audited by the Special Inspector General for Iraqi Reconstruction which found that lax control systems for \$8.7 billion of the money – and \$2.6 billion could not be accounted for at all. 25

Sumarising: For the participants, estimates of military costs involve the following:

- a) The additional costs of the conflict
- b) The need to include the costs of replacing equipment
- c) The need to value the human capital losses (ie. based on the discounted value of future earnings)
- d) Recognition that estimates will differ from out-turns
- e) Possible long-term costs such as the need for peace-keeping forces and a greater threat from terrorism
- f) Possible financial contributions from nations not participating in the conflict.

¹⁵ See Commission on Wartime Contracting (2009). See also written testimony on May 24, 2010 of: Deputy Inspector General Ginger Cruz from the office of the Special Inspector General for Iraq Reconstruction, Assistant Director Kevin L. Perkins of the FBI's Criminal Investigative Division, and Deputy Inspector General James Burch of the Defense Criminal Investigative Service in the Department of Defense. All testimonies are available on the website of the Commission at <http://www.wartimecontracting.gov/index.php/hearings/commission/hearing2010-05-24> (accessed September 8, 2010)

FOR BETTER UNDERSTANDING PROBLEM



Use following publication that provide you deeper understanding of problem:

STIGLITZ Joseph E., BILMES Linda J. *Estimating the Costs of War: Methodological Issues, with Applications to Iraq and Afghanistan*. Accessible on: <http://www.socsci.uci.edu/~mrgarfin/OUP/papers/Bilmes.pdf>

6 COUNTING COST OF ARMED CONFLICTS

Possible procedure of counting total economic costs of armed conflict (By Keit Hartley and Linda Bilmes):

Step 1 – Total relevant appropriations/expenditure to date for military operations;

Step 2 – Add „operational expenditures“ and savings hidden elsewhere in the defense budget;

Step 3 – Correct for inflation and the „time value“ of the money;

Step 4 – Add future expenditures (both direct expenditures and those hidden elsewhere in the budget);

Step 5 – Add future (and current) costs of disability and health care for returning veterans.

Step 6 – Add future costs of restoring the military to its prewar strength; replenish spent armaments, repairing equipment whose maintenance has been deferred;

Step 7 – Add budgetary costs to other parts of government

Step 8 – Add interest;

Step 9 – Estimate the cost to the economy;

Step 10 – Estimate the macroeconomic impact.

FOR BETTER UNDERSTANDING PROBLEM



Use following publication that provide you deeper understanding of problem:

- a) STIGLITZ Joseph E., BILMES Linda J. Estimating the Costs of War: Methodological Issues, with Applications to Iraq and Afghanistan. Accessible on:
- b) STIGLITZ Joseph E., BILMES Linda J. The Three Trillion Dollar War: The Real Cost of the Iraq Conflict. [online]. c2008 last update: 8.4.2008 [cit.2013-06-12] Accessible on : <
http://carnegieendowment.org/files/0408_transcript_stiglitziraq.pdf>.

CONCLUSION

The function of the economic analysis of the armed conflict should be provision of ability to recognize and evaluate not only at the first sight evident costs but also hidden costs of armed conflict. Very delicate topic is even question of probable benefits from armed conflict involvement. In the foreseeable future we can await the quest to find the unifying terminological framework, detailed study of armed conflict with the most exact delimitation conflict costs. Difficulties that will have to be overcome are connected with:

- limited accessibility of data about armed conflicts,
- accuracy of estimates and calculation of armed conflicts costs and benefits,
- ability and possibility of evaluating and following relevance of gained costs value and benefits of armed conflicts.

The economic analysis of the armed conflict can contribute to **the higher knowledge about all its aspects, with accent on its cost side** and that even decrease level of uncertainty of final decision within selection process of the potential solutions of the given problem.