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GLOBAL WAR ON TERRORISM [GWOT]: ACCURACY AND RELIABILITY OF COST ESTIMATES

HEARING

BEFORE THE

SUBCOMMITTEE ON NATIONAL SECURITY, EMERGING THREATS, AND INTERNATIONAL RELATIONS

OF THE

COMMITTEE ON GOVERNMENT REFORM

HOUSE OF REPRESENTATIVES

ONE HUNDRED NINTH CONGRESS

SECOND SESSION

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GLOBAL WAR ON TERRORISM [GWOT]: ACCURACY AND RELIABILITY OF COST ESTIMATES

TUESDAY, JULY 18, 2006

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON NATIONAL SECURITY, EMERGING THREATS, AND INTERNATIONAL RELATIONS,
COMMITTEE ON GOVERNMENT REFORM,
Washington, DC.

The subcommittee met, pursuant to notice, at 2 p.m. in room 2154, Rayburn House Office Building, Hon. Christopher Shays (chairman of the subcommittee) presiding.

Present: Representatives Shays, Burton, Platts, Dent, Kucinich, Van Hollen, Ruppersberger, Higgins, and Waxman.

Staff present: J. Vincent Chase, chief investigator; R. Nicholas Palarino, Ph.D., staff director; Robert A. Briggs, analyst; Robert Kelley, chief counsel; Raj Lalla, Jake Parker, and Jeff Hall, interns; Phil Schiliro, minority chief of staff; Karen Lightfoot, minority communications director/senior policy advisor; Jeff Paran, minority counsel; David Rapallo, minority chief investigative counsel; Andrew Su, minority professional staff member; Earley Green, minority chief clerk; and Jean Gosa, minority assistant clerk.

Mr. SHAYS. I would like to call this hearing to order.

Before we begin the hearing, I just would like to have a dialog with David Walker, the Comptroller General.

Mr. Walker, you testified at a hearing on national security on April 25th, going back a few months ago. In the hearing Mr. Ruppersberger raised some very real and disturbing questions about contracts and the fact that we need to address this issue. At one point in the hearing I asked Mr. Ruppersberger to yield. I said, "Would the gentleman suspend for just a second," and Mr. Ruppersberger said, "Yes, I will." "Mr. Shays—" that is me—"I will say to you that you give us a list of some contractors—" talking to you, Mr. Walker—"some areas within DOD that need a look, and we will have a hearing or a series of hearings on that, and the sooner you provide it to us the sooner we will do it."

Your response, Mr. Walker, was, "I will give you a list." And then Mr. Shays: "Let me just tell you something," and then I spoke, made some comments, I said, "I want you, whatever it is, if it is Haliburton that is on the list, whatever it is I want you to give this subcommittee a list of things that have just irritated you, you are outraged by, or whatever, or suspect things. We will have a hearing, and I will pledge to this committee that we will call them in,

whatever it is, and let's get the politics out of it to the extent we can and go for it."

Mr. Walker, your response was, "I will do that."

I would like to know if you have yet provided the committee with a list.

Mr. WALKER. No, I haven't. You and I agreed, Mr. Chairman, that by Friday you will have the following: No. 1, you will have three to four examples of contracting problems. In addition to that, as part of that you will have example of contracts that are a problem. Furthermore, you will also have specific contractor and/or governmental challenges that contribute to those contracting problems, and you will have it by Friday.

Mr. SHAYS. Thank you, sir. Would you also rate them in terms of which deserves to be looked at first, second, and third? In other words, I don't know how long your list will be, but if it is whatever we would like to just prioritize it, and we will follow your list, however you prioritize it.

Mr. WALKER. I will do that. And the thing I think that is important, Mr. Chairman, is, while we will give three to four specific examples, in some cases the Government shares part of the responsibility for these contracting problems. That is where I think there was a miscommunication. So I will provide that by Friday.

Mr. SHAYS. Let me just say there is no miscommunication. I don't want to go down that road. I was very clear in wanting a list, and we have not yet gotten the list; is that correct? We have not yet gotten the list?

Mr. WALKER. That is correct.

Mr. SHAYS. Yes. I am not trying to place any blame on you, Mr. Walker. I am just trying to say that I said the sooner you provide it the better and we will get to it. It is now July 18th and this was a hearing in April. I want the record to clearly note that we are still waiting for this list.

Mr. WALKER. You will get it by Friday.

Mr. SHAYS. Thank you, sir.

A quorum being present, the hearing on Global War on Terrorism: Accuracy and Reliability of Cost Estimates will come to order.

The global war on terrorism touches on all parts of the U.S. Government budget, covering homeland defense and military and diplomatic operations abroad. To combat terrorism, the United States has initiated three military operations: Operation Enduring Freedom, covering Afghanistan and other GWOT operations ranging from the Philippines to Djibouti, that began immediately after the September 11th attacks; Operation Noble Eagle, providing enhanced security for U.S. military bases and other homeland security initiatives; Operation Iraqi Freedom that began in the fall of 2002 with the buildup of troops for the March 2003, invasion of Iraq and continues with counter-insurgency and stability operations.

Determining the total amount of funding for the global war on terrorism is challenging because of the various ways in which funds are appropriated and the failure of the Department of Defense [DOD], to have auditable financial statements.

According to the Government Accountability Office, Congress has appropriated approximately $430 billion to pay for military and

diplomatic efforts related to the global war on terrorism during the year 2001 through fiscal year 2006. This $430 billion was provided through regular appropriations as well as supplemental and bridge appropriations that fall outside the normal budget process. Most of this money was allocated for ongoing military and diplomatic operations overseas, especially in Iraq and Afghanistan.

For military operations, the DOD has received $386 billion for the global war on terrorism. For reconstruction and stabilization programs in Iraq and Afghanistan, the Departments of State, Defense, and the U.S. Agency for International Development have received the remaining $44 billion.

Today we ask how effective are the Departments of Defense and State processes for producing reliable, accurate, and timely cost estimates for the global war on terrorism. The GAO has found DOD reporting problems make it difficult to know precisely how much the war costs. The global war on terrorism cost reporting by DOD is based on military services reports. At two Army divisions the GAO reviewed Army posting procedures and found 35 percent of transactions improperly posted.

Additionally, U.S. Government agencies, such as the Department of State, do not formally track all global war on terrorism costs because they do not distinguish whether certain expenses are solely attributable to the global war on terrorism. Furthermore, both Defense and State cannot accurately predict future commitments because of inaccurate reporting procedures and failure to distinguish global war on terrorism costs from other obligations.

Beyond inaccuracies in reporting, global war on terrorism costs and future commitments, there is also controversy over the practice of seeking funding through supplemental spending measures. Many believe—and I am one of them—that since the global war on terrorism will be a continued investment over the long term, these costs should be part of the normal budget process.

According to the Congressional Research Service [CRS], supplemental appropriations have been the most frequent means of financing the initial stages of military operations during war; however, past administrations have requested funding for ongoing operations in regular appropriations bills as soon as a projection of costs could be made. This should also be the case for the global war on terrorism.

Why should we want accurate war costs? The answer is obvious: decisionmakers and the public they represent need to know how much this war costs and will cost. The U.S. commitment to the global war on terrorism will likely involve the continued investment of resources, requiring decisionmakers to require difficult tradeoffs as the Nation faces increasing fiscal challenges in the years ahead.

Today we welcome our distinguished witnesses, including the U.S. Comptroller General; the Assistant Secretary and Chief Financial Officer for the Department of State, and the Deputy Comptroller for the Department of Defense; the Assistant Administrator for Asia and the Near East, U.S. Agency for international Development; the Acting Director for the Congressional Budget Office; and the Specialist in National Defense with the Congressional Research Service. We thank them all for appearing before us and we hope

this hearing will educate the American public about the cost of the global war on terrorism.

At this time the Chair would receive the very distinguished ranking Member of the Government Reform Committee, the full committee, Mr. WaxmAn.

[The prepared statement of Hon. Christopher Shays follows:]

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Statement of Rep. Christopher Shays
July 18, 2006

The Global War on Terrorism (GWOT) touches on all parts of the U.S. government budget covering homeland defense and military and diplomatic operations abroad.

To combat terrorism the United States has initiated three military operations:

- Operation Enduring Freedom (OEF) covering Afghanistan and other Global War on Terrorism (GWOT) operations ranging from the Philippines to Djibouti, that began immediately after the 9/11 attacks.

- Operation Noble Eagle (ONE) providing enhanced security for U.S. military bases and other homeland security initiatives.

- Operation Iraqi Freedom (OIF) that began in the fall of 2002 with the build up of troops for the March 2003 invasion of Iraq and continues with counter-insurgency and stability operations.

Determining the total amount of funding for the GWOT is challenging because of the various ways in which funds are appropriated and the failure of the Department of Defense (DOD) to have auditable financial statements.

According to the Government Accountability Office (GAO), Congress has appropriated approximately $430 billion to pay for military and diplomatic efforts related to the GWOT during the period 2001 through fiscal year 2006.

This $430 billion was provided through regular appropriations, as well as supplemental and bridge appropriations that fall outside the normal budget process. Most of this money was allocated for ongoing military and diplomatic operations overseas, especially in Iraq and Afghanistan.

For military operations the DoD has received $386 billion for the Global War on Terrorism. For reconstruction and stabilization programs in Iraq and Afghanistan the Departments of State, Defense and the US Agency for International Development have received the remaining $44 billion.

Today we ask: "How effective are the Departments of Defense and State processes for producing reliable, accurate, and timely cost estimates for the Global War on Terrorism?"

The GAO has found DoD reporting problems make it difficult to know precisely how much the war costs. GWOT cost reporting by DoD is based on military services' reports. At two Army divisions the GAO reviewed Army posting procedures and found 35 percent of transactions improperly posted.

Additionally, US government agencies such as the Department of State (DoS) do not formally track all GWOT costs because they do not distinguish whether certain expenses are solely attributable to the Global War on Terrorism.

Furthermore, both Defense and State cannot accurately predict future commitments because of inaccurate reporting procedures and failure to distinguish GWOT costs from other obligations.

Beyond inaccuracies in reporting GWOT costs and future commitments, there is also controversy over the practice of seeking funding

through supplemental spending measures. Many believe, and I am one of them, that since the Global War on Terrorism will be a continued investment over the long term these costs should be part of the normal budget process.

According to the Congressional Research Service, supplemental appropriations have been the most frequent means of financing the initial stages of military operations during war. However, past administrations have requested funding for ongoing operations in regular appropriations bills as soon as a projection of costs could be made. This should also be the case for the GWOT.

Why should we want accurate war costs? The answer is obvious. Decision makers and the public they represent need to know how much this war costs, and will cost. The US commitment to GWOT will likely involve the continued investment of resources, requiring decision makers to consider difficult trade-offs as the nation faces increasing fiscal challenges in the years ahead.

Today we welcome our distinguished witnesses including: the US Comptroller General; the Assistant Secretary and Chief Financial Officer for the Department of State; and the Deputy Comptroller for the Department of Defense; the Assistant Administrator for Asia and the Near East, US Agency for International Development; the Acting Director for the Congressional Budget Office; and the Specialist in National Defense with the Congressional Research Service.

We thank them all for appearing before us and we hope this hearing will educate the American public about the costs of the Global War on Terrorism.

Mr. WAXMAN. Thank you, Mr. Chairman.

The purpose of today's hearing is to assess the Bush administration's global war on terror. Based on the facts and the data we have before us, it is clear that the administration's approach is failing.

There are two key problems with the administration's approach to countering global terrorism. The first is that costs are spiraling out of control with inadequate accountability. The second is that the administration's actions have actually incited terrorism.

First, estimated spending has quadrupled over the past 5 years, increasing from about $31 billion to more than $122 billion this year. Obviously, huge costs are associated with Iraq, but massive waste, fraud, and abuse have undermined our efforts both to rebuild Iraq and to provide support to our troops.

Three years ago, we first raised the question about these out-of-control costs. The excuse then was the fog of war. This isn't the fog of war, it is the fog of incompetence, the fog of indifference, the fog of arrogance. We have out-of-control costs, while at the same time our troops don't have the armor and equipment they need, and it is mind boggling. This has to stop. The incompetence, the fraud, waste, and abuse, the squandering of billions and billions of dollars, it has to stop. We owe accountability to America's families that are paying for this war.

For example, the Bush administration handed out over $9 billion in bricks of cash to Iraqi ministries with no monetary controls, and it now has no idea what happened to that money; $9 billion in cash simply vanished.

One U.S. official who worked for the CPA, Frank Willis, described it as the "Wild West." He said Iraq was a free-fraud zone, with no accountability to prevent corruption.

The administration also squandered money it should have spent on our troops. By now we all know that Haliburton had monopoly contracts to provide our troops with meals and housing and laundry services. When we talked to former Haliburton employees, they told us how the company intentionally inflated its prices. They said the informal company motto was: don't worry about the price, the contract is cost plus. But the administration has let them get away with it. GAO reported that the Army set no spending limits on Haliburton until 2004. According to the Government Accountability Office, cost constraint did not become a factor until almost a year into the operation.

This is an incredible thing. The administration didn't control Haliburton's overcharges until a year after the invasion; meanwhile, our troops didn't have the body armor they needed, they lacked night vision goggles, and they were driving around in unarmored Humvees. As a result, we have now spent $50 billion on Iraq reconstruction, including $30 billion from U.S. taxpayers, but we have virtually nothing to show for it. We spent $2 billion on Iraq's oil infrastructure, but production is well below pre-war levels. We invested $4 billion on electricity generation, but peak output has been at pre-war levels. The situation is the same for drinking water.

As Mr. Walker, the head of the Government Accountability Office, testified just last week before this committee, the Bush admin-

istration has yet to prove that is has made a difference in the Iraqi people's quality of life.

Well, the second problem is that the administration is actually inciting more terrorism. When he testified before the 9/11 Commission, Richard Clarke, National Security Council official under President Bush, warned that Iraq had no link to Al Qaeda and that unilaterally invading Iraq without the support of our allies would increase terrorism and further endanger the United States. He also warned that Iraq would divert us from the war on terror. Well, the facts are that the Bush administration never put more than 20,000 troops in Afghanistan to hunt for Osama Bin Laden, but he has now over 100,000 troops mired in Iraq. Why?

The Bush administration spent only a few billion in Afghanistan, but it has spent literally hundreds of billions of dollars in Iraq. Bin Laden might be in Afghanistan. He might be in Pakistan. But I have seen no intelligence reports suggesting that he might be in Iraq.

What are the results of this misguided approach? Global terror attacks are now at record levels. Worldwide terrorist attacks have increased steadily each year since 2001, growing from a few hundred per year to an astonishing 11,000 per year. Deaths and injuries from terrorist attacks have also skyrocketed, increasing from about 5,500 in 2001 to a record 39,000 last year.

Iraq is a quagmire of waste and incompetence. Osama Bin Laden remains at large, taunting the administration and rallying more recruits. North Korea now has several nuclear weapons, where before it had none. Hezbollah has become emboldened and is openly attacking Israel. Iran is actively seeking nuclear weapons and is essentially ignoring this administration's overtures.

This is the result of 5 years of this administration's global war on terror. This is the result of 5 years of a rubber stamp Republican Congress. And these are the trend lines, the facts, and the data, and they show no signs of reversing.

Thank you, Mr. Chairman.

[The prepared statement of Hon. Henry A. Waxman follows:]

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July 18, 2006

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There are two key problems with the Administration's approach to countering global terrorism. The first is that costs are spiraling out of control, with inadequate accountability. The second is that the Administration's actions have actually incited terrorism.

First, estimated spending has quadrupled over the past five years, increasing from about $31 billion to more than $122 billion this year. Obviously, huge costs are associated with Iraq. But massive waste, fraud, and abuse have undermined our efforts both to rebuild Iraq and to provide support to the troops.

Three years ago we first raised questions about out-of-control costs. The excuse then was the fog of war. This isn't the fog of war. It's the fog of incompetence. It's the fog of indifference. It's the fog of arrogance.

We have out-of-control costs while at the same time our troops don't have the armor and equipment they need. It's mind-boggling.

This has to stop. The incompetence, the fraud, waste and abuse, the squandering of billions and billions of dollars — it has to stop. We owe accountability to the American families that are paying for this war.

For example, the Bush Administration handed out $9 billion in bricks of cash to Iraqi ministries with no monetary controls, and it now has no idea what happened to the money. Nine billion in cash simply vanished.

One U.S. official who worked for the CPA, Frank Willis, described it as the "wild west." He said Iraq was a "free fraud zone" with no accountability to prevent corruption.

The Administration also squandered money it should have spent on our troops. By now, we all know that Halliburton has the monopoly contract to provide our troops with meals and housing and laundry services.

When we talked to former Halliburton employees, they told us how the company intentionally inflated its prices. They said the informal company motto was: "Don't worry about price. It's cost-plus."

But the Administration let them get away with it. GAO reported that the Army set no spending limits on Halliburton until 2004. According to GAO, "cost constraint did not become a factor ... until almost a year into the operations."

This is an incredible finding. The Administration didn't control Halliburton's overcharges until a year after the invasion. Meanwhile, our troops didn't have the body armor they needed, they lacked night vision goggles, and they were driving around in unarmored Humvees.

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The Bush Administration spent only a few billion dollars in Afghanistan, but it has spent literally hundreds of billions of dollars in Iraq. Bin Laden might be in Afghanistan, he might be in Pakistan, but I've seen no intelligence report suggesting he is in Iraq.

What are the results of this misguided approach? Global terror attacks are now at record levels. Worldwide terrorist attacks have increased steadily each year since 2001, growing from a few hundred per year to an astonishing 11,000 last year.

Deaths and injuries from terrorist attacks have also skyrocketed, increasing from about 5,500 in 2001 to a record 39,000 last year.

Iraq is a quagmire of waste and incompetence. Osama bin Laden remains at large, taunting the Administration, and rallying more recruits. North Korea now has several nuclear weapons where before it had none. Hezbollah has become emboldened and is openly attacking Israel. Iran is actively seeking nuclear weapons and is essentially ignoring the Administration's overtures.

This is the result of five years of the Administration's global war on terror. This is the result of five years of a rubber-stamp Republican Congress. These are the trend lines, the facts, and the data, and they show no signs of reversing.

Mr. SHAYS. Mr. Kucinich, you have the floor.

Mr. KUCINICH. I want to thank the Chair for holding this hearing and thank him and Mr. Waxman. Mr. Waxman, thank you for your leadership on this.

This is an urgent hearing, because this administration from day one has intentionally mislead, distorted, and flat out lied to the American people and the Congress about the real cost of the war in Iraq. It is imperative for Congress and the American people to know how much taxpayers' dollars are being spent in Iraq and Afghanistan. Furthermore, it is essential that we understand the key assumptions driving new requests for the war; namely, how long does the administration intend to stay in Iraq and Afghanistan? And what, if any, taxpayer money is being used to build permanent bases in Iraq?

Currently the war in Iraq being conducted with no end in sight and, except for this committee, not much congressional oversight, costs our country $8 billion a month, $2 billion a week, and $267 million a day. The cost of the war today is estimated at $296 billion.

Now, with this kind of money we could hire over 5 million public school teachers for a year, we could build over 2.5 million additional housing units, would could have paid for tens of millions of young people to attend HeadStart programs, provided 4-year scholarships at public universities for over 10 million American young people.

When you factor in the latest request for war funding by the administration, the total cost of war in Iraq and Afghanistan is set to exceed half a trillion dollars in the next fiscal year. Through the end of 2006, Congress will have appropriated a total of $437 billion, with Iraq accounting for nearly 75 percent, 75 percent of these costs. Factoring in the costs for 2007, the cost will reach $600 billion soon.

Not only do the costs of the war in Iraq account for the vast majority of this funding, but they continue to increase year after year. Annual appropriations for Iraq jumped 30 percent between 2004 and 2006 and have now surpassed $100 billion per year.

Former U.S. Chief Economist and Nobel-laureate Joseph Stieglitz estimated the long-term cost of the war in Iraq as being between $1 and $2 trillion—trillion. In selling the Iraq war to the American people, the administration insisted the total cost would be between $50 and $60 billion, a tremendous amount of money, but when former White House economic advisor Lawrence Lindsay estimated a high limit of $100 billion to $200 billion for the entire operation, the administration condemned the estimate as very, very high, and Mr. Lindsay was soon out of a job.

Top administration officials have also proclaimed that much of the expense would be self financed through oil revenue and other Iraqi assets. Secretary Rumsfeld told the American people, "I don't believe the United States has a responsibility for reconstruction, as Iraqi resources would be so readily available." The administration knowingly made these claims, and those claims were false, just like the false claims of WMDs.

The administration's predictions were either wilfully ignorant of expert assessment or meant to hide the true cost from Congress

and the American people. But the American people are confronted with the grim reality in their pocketbooks. Their children's debt burden is increasing, funds are continuing to be siphoned away from education, Social Security, health care, or the repair of devastation caused by Hurricane Katrina.

But the costs do not end there. The human costs are in true sense immeasurable. Over 2,500 American soldiers have lost their lives. Estimates have been up to 48,000 wounded. Scores of Iraqi citizens, actually perhaps over 100,000 innocent Iraqi citizens killed, countless injured. While our coffers have been emptied to fund this war, far too many coffins have been filled.

These mighty costs and how the American people were so ardently assured otherwise are not the end of the story. There are also significant problems in how this taxpayer money is being accounted for and the questions on how transparently it is being spent. This administration has yet to answer questions I raised about $9 billion in Iraqi reconstruction funds that have still not been accounted for. GAO continues to tell us it has significant concerns about the reality of the Department of Defense cost reporting, concluding that neither Congress nor the DOD can know how much the war on terror is costing or how appropriated funds are being spent.

Problems with transparency go even further. In order for Congress to responsibly set funding levels, we need to talk about the assumptions behind the requests, whether they are about troop levels, plans for permanent bases in Iraq, troop rotation plans, or equipment replacement. Instead, these assumptions are not made at all transparent in the supplemental or emergency funding requests that make them up 91 percent of Pentagon funding for the global war on terror and the war in Iraq.

This administration has stonewalled this Congress at every turn, continuing to refuse to turn over the most basic of information needed for us to provide even minimal oversight. We must not abandon, we will not abandon our constitutional responsibility to provide checks and balances to the executive branch, especially with an administration that has proven its lack of credibility time and again.

It is great that the panelists are here. I thank them for their expertise on these issues and hope we can find a way to work to make the funding process more transparent and more accountable. The American people certainly deserve to know the full costs of prosecuting the war, how those costs are affecting their everyday lives today and in years to come.

Mr. Chairman, once again I want to thank you for the leadership that you have shown on these issues in providing an open forum that otherwise wouldn't be provided in this House. Thank you.

[The prepared statement of Hon. Dennis J. Kucinich follows:]

Opening Statement of Dennis J. Kucinich
Ranking Minority Member
U.S. House of Representatives
Subcommittee on National Security, Emerging Threats and International Relations

Hearing on "Global War on Terrorism (GWOT): Accuracy and Reliability of Cost Estimates"

July 18, 2006

Good afternoon, Chairman Shays, Mr. Walker and the witnesses here today.

I would like to thank the Chairman and the Subcommittee for holding this important oversight hearing.

This is an urgent hearing because this Administration from day one has intentionally misled, distort and flat out lied to the American people, and the Congress, about the real cost the war in Iraq.

It is imperative for Congress and the American people to know what taxpayer dollars are being spent on in Iraq and Afghanistan. Furthermore, it is essential that we understand the key assumptions driving new requests for war funding, mainly: how long does the Administration plan to remain in Iraq and Afghanistan? And, what, if any taxpayer money is being used to build permanent bases in Iraq?

Currently, the war in Iraq – being conducted with no end in sight and virtually no Congressional oversight – costs our country $8 billion a month, $2 billion a week, and, $267 million a day.

The cost of war today is estimated at over $296 billion. With this money, we could have instead:

- hired 5,144,762 additional public school teachers for one year.
- insured 177,765,455 children for one year.
- built 2,673,021 additional housing units.
- paid for 39,320,324 children to attend a year of Head Start.
- provided 14,391,531 students four-year scholarships at public universities.

Factoring in the latest requests for war funding by the Administration, the total cost of wars in Iraq and Afghanistan is set to exceed half a trillion dollars in the next fiscal year. Through the end of 2006, Congress will have appropriated a total of $437 billion dollars, with Iraq accounting for nearly 75% of these costs. Factoring in the costs for 2007, the costs will reach $600 billion soon.

Not only do the costs of the war in Iraq account for the vast majority of this funding, but they continue to increase year after year. Annual

appropriations for Iraq jumped 30% between 2004 and 2006 and have now surpassed $100 billion per year.

Former U.S. chief economist and Nobel-laureate Joseph Stieglitz estimated the long-term costs for Iraq alone between $1 and $2 trillion!

In selling the Iraq war to the American people, the Bush administration insisted the total costs would be only $50 or $60 billion. When former White House economic advisor Lawrence Lindsay estimated a "high limit" of $100 to $200 billion for the entire operation, the administration condemned the estimate as "very, very high" and Mr. Lindsay was soon out of a job.

Top administration officials also proclaimed that much of the expense would be self-financed through oil revenue and other Iraqi assets. Secretary Rumsfeld told the American people that, "I don't believe that the United States has responsibility for reconstruction" as Iraqi resources would be so readily available.

The Administration knowingly made these false claims, just like their false claims of WMDs, only to mislead and fool the American people in order to support the Administration's march to war.

The Administration's predictions were willfully ignorant of expert assessments, and meant to hide the true costs from Congress and the

American people. But the American people are confronted with the grim reality in their pocketbooks. Their children's debt burden is increasing, and funds are continuing to be siphoned away from education, social security, health care, or the repair of the devastation caused by Hurricanes Katrina and Rita in our own country.

But the costs do not end there. The human costs are in the truest sense immeasurable. Over 2,500 American soldiers have lost their lives, estimates of up to 48,000 have been wounded, and scores of Iraqi civilians have been killed and wounded. While our coffers have been emptied to fund this war, far too many coffins have been filled.

These mighty costs, and how the American people were so ardently assured otherwise, are not the end of the story. There are also significant problems in how this taxpayer money is accounted for, and questions on how transparently it is being spent. This Administration has still yet to answer questions I have raised about $9 billion in Iraqi Reconstruction Funds that have been accounted for.

GAO continues to tell us it has "significant concerns" about the reliability of the Department of Defense's cost reporting, concluding that "neither DOD nor Congress can know how much the War on Terror is costing or how appropriated funds are being spent."

Problems with transparency go even further. In order for the Congress to responsibly set funding levels, we need to talk about the assumptions behind the requests, whether they are about troop levels, plans for permanent U.S. bases in Iraq, troop rotation plans, or equipment replacement. Instead, these assumptions are not made at all transparent in the supplemental or "emergency" funding requests that make up 91% of Pentagon funding for the global war on terror and war in Iraq.

This Administration has stonewalled Congress at every turn. Continuing to refuse to turn over the most basic of information needed for us to provide even minimal oversight.

We must not abandon our Constitutional role to check and balance the executive branch, especially with an Administration that has proven its lack of credibility time and again.

I thank the panelists here today for their expertise on these issues, and I am hopeful that we can work to make the funding process more transparent and spending more accountable. The American people deserve to know the full costs of prosecuting this war, and how those costs are affecting their everyday lives, today and in years to come. Thank you, Mr. Chairman. I yield back.

Mr. SHAYS. I thank the gentleman very much.

Mr. Higgins, you have been very patient since you were the first here.

Mr. HIGGINS OF NEW YORK. Thank you, Mr. Chairman.

I just wanted to make reference to the Government Accountability Office report which was the subject of a similar hearing in this committee last week. The report had stated that a number of the assumptions that the administration had made relative to the financing of the Iraqi war have changed. I would just state that assumptions don't change; facts change, and facts serve as a basis for new assumptions. The assumptions that the administration had made relative to the financing of this war were dead wrong and fundamentally flawed.

The fact of the matter is the administration said that this war would be financed and its reconstruction by oil revenues and also from the international community. That obviously has not happened. And $1.5 billion, or $6 billion a month is the cost to this Government, and in many cases it is off budget, so it is for future generations. So on the actual accuracy of the number and this characterization of assumptions that have changed, I think we need to talk about facts that have changed that should form the basis for new assumptions if we are to be at all productive in this process.

I would also say that the administration has an obligation to level with this Congress and the American people about the true cost, because not only does it affect the current Government and this Congress, but it affects future generations, as well.

Then there is the deeper issue which has been touched upon in this committee about accountability in the outlay, the expenditure of these dollars, however much they are in reality. That is, if moneys are not being spent for their intended purpose to reconstruct Iraq, then where are they? Is there fraud and abuse? Is it pervasive? Is it isolated? These are the kinds of issues that we need to know, as well.

With that I will yield back.

Mr. SHAYS. I thank the gentleman.

Mr. Van Hollen, you will close up here.

Mr. VAN HOLLEN. I thank you, Mr. Chairman, and thank you for holding another in a very important series of hearings. This hearing is entitled Global War on Terrorism: Accuracy and Reliability of Cost Estimates. I think that is a very important issue to be investigating. But I also think it is important that we sort of take the veil off the global war on terrorism and look at the different components, because within that overall umbrella you, of course, have military action against Afghanistan and also action against Iraq and other efforts in terrorism.

This country, this Congress, in fact, the world community was united behind the United States in our decision to take action in Afghanistan. After all, the terrible attacks of September 11, 2001, were launched by Al Qaeda, Osama Bin Laden as its head, from Afghanistan while the Taliban government gave them refuge and safe haven.

And the international community, as we know, passed a resolution at the United Nations unanimously condemning that and join-

ing the United States in the fight on terrorism in Afghanistan, and NATO, for the first time in its history, invoked one of the articles of its charter saying an attack against one was an attack against all. That was a necessary military action against the people directly responsible for attacking this United States on September 11, 2001, and I think the American people were fully prepared to bear the costs of that war and continue to bear the costs, because we need to get it right in Afghanistan.

We recall last time we were engaged in Afghanistan after the Soviet Union left, the United States decided it didn't have its interests engaged there any more, left, and what you had was a failed state that Al Qaeda took advantage of. We don't want that to happen again in Afghanistan. We need to finish the job, and the American people are united there.

The situation in Iraq is very different. I think we need to approach it differently when we consider the cost, because that was a war of choice. We now know there were no weapons of mass destruction. We know there was no collaboration between Osama Bin Laden and Al Qaeda on the one hand and Saddam Hussein on the other.

The President, in a speech he gave shortly before going to war before the American Enterprise Institute, predicted that by going to war in Iraq you would create a domino effect of democracy and stability in the Middle East region. We just have to look at the terrible events going on there today to know that the opposite has happened.

So the war in Iraq was very different, and when we consider the costs we have to consider them differently.

Finally, when it comes to accountability I think you see a very different standard applied to the two. Again, when it came to Afghanistan people understood the risks. They understood the challenge. They understood the threat, and they responded. In the case of Iraq we have a series of predictions by administration officials that were dead wrong, and yet the people who were wrong were either rewarded in some way or otherwise received positive reinforcement. The people who were wrong received positive and the people who were right were consistently sort of diminished.

Since we are focusing on costs here I will close here, Mr. Chairman, but I do think it is important to go back when Lawrence Lindsay, who was the chief economic advisor, predicted that the cost of the war would be between $100 billion and $200 billion, and Mitch Daniels, who was then the head of Office of Management and Budget and others in the administration said it is not going to be that high.

Well, we now know that Lawrence Lindsay's predictions were, in fact, low—low not just for the global war on terror but low for Iraq. We are already far above that number, and we haven't begun to see the end of it. Yet, Paul Wolfowitz, when he was Deputy Secretary of Defense, also famously predicted that, when it came to reconstruction, Iraqi oil revenue would be able to pay the cost. We haven't even gotten back to pre-war levels there.

So whether it was on weapons of mass destruction, whether it was on this claim, the manufactured link between Al Qaeda on the one hand and Saddam Hussein on the other, whether it was the

cost of the war, and many other things, people just got it wrong. And when you continue to ignore people who get it wrong, when you ignore or reward failure, you get more failure. Unfortunately, that is what we have today in Iraq.

Thank you, Mr. Chairman.

Mr. SHAYS. The Chair would recognize Mr. Dent.

Mr. DENT. Thank you, Mr. Chairman. I do want to thank you for holding this hearing. It is very important that we continue this oversight on the Iraq issue.

With that, I would like to yield my time to the chairman for a statement.

Mr. SHAYS. Thank you. I won't use much time, but to just say to my colleagues that I agree with their very real criticism about our assessment of the cost of this war. That is why we are having this hearing. I would disagree with my colleagues about their sense of the importance of the war in Iraq. I happen to believe it is a noble effort and I believe, in fact, that Iraq is the central front in the global war on terror, and I just want to be on record as saying that. But this is a hearing, and now I would introduce our colleagues here who are testifying.

This is Global War on Terrorism: Accuracy and Reliability of Cost Estimates. We have before us the Honorable David M. Walker, Comptroller General of the United States, Government Accountability Office; we have Mr. Brad Higgins, Assistant Secretary, Chief Financial Officer, Department of State, and I would say a constituent, which places additional burdens on you, Mr. Higgins, and on me; Mr. John P. Roth, Deputy Comptroller, Office of the Undersecretary of Defense, Department of Defense; Mr. James R. Kunder, Assistant Administrator for Asia and the Near East, U.S. Agency for International Development, referred to as USAID; Mr. Donald M. Marron, Acting Director, Congressional Budget Office; and Ms. Amy Belasco, Specialist in National Defense, Foreign Affairs, Defense and Trade Division, Congressional Research Office. I think my statement gave you a larger title than your title actually is.

It is nice to have you here and to welcome you. At this time, as you know, we do swear in our witnesses.

[Witnesses sworn.]

Mr. SHAYS. Note for the record our witnesses have responded in the affirmative.

I thank you all for your patience. As you know, we like our witnesses to address us for 5 minutes, but this committee does not put the clock on the first 5 minutes. But, given that we have six panelists, it would be good to be as close to the 5-minutes as you can, but we are not going to stop you if you go over.

Mr. Walker, you have the floor.

STATEMENTS OF DAVID M. WALKER, COMPTROLLER GENERAL OF THE UNITED STATES, GOVERNMENT ACCOUNTABILITY OFFICE; BRADFORD R. HIGGINS, ASSISTANT SECRETARY, CHIEF FINANCIAL OFFICER, BUREAU OF RESOURCE MANAGEMENT, DEPARTMENT OF STATE; JOHN P. ROTH, DEPUTY COMPTROLLER (PROGRAM/BUDGET), OFFICE OF THE UNDERSECRETARY OF DEFENSE (COMPTROLLER), DEPARTMENT OF DEFENSE; JAMES R. KUNDER, ASSISTANT ADMINISTRATOR FOR ASIA AND THE NEAR EAST, U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT [USAID]; DONALD B. MARRON, ACTING DIRECTOR, CONGRESSIONAL BUDGET OFFICE; AND AMY F. BELASCO, SPECIALIST IN NATIONAL DEFENSE, FOREIGN AFFAIRS, DEFENSE AND TRADE DIVISION, CONGRESSIONAL RESEARCH OFFICE

STATEMENT OF DAVID M. WALKER

Mr. WALKER. Chairman Shays, Ranking Member Kucinich, members of the subcommittee, I appreciate the opportunity to be with you this morning.

I assume that my entire statement will be entered into the record and I now move to summarize it.

As has been noted, the testimony today is dealing with funding, reported costs, and future commitments of the global war on terrorism, and our testimony is focused on the overseas costs, as per the request of the key subcommittee staff.

At the outset, Mr. Chairman, as I said last week, I want to compliment you and this subcommittee for your continued commitment to oversight in this area. I think you are to be commended for that. It is very important, and you are one of the few continuing to do that.

I testified last week, as has been mentioned, on the new national strategy for victory in Iraq. During that testimony I noted several positive attributes about the new strategy, including a clear purpose and scope and the fact that strategy identifies Iraq as "a vital national interest and a central front in the war on terror." However, I also noted during that hearing that there were certain deficiencies, one of which was the absence of adequate current and future cost data for Iraq.

While this hearing is focused on the financial costs, needless to say there is no way to compare the financial cost with the loss of human life.

Since the beginning of the global war on terrorism in 2001, Congress has appropriated about $430 billion to the Department of Defense and other U.S. Government agencies for military, diplomatic, and other efforts in support of the global war on terrorism. This funding has been provided through regular appropriations, as well as supplemental appropriations, which are provided, as you know, outside the normal budget process.

Since September 2001, DOD has received roughly $386 billion for global war on terrorism military operations, including funding for homeland defense through Operation Noble Eagle. This $386 billion includes bridge funding in fiscal years 2005 and 2006 to continue global war on terrorism operations until supplemental appropriations could be enacted.

In addition, U.S. Government agencies, including the Department of State, the USAID have received about $44 billion since 2001 to fund reconstruction and stabilization programs in Iraq and Afghanistan, and an additional $400 million for the commander's emergency response program in Iraq and Afghanistan.

For fiscal year 2007, DOD has requested another $50 billion in bridge funding for military operations, and other U.S. Government agencies have requested $771 million for reconstruction and stabilization activities.

Since 2001 U.S. Government agencies have reported hundreds of billions of dollars in cost associated with the global war on terrorism; however, as we have previously reported, we have certain concerns with regard to the DOD's reliability and cost reporting. I might note for the record some progress has been made since our last testimony, especially with regard to timeliness, but we still have concerns with regard to reliability of some of these cost estimates. I wish reliability was only a concern with regard to Iraq or the global war on terrorism. As you know, Mr. Chairman, it has been a concern throughout financial management throughout DOD for a number of years.

DOD's reported costs for GWOT operations overseas have grown steadily in each fiscal year through fiscal year 2005 from about $105 million in fiscal year 2001 to begin for the preparations for operations in Afghanistan to about $81.5 billion in fiscal year 2005, and has been mentioned about $1.5 billion a week with regard to Iraq. With this steady growth, it is important to assure that all commands seek to control costs to the extent possible, while providing appropriate support for our troops.

With regard to the cost of military operations, about $23 billion has been obligated for Iraq construction and stabilization, in addition to those military operations, as of 2006. However, U.S. Government agencies other than DOD do not formally track all global war on terrorism costs.

Let's face it, though: DOD is most of the money. This, along with DOD's cost reliability and reporting problems make it difficult but not impossible for the decisionmakers to reliably know how much the war is costing, to determine how appropriated funds are being spent, and to use historical data to predict future trends. Predicting future costs will be difficult but not impossible because they are dependent on several direct and indirect cost variables; however, they are likely to be hundreds of billions of dollars in the future. I know CBO will probably testify some on that.

With regard to GWOT costs, they are likely to continue for the foreseeable future. No one knows for sure how long the global war on terrorism will last. Decisionmakers will have to carefully weigh priorities and make difficult choices, given increasing fiscal pressures. In assessing the tradeoffs, we would encourage the Department of Defense to consider moving other GWOT costs into the baseline budget, as it has done with Operation Noble Eagle.

I know, Mr. Chairman, you have had some concerns with regard to continued supplemental funding. This is consistent with our prior suggestion that, once an operation reaches a known level of effort or reasonably reliable level of effort and the costs are more predictable, more funding should be built into the baseline budget.

This has been the approach that has been used in other conflicts in the past, and we believe it should be considered for this conflict, as well.

Thank you, Mr. Chairman. I would be happy to answer any questions you or the other Members may have.

[The prepared statement of Mr. Walker follows:]

United States Government Accountability Office

GAO

Testimony

Before the Subcommittee on National Security, Emerging Threats, and International Relations, Committee on Government Reform, House of Representatives

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GLOBAL WAR ON TERRORISM

Observations on Funding, Costs, and Future Commitments

Statement of David M. Walker
Comptroller General of the United States

GAO-06-885T

July 18, 2006

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Highlights

Highlights of GAO-06-885T, a testimony to the Chairman, Subcommittee on National Security, Emerging Threats, and International Relations, Committee on Government Reform, House of Representatives

GLOBAL WAR ON TERRORISM

Observations on Funding, Costs, and Future Commitments

Why GAO Did This Study

After the terrorist attacks of September 11, 2001, the President announced a Global War on Terrorism (GWOT), requiring the collective instruments of the entire federal government to counter the threat of terrorism. Ongoing military and diplomatic operations overseas, especially in Iraq and Afghanistan, constitute a key part of GWOT. These operations involve a wide variety of activities such as combating insurgents, civil affairs, capacity building, infrastructure reconstruction, and training military forces of other nations. The U.S. has reported substantial costs to date for GWOT related activities and can expect to incur significant costs for an unspecified time in the future, requiring decision makers to consider difficult trade-offs as the nation faces increasing long-range fiscal challenges.

GAO has issued several reports on current and future financial commitments required to support GWOT military operations, as well as diplomatic efforts to stabilize and rebuild Iraq. This testimony discusses (1) the funding Congress has appropriated to the Department of Defense (DOD) and other U.S. government agencies for GWOT-related military operations and reconstruction activities since 2001; (2) costs reported for these operations and activities and the reliability of DOD's reported costs, and (3) issues with estimating future U.S. financial commitments associated with continued involvement in GWOT.

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To view the full product, including scope and methodology, click on the link above. For more information, contact Sharon L. Pickup at (202) 512-9619 or pickups@gao.gov.

What GAO Found

Since 2001, Congress has appropriated about $430 billion to DOD and other government agencies for military and diplomatic efforts in support of GWOT. This funding has been provided through regular appropriations as well as supplemental appropriations, which are provided outside of the normal budget process. Since September 2001, DOD has received about $386 billion for GWOT military operations. In addition, agencies including the Department of State, DOD, and the Agency for International Development have received since 2001 about $44 billion to fund reconstruction and stabilization programs in Iraq ($34.5 billion) and Afghanistan ($9 billion) and an additional $400 million to be used in both Iraq and Afghanistan.

Since 2001, U.S. government agencies have reported significant costs associated with GWOT, but GAO has concerns with the reliability of DOD's reported cost data. Through April 2006, DOD has reported about $273 billion in incremental costs for GWOT-related operations overseas—costs that would not otherwise have been incurred. DOD's reported GWOT costs and appropriated amounts differ generally because DOD's cost reporting does not capture some items such as intelligence and Army modular force transformation. Also, DOD has not yet used funding made available for multiple years, such as procurement and military construction. GAO's prior work found numerous problems with DOD's processes for recording and reporting GWOT costs, including long-standing deficiencies in DOD's financial management systems and business processes, the use of estimates instead of actual cost data, and the lack of adequate supporting documentation. As a result, neither DOD nor the Congress reliably know how much the war is costing and how appropriated funds are being used or have historical data useful in considering future funding needs. GAO made several recommendations to improve the reliability and reporting of GWOT costs. In addition to reported costs for military operations, U.S. agencies have obligated about $23 billion of $30 billion received for Iraqi reconstruction and stabilization, as of January 2006.

U.S commitments to GWOT will likely involve the continued investment of significant resources, requiring decision makers to consider difficult trade-offs as the nation faces increasing fiscal challenges in the years ahead; however, predicting future costs is difficult as they depend on several direct and indirect cost variables. For DOD, these include the extent and duration of military operations, force redeployment plans, and the amount of damaged or destroyed equipment needed to be repaired or replaced. Future cost variables for other U.S. government agencies include efforts to help form governments and build capable and loyal security forces in Afghanistan and Iraq, and meet the healthcare needs of veterans, including providing future disability payments and medical services.

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss our work to date on the funding, reported costs,[1] and future commitments of the Global War on Terrorism (GWOT) overseas. I recently testified on the National Strategy for Victory in Iraq, in which I stated that there are some positive attributes to the new strategy, including a clear purpose and scope.[2] The strategy also identifies U.S. involvement in Iraq as a "vital national interest and the central front in the war on terror." However, among its deficiencies is the absence of current and future cost data for Iraq. After the terrorist attacks of September 11, 2001, the President announced a Global War on Terrorism, requiring the collective instruments of the entire federal government to counter the threat of terrorism. The United States and its partners are attacking terrorists both at home and abroad, denying terrorists sanctuary and sponsorship, disrupting the financing of terror, and building and maintaining a united global front against terrorism. Ongoing military and diplomatic operations overseas constitute a key part of GWOT and involve a wide variety of activities such as combating insurgents, civil affairs, capacity building, reconstruction operations, and training military forces of other nations. These operations are currently focused on Iraq and Afghanistan. Clearly, costs to the United States in financial terms in no way compare to the loss of human life. To date, over 2,800 military personnel have died as a result of GWOT operations and many more have been wounded in action.

As I have highlighted in previous testimony, our nation is not only threatened by external security threats, but also from within by growing fiscal imbalances due primarily to known demographic trends and rising health care costs.[3] These trends are compounded by the near-term deficits arising from new discretionary and mandatory spending as well as lower revenues as a share of the economy. If left unchecked, these fiscal imbalances will ultimately impede economic growth, have an adverse effect on our future standard of living, and in due course affect our ability

[1]For purposes of this testimony, the term "costs" refers to the obligations that have been incurred by U.S. agencies in support of GWOT. Obligations are incurred through actions such as orders placed, contracts awarded, services received, or similar transactions made during a given period that will require payments during the same or a future period.

[2] GAO, *Rebuilding Iraq: More Comprehensive National Strategy Needed to Help Achieve U.S. Goals and Overcome Challenges,* GAO-06-953T (Washington, D.C.: July 11, 2006).

[3]GAO, *Defense Management: Key Elements Needed to Successfully Transform DOD Business Operations,* GAO-05-629T (Washington, D.C.: Apr. 28, 2005).

to address key national and homeland security needs. These factors create the need to make choices that will only become more difficult and potentially disruptive the longer they are postponed. The United States' commitment to GWOT will likely involve the continued investment of significant resources, requiring decision makers to consider difficult trade-offs as the nation faces increasing fiscal challenges, including a growing debt burden and interest costs on such debt, in the years ahead.

My testimony today will focus on the financial commitments required to support military operations associated with GWOT in Iraq and Afghanistan, as well as diplomatic efforts to stabilize and rebuild Iraq. Specifically, I will discuss (1) the funding Congress has appropriated to the Department of Defense (DOD) and other U.S. government agencies for GWOT-related military operations and reconstruction and stabilization activities since 2001, (2) costs reportedly incurred for these operations and activities and the reliability of DOD's reported costs, and, (3) issues with estimating the future financial commitments associated with the United States' continued involvement in GWOT.

In preparing this testimony, we have relied on previously issued GAO reports[4] and testimonies on the costs and other aspects of military operations and reconstruction and stabilization activities, as well as a large body of ongoing work on GWOT-related topics. We performed our work in accordance with generally accepted government auditing standards.

Summary

Since the beginning of GWOT in 2001, Congress has appropriated about $430 billion to DOD and other U.S. government agencies for military and diplomatic efforts in support of GWOT. This funding has been provided through regular appropriations as well as supplemental appropriations, which are provided outside of the normal budget process. Since September 2001, DOD has received about $386 billion for GWOT military operations, including funding for homeland defense through Operation Noble Eagle. This $386 billion includes "bridge" funding in fiscal years 2005 and 2006 to continue GWOT operations until supplemental appropriations could be enacted. In addition, U.S. government agencies,

[4]For example, see GAO, *Global War on Terrorism: DOD Needs to Improve the Reliability of Cost Data and Provide Additional Guidance to Control Costs*, GAO-05-882 (Washington, D.C.: Sept. 21, 2005) and GAO, *Rebuilding Iraq: Governance, Security, Reconstruction, and Financing Challenges*, GAO-06-697T (Washington, D.C.: Apr. 25, 2006).

including the Department of State (State), DOD, and the United States Agency for International Development (USAID), have received about $44 billion since 2001 to fund reconstruction and stabilization programs in Iraq ($34.5 billion) and Afghanistan ($9 billion) with an additional $400 million for the Commanders' Emergency Response Program in Iraq and Afghanistan. For fiscal year 2007, DOD has requested another $50 billion in bridge funding for military operations and other U.S. government agencies have requested $771 million for reconstruction and stabilization activities.

Since 2001, U.S. government agencies have reported hundreds of billions of dollars in costs associated with GWOT; however, we have previously reported on our concerns with DOD's data reliability and cost reporting.[5] DOD has reported incremental costs of about $273 billion for overseas GWOT-related activities through April 2006. This amount includes almost $215 billion for operations in Iraq and almost $58 billion for operations in Afghanistan, the Horn of Africa, the Philippines, and elsewhere.[6] These reported costs do not include obligations for intelligence and the Army's modular force transformation. The difference between the amount appropriated and DOD's reported costs through April 2006 can generally be attributed to unreported costs for intelligence and Army modular force transformation, as well as funding for procurement, military construction, and research, development, test, and evaluation, which can be obligated over multiple years, that has not yet been obligated. However, our prior work has found numerous problems with DOD's processes for recording and reporting costs for GWOT, including long-standing deficiencies in DOD's financial management systems and business processes, the use of estimates instead of actual costs, and the lack of adequate supporting documentation. For example, we found inadvertent double counting in a portion of DOD's reported costs amounting to almost $1.8 billion from November 2004 through April 2005. Furthermore, DOD's reported costs for GWOT operations overseas have grown steadily in each fiscal year through fiscal year 2005—from about $105 million in fiscal year 2001, to begin preparation for operations in Afghanistan, to about $81.5 billion in fiscal year 2005. With this steady growth, it is important to ensure that all commands seek to control costs to the extent possible. In addition to reported costs for military operations, about $23 billion has been obligated

[5]GAO-05-882.

[6] In addition to the costs for overseas operations, DOD has also reported obligations of $27.7 billion through April 2006 for operations in defense of the homeland U.S., under Operation Noble Eagle.

for Iraqi reconstruction and stabilization, as of January 2006. However, U.S. government agencies, other than DOD, do not formally track all GWOT costs. This, along with DOD's cost reliability and reporting problems, make it difficult for the decision makers to reliably know how much the war is costing, to determine how appropriated funds are being spent, and to use historical data to predict future trends.

The United States' commitments to GWOT will likely involve the continued investment of significant resources, requiring decision makers to consider difficult trade-offs as the nation faces increasing fiscal challenges in the years ahead. Predicting future costs will be difficult because they are dependent on several direct and indirect cost variables; however, they are likely to be in the hundreds of billions of dollars. Future cost variables for DOD include the extent and duration of military operations, the facilities that will be needed to support servicemembers overseas, force redeployment plans and the costs to repair and replace damaged or destroyed equipment used during operations. Future cost variables for other U.S. government agencies include the efforts to help form national and provincial governments and build management capacity as well as capable and loyal security forces in both Afghanistan and Iraq. There will also be further need for funding reconstruction activities to restore, sustain, and protect critical infrastructure. Another long-term cost associated with GWOT will be caring for veterans. The Department of Veterans' Affairs (VA) estimated that more than 100,000 GWOT veterans are currently using VA facilities, and future healthcare costs will likely increase as more servicemembers require treatment from injuries and mental health conditions such as post-traumatic stress disorder. There will also be future commitments associated with payments to those veterans with long-term disabilities. With GWOT costs likely continuing for the foreseeable future, decision makers will have to carefully weigh priorities and make difficult financial decisions. In assessing trade-offs, we would encourage DOD to consider moving other GWOT costs into the baseline budget, as it has done with Operation Noble Eagle. This is consistent with our prior suggestion that, once an operation reaches a known level of effort and costs are more predictable, more funding should be built into the baseline budget.

Background

The United States is engaged in a comprehensive effort to protect and defend the homeland and defeat terrorism. Using all instruments of national power, the United States and its partners are attacking terrorists both at home and abroad, denying terrorists sanctuary and sponsorship, disrupting the financing of terror, and building and maintaining a united

global front against terrorism. After the terrorist attacks of September 11, 2001, military operations began with Operation Noble Eagle, which is aimed at defending the U.S. homeland from terrorist attacks, and Operation Enduring Freedom, which takes place principally in and around Afghanistan, but also covers additional operations in the Horn of Africa, the Philippines, and elsewhere. In 2003, DOD began Operation Iraqi Freedom, which takes place in and around Iraq. DOD and the military services are responsible for carrying out these operations. Recently, DOD reported about 132,000 U.S. military personnel are deployed to Iraq and about 15,000 are deployed to Afghanistan.

Diplomatic efforts are also underway to rebuild areas in and around Iraq and Afghanistan, as well as to assist these countries in rebuilding their governments and creating secure nations. State is responsible for all U.S. activities in Iraq except security and military operations. Other U.S. government agencies also play significant roles in this reconstruction effort, including the USAID and the U.S. Army Corps of Engineers. The Multi-National Security Transition Command-Iraq, which operates under the Multi-National Force-Iraq, leads coalition efforts to train, equip, and organize Iraqi security forces. In Afghanistan, USAID manages the majority of reconstruction programs and operations. Other U.S. agencies provide additional assistance, including DOD. Members of the North Atlantic Treaty Organization also play a key role in training and equipping Afghan forces.

Since 2001, DOD has prepared reports on the costs of its involvement in GWOT. The costs of military contingency operations are referred to as "incremental costs," which are costs that are directly attributable to the operation and would not otherwise have been incurred, were it not for the operation. Specifically, the costs are above and beyond baseline training, operations, and personnel costs. Incremental costs include the pay of mobilized reservists as well as the special pays and allowances for deployed personnel, such as imminent danger pay and foreign duty pay for those personnel serving in Operation Iraqi Freedom and Operation Enduring Freedom; the cost of transporting personnel and materiel to the theater of operation and supporting them upon arrival; and the operating cost of equipment, such as vehicles and aircraft, among many other costs. Costs that are incurred regardless of whether there is a contingency operation, such as the base pay of active duty military personnel, are not considered incremental.

DOD tracks the obligations incurred to support GWOT and produces a monthly cost report, which is distributed throughout the department and

used by senior DOD leadership, along with other information, in discussing the cost of the war. It is also used in formulating future budget requests to fund GWOT. The report identifies the monthly and cumulative incremental GWOT obligations. DOD reports the costs by service, defense agency, contingency operation, and appropriation. On October 1, 1998, DOD implemented a standard contingency cost breakdown structure consisting of 55 cost categories to improve contingency cost reporting consistency between its multiple services and agencies. Examples of cost categories include facilities/base support and airlift. Furthermore, this cost breakdown structure was also to facilitate future efforts to understand and interpret differences between estimated and actual costs. DOD Financial Management Regulation 7000.14-R, volume 12, chapter 23, generally establishes financial policy and procedures related to DOD contingency operations. The regulation incorporates the common cost categories and multiple subcategories, which were established in 1998 and updated in September 2005, that are used to report DOD's monthly GWOT costs.

Obligations are the foundation of all GWOT cost reporting. For example, operation and maintenance obligations in support of GWOT represent tens of thousands, if not hundreds of thousands, of individual transactions ranging in value from one penny to millions of dollars. When obligations are incurred, the military services enter them into their accounting systems using accounting codes. Using the Army as an example, an Army budget activity, such as an installation or unit, initially obligates funds for acquired goods and services by using the Standard Army Accounting Classification Code. An obligation entry includes information on the funding source; the operational mission, such as Operation Iraqi Freedom; and the category of cost. The cost categories are established by the services.

Funding for the Global War on Terrorism

Since 2001, Congress has appropriated about $430 billion to DOD and other U.S. government agencies for military operations and reconstruction and stabilization activities supporting GWOT. Much of the funding has come in the form of supplemental appropriations. Some funding has also come through the normal baseline budget appropriated to the departments. For example, in fiscal years 2005 and 2006, DOD was provided so-called "bridge" funding—$25 billion and $50 billion, respectively—through its regular appropriation, which was intended to fund operations from the beginning of the fiscal year until a supplemental appropriation could be enacted. Also, funds are appropriated to the various appropriations accounts for each department and are not specifically designated for operations in Iraq or Afghanistan. Since

September 2001, DOD has received about $386 billion to fund military operations supporting GWOT. In addition, about $44 billion has been made available to U.S. agencies—including DOD, USAID, and State—for reconstruction and stabilization efforts in Iraq ($34.5 billion) and Afghanistan ($9 billion) with an additional $400 million for use in Iraq and Afghanistan through the Commander's Emergency Response Program. These efforts include training and equipping of security forces and repairing critical infrastructure. (See table 1.) For fiscal year 2007, DOD has requested another $50 billion in bridge funding for military operations and other U.S. government agencies have requested $771 million for reconstruction and stabilization activities.

Table 1: Total GWOT Military Operations and Reconstruction and Stabilization Funding for Fiscal Years 2001 through 2006

Budget authority in millions

	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006	Total
Military operations[a]	16,623	17,749	73,546	61,400	100,888[b]	116,022	**386,228**
Reconstruction and stabilization[c]	-	500	4,800	21,800	9,100	7,730	**43,930**
Total	**16,623**	**18,249**	**78,346**	**83,200**	**109,988**	**123,722**	**430,128**

Source: GAO.

[a]GAO analysis based on congressional appropriations acts.

[b]Of this total, $25 billion was available to DOD in FY 2004 for military operations.

[c]GAO analysis for Iraq and Congressional Research Service reports for Afghanistan. Reconstruction and Stabilization funds are for Iraq and Afghanistan only.

The $386 billion DOD has received to fund military operations supporting GWOT also includes funding for homeland defense under Operation Noble Eagle. This operation was funded through supplemental appropriations for DOD until fiscal year 2005, when it was moved into DOD's baseline budget. This movement is consistent with our prior suggestion that, once an operation reaches a known level of effort and costs are more predictable, more funding should be built into the baseline budget. This $386 billion also includes funding for DOD's intelligence programs, as well as other DOD initiatives, such as the Army's efforts to transform its traditional division-based force into a more rapidly deployable modular force that is better able to conduct joint and expeditionary operations. Beginning in fiscal year 2007, the Army's modular transformation will be included in DOD's regular baseline appropriation. Prior to passage of the most recent supplemental appropriation, military service officials told us that they had already spent the $50 billion bridge that was included in the fiscal year 2006 defense appropriations act and had started to use baseline appropriations for GWOT activities, as well as undertake cost-cutting

measures until the supplemental was enacted.[7] DOD has requested another $50 billion in bridge funding as part of its fiscal year 2007 budget.

In addition to the funding provided to support military operations, Congress has appropriated about $44 billion to DOD and other U.S. government agencies to support important reconstruction and stabilization activities in Iraq and Afghanistan since 2001. These activities support GWOT objectives because they help train and equip local security forces, and help establish the foundations of a sound economy with the capacity to deliver essential services, such as clean water and reliable electricity. A growing economy also provides employment opportunities as an alternative to recruitment efforts made by insurgents. Since 2003, about $34.5 billion[8] has been provided to support these types of activities in Iraq and, since September 2001, about $9 billion to support these activities in Afghanistan. The recent supplemental appropriation also provided an additional $400 million for the Commander's Emergency Response Program for use in Iraq and Afghanistan. This would bring total reconstruction and stabilization funding to over $44 billion.

Funding for reconstruction and stabilization efforts has supported the following activities, among others:

- **Training and equipping of Iraqi security forces.** Since fiscal year 2003, about $11.7 billion has been made available for U.S. security and justice programs in Iraq, including funds to train and equip the Iraqi security forces. Over the past several months, the Secretaries of State and Defense have cited progress in developing Iraqi security forces, and reported that the numbers of operational army personnel and trained and equipped police have increased from about 142,000 in March 2005 to about 266,000 in June 2006. However, as we have previously reported, the number of trained and equipped forces does not provide reliable information on their capabilities.[9] In addition, the administration received $3.0 billion in the recent fiscal year 2006

[7]Emergency Supplemental Appropriations Act for Defense, the Global War on Terror, and Hurricane Recovery, 2006, Pub. L. No. 109-234 (2006).

[8]The $34.5 billion includes funding for the following activities and programs: security and justice; restoring essential services such as oil, electricity, and water; other sectors; and administrative costs.

[9]GAO, *Rebuilding Iraq: Preliminary Observations on Challenges in Transferring Security Responsibilities to Iraqi Military and Police,* GAO-05-431T, (Washington, D.C., Mar. 14, 2005).

supplemental appropriation to continue moving the Iraqi security forces toward stand-alone operational capacity.

- **Restoring Iraq's essential services.** Since fiscal year 2003, about $10.5 billion has been made available for restoring essential services in Iraq, specifically activities in the oil, water, health, and electricity sectors. U.S. reconstruction efforts have helped increase electricity generation capacity, restart crude oil production, and restore some water treatment plants. However, key reconstruction goals in the oil, electricity, and water sector have yet to be achieved due to security, management, and sustainment challenges in U.S.-funded projects. The administration received an additional $1.5 billion in the recent supplemental appropriation for reconstruction assistance to Iraq, including $50 million to USAID's Iraq Community Action Program and $50 million for democracy, rule of law, and reconciliation programs.

- **Training and equipping the Afghan national army.** The United States led the international effort to train and equip the Afghan national army, which is crucial to both long-term security and U.S. counter-terror efforts. About 26,500 troops have been trained and equipped and the defense force is projected to reach up to 70,000 military and civilian personnel, according to State reporting. The administration has received $1.9 billion in the fiscal year 2006 supplemental appropriation to further prepare Afghan security forces to operate without U.S. support.

The U.S. government also funds a variety of other programs that indirectly support GWOT. For example, Congress provides funding for security assistance on a worldwide basis to help train or equip foreign security forces (military and police). In fiscal year 2006, Congress provided an estimated $4.5 billion for two security assistance programs, the International Military Education and Training program and Foreign Military Financing program. In addition, the U.S. government reported costs of $1.2 billion on worldwide public diplomacy programs in fiscal year 2005.

The U.S. Has Reported Hundreds of Billions in Costs of Ongoing Military and Reconstruction and Stabilization Operations, but Data Weaknesses Make It Difficult to Reliably Know Cost of Military Operations

Since GWOT began in 2001, U.S. government agencies have reported hundreds of billions of dollars in costs for overseas military and reconstruction operations; however, as we have previously reported, data reliability and reporting concerns make it difficult to know DOD's total GWOT costs. Since 2001, DOD has reported costs of about $273 billion on overseas GWOT military operations through the end of April 2006. The department's reported costs have grown steadily from a reported about $105 million in fiscal year 2001, to begin preparations for operations in Afghanistan, to over $81.5 billion in fiscal year 2005. U.S government agencies have reported costs of about $23 billion for Iraqi reconstruction and stabilization. However, U.S. government agencies, other than DOD, do not formally track all GWOT costs. This, along with DOD's cost reliability and reporting problems, make it difficult for the decision makers to reliably know how much the war is costing, to determine how appropriated funds are being spent, and to use historical data to predict future trends.

DOD's Reported Costs for Military Operations

Since the attacks of September 11, 2001, DOD has reported cumulative incremental costs of about $273 billion, through the end of April 2006, on military operations overseas in support of GWOT. This amount includes almost $215 billion for operations in Iraq and almost $58 billion on operations in Afghanistan, the Horn of Africa, the Philippines, and elsewhere. This does not include obligations for intelligence activities and the Army's modular force transformation. The difference between the amount appropriated and DOD's reported costs through April 2006 can generally be attributed to these unreported obligations for intelligence and Army modular force transformation, as well as funding for procurement, military construction, and research, development, test, and evaluation, which can be obligated over multiple years, that has not yet been obligated. In addition to the costs for overseas operations, DOD has also reported obligations of $27.7 billion through April 2006 for operations in defense of the homeland U.S., under Operation Noble Eagle.

To date, the largest reported costs for the overseas GWOT operations have typically been associated with two of DOD's appropriations accounts—operation and maintenance and military personnel. Operation and maintenance expenses cover a number of things, such as operational support for housing, food, and services; transportation to move people and supplies and equipment into the theaters; and the repair of equipment. Military personnel expenses include military pay and allowances for mobilized reservists, as well as the special payments or allowances, such as imminent danger pay and the family separation allowance that all

qualifying military personnel receive. While expenses for operation and maintenance, and military personnel have tended to be among the highest, DOD has also reported incurring costs for procurement of equipment and other items.

As we have reported in the past, we have significant concerns about the overall reliability of DOD's reported cost data. As a result, neither DOD nor Congress can reliably know how much the war is costing. As we reported in September 2005, we found numerous problems with DOD's processes for recording and reporting costs for GWOT.[10] Factors affecting the reliability of DOD's reported costs include long-standing deficiencies in DOD's financial management systems and business processes, the use of estimates instead of actual costs, and the lack of supporting documentation. In at least one case, our work showed that some reported costs may have been materially overstated. Specifically, reported obligations for mobilized Army reservists in fiscal year 2004 were based primarily on estimated rather than actual information and differed from related payroll information by as much as $2.1 billion, or 30 percent of the amount DOD reported in its cost report. In addition, we found inadvertent double counting in a portion of DOD's reported costs amounting to almost $1.8 billion from November 2004 through April 2005.

In our September 2005 report, we made several recommendations to the Secretary of Defense to (1) undertake a series of steps to ensure that the services' reported GWOT costs are accurate and reliable; (2) direct the Office of the Under Secretary of Defense (Comptroller) to oversee the services' efforts and to develop a systematic process to review and test the reliability of the overall GWOT reports; (3) expand the department's financial management regulation for contingency operations to include contingencies as large as GWOT; and (4) establish guidelines to control costs and require the services to keep the Comptroller's office informed of their efforts in this area.

Since the time of our report, we know that DOD has taken some measures in response to our recommendations intended to improve the reliability and accuracy of its cost reports, such as requiring the military services to identify variances in reported costs from month to month, and determine the causes. However, our initial review suggests that DOD and the services have yet to take sufficient action to fully implement these measures and

[10]GAO-05-882.

that certain weaknesses in cost reporting continue to exist. Without aggressive action on the part of DOD and the services, the reliability of cost reports will remain in question. Also, there has been an ongoing issue with the timeliness of DOD's cost reporting. For example, the cost reports for October through December 2005 were not issued until March 2006. To address this long-standing problem, Congress, in the National Defense Authorization Act for Fiscal Year 2006, directed that DOD provide the cost reports to GAO no later than 45 days after the end of the month being reported.[11] DOD has now provided GAO with the March and April cost reports on schedule.

DOD's Reported Costs Have Steadily Grown

DOD's reported costs for GWOT operations have grown steadily in each fiscal year through fiscal year 2005—from about $105 million in fiscal year 2001 to about $81.5 billion in fiscal year 2005. For fiscal year 2006, as of April 2006, DOD has reported obligations of about $49 billion; about $41.9 billion for Iraq and about $7.5 billion for Afghanistan. These amounts include about

- $22.5 billion in operating support, which pays for transportation, fuel, maintenance, housing, food, services, and other items;
- $5.3 billion for procurement of equipment and other items;
- $9.9 billion in military personnel costs, including special pays and allowances for deployed military personnel;
- $2.9 billion for personnel support, including clothing and medical support;
- $4.0 billion for transportation, including airlift and sealift;
- $2.6 billion in support for the Iraq Security Forces;
- $813 million for the Afghanistan Security Forces; and,
- $474 million in support of coalition forces.

Costs for the remainder of fiscal year 2006 are expected to be higher than DOD anticipated, in part because the Army has been unable to follow through with plans to close a number of forward operating bases and consolidate troops at some of the larger locations. Also, savings resulting from a United States and coalition hand-off of operations in Afghanistan to troops from nations representing the North Atlantic Treaty Organization is not expected to be realized until after fiscal year 2007. Furthermore, the

[11]Pub. L. No. 109-163, §1221(c) (2006).

rising cost of fuel is likely to push costs even higher than envisioned at the start of the fiscal year.

In examining the historical growth of reported overseas GWOT costs, the largest increase has been in operations and maintenance expenses. For example, between fiscal year 2002 and fiscal year 2005, DOD has reported increases in these expenses from about $7.6 billion to about $48.7 billion. According to DOD, some of this increase is attributable to higher fuel costs and increased operational support costs for contracts to provide housing, food, and services for the military locations in Iraq and Afghanistan. For the same time frames, reported obligations for military personnel have increased from about $3.4 billion to about $14.9 billion, and reported procurement obligations have increased from $0 to about $16.5 billion.

With the steady growth in reported GWOT costs, we believe there is a need to ensure that all commands seek to control costs to the extent possible. As we reported in September 2005, individual commands have taken steps to control costs and DOD policy generally advises its officials of their financial management responsibilities to ensure the prudent use of contingency funding.[12] However, DOD has not established guidelines that would require commands to take steps to control costs and keep DOD informed of these steps as we recommended in our prior report. In the absence of such guidelines and reports, DOD cannot be sure that enough is being done to control costs.

U.S. Government Agencies Have Reported Obligating Most of Their Reconstruction and Stabilization Program Funding

U. S. government agencies have reported obligating $23 billion for Iraqi reconstruction and stabilization, as of January 2006. However, U.S. government agencies, other than DOD, do not formally track all GWOT costs. Among other uses, these funds have been used for infrastructure repair of the electricity, oil, water, and health sectors; training and equipping of Iraqi security forces (military and police); and administrative expenses.

State reports that the remaining funds will not be used for large reconstruction projects, but to sustain the projects that have already been built and to build greater capacity at the national, provincial, and municipal levels for better and more responsive governments.

[12]GAO-05-882.

Global War on Terrorism Costs Will Likely Continue for the Foreseeable Future

It appears the United State's military and diplomatic commitments in Iraq and Afghanistan will continue for the foreseeable future and are likely to be in the hundreds of billions of dollars. However, costs are difficult to predict because they depend on several direct and indirect cost variables. DOD's future costs will likely be affected by the pace and duration of military operations, the types of facilities needed to support troops overseas, force redeployment plans, and the amount of damaged or destroyed equipment that will need to be repaired or replaced. Other future costs to the U.S. government include nation-building and reconstruction efforts and treating injured GWOT veterans. These costs will require administration decision makers and Congress to consider difficult trade-offs as the nation faces increasing fiscal challenges in the years ahead.

Future DOD Costs

The future costs associated with DOD's commitments to GWOT depend on several variables, including (1) the extent and duration of operations, (2) the types of facilities that will be required to support troops overseas, and (3) the amount of equipment that will need to be restored or replaced. As DOD has done with Operation Noble Eagle, we would encourage the department to consider moving other GWOT costs into the baseline budget. This is consistent with our prior suggestion that, once an operation reaches a known level of effort and costs are more predictable, more funding should be built into the baseline budget.[13] Doing so will assist decision makers in determining investment priorities and making trade-offs among funding needs.

Extent and Duration of Military Operations

It is uncertain how long DOD will be engaged in a high pace of military operations associated with GWOT, making it difficult to predict costs associated with future troop levels and mission requirements. There has also been some discussion of reducing the number of troops in Iraq and Afghanistan. However, DOD officials have not announced information about the level or timing of any troop reduction or redeployment plans. While it would appear that reducing the number of troops in theater could lower costs for these operations, we have seen from previous operations in Bosnia and Kosovo that costs may rise due to the increased use of contractors to replace the military personnel. Bases still have to be maintained, even with fewer military members in them. Also, if the pace of

[13]GAO, *Bosnia: Costs Are Exceeding DOD's Estimate,* GAO/NSIAD-96-024BR (Washington, D.C.: July 25, 1996).

operations remains high because of security concerns or hostilities, costs for force protection, fuel, and other items could remain high.

Facilities to Support Overseas Troops

The United States does not currently have any basing agreements with Iraq. DOD has constructed facilities in Iraq and neighboring countries supporting missions in both Iraq and Afghanistan. Examples of facilities funded by military construction funds and other appropriations funding include force protection, airfield and road improvements, fuel handling, power and water distribution, and support facilities. The Secretary of Defense recently testified that already some 30 U.S. military bases have been returned to Iraqi control or closed altogether.[14] If the United States decides to enter into agreements with the new governments in Iraq and Afghanistan to have an enduring presence in these countries, costs to make our temporary bases into more permanent facilities could be significant.

Equipment Restoration and Replacement

Sustained GWOT operations have and will continue to take a toll on the condition and readiness of military equipment. The United States faces short-and long-term costs to maintain and restore equipment in theater, as well as reequip units as these missions end and the units return to their home stations. The uncertainties of how long ongoing operations will continue make it difficult to estimate future costs of maintaining and replacing this large amount of equipment.

The Army and Marine Corps will have the largest reset costs of the services. DOD has reported Army equipment usage rates have averaged two to eight times those of peacetime rates, while senior Marine Corps officials testified that the ground equipment used by the Corps in ongoing operations has experienced usage rates four to nine times that of peacetime rates. We recently testified that the services are currently funding their reset programs through the use of supplemental appropriations and plan to rely on supplemental appropriations for reset funding through at least fiscal year 2007.[15] According to recent testimony, the Army requirement for reset in fiscal year 2007 is $17.1 billion. The Army expects the requirement beyond fiscal year 2007 to be $12 billion to

[14]"Senate Armed Services Committee Holds Hearing on Defense Authorization", a speech presented by Secretary of Defense, Donald Rumsfeld at the Senate Armed Services Committee, Feb. 7, 2006.

[15]GAO, *Defense Logistics: Preliminary Observations on Equipment Reset Challenges and Issues for the Army and Marine Corps*, GAO-06-604T (Washington, D.C.: Mar. 30, 2006).

$13 billion per year through the end of the conflict and for a minimum of two to three years thereafter. In recent testimony, the Marine Corps stated that $11.9 billion is needed to manage the equipment in Operation Iraqi Freedom and Operation Enduring Freedom for fiscal year 2007 and an estimated additional requirement of $5.3 billion for each year that the conflict continues. The uncertainties of pace and duration of ongoing operations as well as the overall condition of major equipment items make it difficult to estimate future equipment reset costs. Equipment used in operations in Iraq will eventually require more intensive repair and overhaul than what is typically expected in peacetime. While the services are working to refine overall requirements, the total requirements and costs are unclear.

In addition to resetting a large number of major equipment items, the Army and Marine Corps must also plan to replace active, National Guard, and Reserve equipment left in theater to support ongoing operations. As we previously testified, in late 2003 the Army began to direct redeploying National Guard and Reserve units to leave their equipment in theater for use by deploying forces.[16] DOD policy requires the Army to replace equipment transferred to it from the Reserve Component including temporary withdrawals or loans in excess of 90 days,[17] yet at the time of our report in October 2005, the Army had neither created a mechanism in the early phases of the war to track Guard equipment left in theater nor prepared replacement plans for this equipment, because the practice of leaving equipment behind was intended to be a short-term measure. As of June 2006, only 3 replacement plans have been endorsed by the Secretary of Defense, all to replace National Guard equipment, while 22 plans are in various stages of approval. While the exact dollar estimate for these replacements will not be known until operations in Iraq cease, it will likely cost billions of dollars.

Future Nation-Building Costs

Future cost variables for other U.S. government agencies include the efforts to help form national and provincial governments and build management capacity in both Afghanistan and Iraq and build capable and loyal Iraqi and Afghani security forces. Also, there will be further need for funding to restore, sustain, and protect infrastructure. The new Iraqi

[16]GAO, *Reserve Forces: Army National Guard's Role, Organization, and Equipment Need to be Reexamined,* GAO-06-170T (Washington, D.C.: Oct. 20, 2005).

[17]Department of Defense Directive 1225.6, *Equipping the Reserve Forces* (Apr. 7, 2005).

government will need significant help in building the procurement, financial management, and accountability systems needed to govern and provide basic services to millions of its citizens. In addition, the 18 provincial governments will also require assistance in building management capacity and delivering results to the Iraqi people that make a difference in their daily lives. The costs of sustaining an Iraqi force of 266,000 personnel may require the Iraqi government to spend more money on personnel, maintenance, and equipment than originally anticipated. In addition, the new Iraqi security forces will have recurring training needs, and will need additional assistance in replacing lost or stolen equipment, and in developing improved logistical and sustainment capabilities.

While most of the reconstruction money for Iraq has been obligated, additional funds will be needed to finance remaining reconstruction needs, and to restore, sustain, and protect the infrastructure that has been built to date. For example,

- **Iraqi needs are greater than originally anticipated**. In the next several years, Iraq will need an estimated $30 billion to reach and sustain oil capacity of 5 million barrels per day, according to industry experts and U.S. officials. For electricity, they will need $20 billion through 2010, according to the Department of Energy's Energy Information Administration. Iraqi budget constraints and limited government managerial capacity limit its ability to contribute to future rebuilding efforts.

- **There is widespread corruption in Iraq.** Reconstruction efforts have not taken the risk of corruption into account when assessing the costs of achieving U.S. objectives in Iraq. The International Monetary Fund, the World Bank, Japan, and the European Union officials cite corruption in the oil sector as a special problem. In addition, according to State officials and reporting documents, about 10 percent of refined fuels are diverted to the black market, and about 30 percent of imported fuels are smuggled out of Iraq and sold for a profit.

- **Future international contributions for Iraq may be limited**. Most of the U.S. funds have been obligated and about 70 percent of the $13.6 billion in international pledges are in the form of loans.

- **The new U.S. embassy will be costly**. The embassy is projected to cost about $592 million, but the full cost of establishing a diplomatic presence across Iraq is still unknown.

- **Additional funds are needed to train and equip Afghan security forces.** The United States, other donors, and the new Afghan government face significant challenges to establishing viable Afghan army and police forces.[18] Although DOD and State have not yet prepared official cost estimates, the army and police programs could cost up to $7.2 billion to complete and about $600 million annually to sustain. Moreover, slow progress in resolving other Afghan security problems—the lack of an effective judiciary, the substantial illicit narcotics industry, and the continued presence of armed militias—threaten to undermine overall progress made toward providing nationwide security and ensuring the stability of the Afghan government.

Future Costs for Veterans

Lastly, one of the variables that can influence how much these efforts will cost the United States is the long-term cost of caring for our veterans. Both improvements in medical care in the field and in body armor have increased the survival rate of those who are seriously injured in combat. However, seriously injured survivors will likely require substantial long-term medical care from the VA, and may require extensive inpatient and home and community-based support services to assist those with traumatic brain injury, spinal cord injury, and other severely disabling conditions. We also know that many servicemembers have been exposed to intense and prolonged combat, which research has shown to be strongly associated with the risk of developing post-traumatic stress disorder. This disorder can occur after experiencing or witnessing a life-threatening event and is the most prevalent mental health disorder resulting from combat. Mental health experts predict that 15 percent or more of the servicemembers returning from operations in Iraq and Afghanistan will develop post-traumatic stress disorder.[19] In addition to an influx of more severely injured patients, the VA health care system will be required to serve large numbers of returning veterans with shorter term, more routine, health care needs.

[18]GAO, *Afghanistan Security: Efforts to Establish Army and Policy Have Made Progress, but Future Plans Need to be Better Defined*, GAO-05-575 (Washington, D.C.: June 30, 2005). The estimates in this report have not been updated.

[19]GAO, *Post-Traumatic Stress Disorder: DOD Needs to Identify the Factors Its Providers Use to Make Mental Health Evaluation Referrals for Servicemembers*, GAO-06-397 (Washington, D.C.: May 11, 2006).

VA has estimated that a little more than 100,000 veterans from operations in Iraq and Afghanistan are currently using VA health care services. VA originally underestimated by 77,000 the number of returning veterans who would use its health care, which in part required the VA to request additional appropriations in both fiscal years 2005 and 2006. Long-term estimates of how many returning veterans will use VA health care and the costs of that care are imprecise for a variety of reasons, including uncertainty about the duration of operations in the theaters as discussed above. But, current levels of usage by returning servicemembers indicate a growing VA health care workload and costs. Furthermore, while we have no clear idea of the magnitude, there will undoubtedly be long-term financial commitments associated with payments to veterans with long-term disabilities.

Mr. Chairman, this concludes my prepared statement. I would be happy to answer any questions you and the subcommittee members may have.

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Mr. SHAYS. Thank you, Mr. Walker.
Mr. Higgins.

STATEMENT OF BRADFORD R. HIGGINS

Mr. HIGGINS. Chairman Shays, Congressman Kucinich, and members of the subcommittee, thank you for asking me to appear before you to discuss the Department of State's budget process for funding the global war on terror.

In my confirmation hearing this past January, I made a commitment to not only seek the funds sufficient to complete our mission, but also to make sure that these funds were spent for maximum effect, issues that I believe are central to this hearing.

In my role as Assistant Secretary for Resource Management and the Chief Financial Officer, I am responsible for administering the development of the Department's internal planning, budgeting, and accounting functions. As you are aware, the department recently reorganized the administration of foreign assistance programs under the new Director of U.S. Foreign Assistance, Ambassador Randall Tobias. While I work closely with Ambassador Tobias to coordinate budgetary matters for both the foreign assistance and the State operating accounts, he has authority for both State and USAID foreign assistance funding and programs. As such, I am pleased to have joining me as a witness to help respond to questions on foreign assistance USAID's Assistant Administrator for Asia and Near East, Jim Kunder.

I am here today to discuss the Department's resources associated with the global war on terror in Iraq and Afghanistan. In response to your specific questions, to date the Department has appropriated $34.6 billion for foreign assistance activities and State Department operations in Iraq and Afghanistan, representing approximately 8 percent of the total U.S. Government funding for these two countries.

Breaking this down further, $26.5 billion has been provided for Iraq and $8.1 billion for Afghanistan.

Of the $34.6 billion, $31.1 billion has been provided in supplemental appropriations, as well, of the $34.6 billion, $30.5 billion or 88 percent was for foreign assistance. The remaining $4.1 billion, or 12 percent, was appropriated for State and USAID operations and for construction of embassy and other facilities in Iraq and Afghanistan. Of the funding appropriated to date, $28.2 billion, greater than 80 percent, has been obligated.

The Department separately tracks and regularly reports on the status of these supplemental funds, such as through the quarterly Section 2207 report on the Iraq relief and reconstruction fund that we all know as IRRF, as well as other periodic reports required by law. In order to develop reliable and accurate budget estimates, the Department works very closely with its embassies in both Iraq and Afghanistan to identify critical requirements and to better manage the very high but very necessary expenses that are crucial to winning the global war on terror.

Costs that can be adequately projected and justified are included in the President's annual budget submission; however, because conditions are dynamic it is important that both our budget approach and our response remain flexible to provide additional resources

outside the annual appropriations process, as warranted by changing circumstances.

As conditions evolve, the Department will work diligently to integrate our resource requirements for both countries into the Department's annual budget submission. Costs that could not be reasonably funded through the use of existing Department funds have been provided through supplemental appropriations. This supplemental funding has been critical to the Department in supporting our operations and our activities, for which we are grateful to Congress for its support.

We are all aware that the operating environment in Iraq and Afghanistan is both constantly changing and hostile. These timely supplemental appropriations, which are much closer to when the funds are actually used, have allowed the Department to better project funding requirements for the extraordinary security and evolving assistance required to further our diplomatic efforts.

Thank you for the opportunity to address the subcommittee. I look forward to addressing your specific questions.

[The prepared statement of Mr. Higgins follows:]

TESTIMONY BEFORE HOUSE SUBCOMMITTEE ON NATIONAL SECURITY, EMERGING THREATS, AND INTERNATIONAL RELATIONS
COMMITTEE ON GOVERNMENT REFORM

ASSISTANT SECRETARY BRADFORD R HIGGINS
CHIEF FINANCIAL OFFICER FOR THE DEPARTMENT OF STATE

Global War on Terrorism: Accuracy and Reliability of Cost Estimates

July 18, 2006

Chairman Shays, Congressman Kucinich and fellow members of the Committee, thank you for asking me to appear before you today to discuss the Department of State's budget process for funding the Global War on Terror (GWOT). In my confirmation hearing, I made a commitment to not only seek the funds sufficient to complete our mission but also to make sure these funds were spent for maximum effect, issues that are central to today's hearing.
In my role as Assistant Secretary and the CFO, I am responsible for administering the development of the Department's internal planning, budgeting, and accounting functions. As you are aware, the Department recently reorganized its administration of Foreign Assistance programs under the new Director of U.S. Foreign Assistance (DFA), Ambassador Randall Tobias. While I work closely with the Director of Foreign Assistance to coordinate budgetary matters for both the Foreign Assistance and the State

Operating accounts, Ambassador Tobias has authority over all Department of State and USAID foreign assistance funding and programs. I am pleased that joining me as a witness today to respond to questions focusing on foreign assistance is USAID's Assistant Administrator for the Asia and Near East bureau, Jim Kunder.

I am here today to address the Department's resources associated with the Global War On Terror in Iraq and Afghanistan.

In response to your specific questions, to date, the Department has been appropriated $34.6 billion for foreign assistance activities and State Department operations in Iraq and Afghanistan, with $31.1 billion of this funding having been provided in supplemental appropriations. Of this amount, $26.5 billion is for Iraq and $8.1 billion is for Afghanistan. Of the $34.6 billion provided, $30.5 billion or 88 percent was for Foreign Assistance activities. The remaining $4.1 billion, or 12 percent, was appropriated for State and USAID Operations and for construction of embassy and other facilities in Iraq and Afghanistan.

Of the funding appropriated to date, over $28 billion, greater than 80 percent, has been obligated. The Department separately tracks and regularly reports on the status of these supplemental funds such as through the quarterly Section 2207 report on the Iraq Relief and Reconstruction Fund (IRRF) as well as other periodic reports required by law.

In order to develop reliable and accurate budget estimates, the Department works very closely with State's field operations in both Iraq and Afghanistan to identify critical requirements and better manage the necessary, yet extraordinary expenses, that are crucial to supporting the Global War On Terror. Those costs that can be adequately projected and justified are included in the President's annual budget submission. However, because conditions are dynamic, it is important that both our budget approach and response remain flexible to provide additional resources outside the annual appropriations process as warranted by changing circumstances. As conditions change, the Department is continuing to work diligently to integrate our resource requirements for both Iraq and Afghanistan into the Department's annual budget submission.

Costs that could not be reasonably funded through the use of existing Department funds have been provided through supplemental appropriations. This supplemental funding has been critical to the Department in supporting our operations and activities. As we are all well aware, the operating environment in Iraq and Afghanistan is both constantly changing and hostile. These timely supplemental appropriations, which are made closer to when the funds are actually used, have allowed the Department to better project funding requirements for the extraordinary security and evolving assistance required to further our diplomatic efforts.

Thank you for the opportunity to address the committee and I look forward to addressing your specific questions.

Mr. SHAYS. Thank you, Mr. Higgins. I am sure you will get a number.

Mr. Roth.

STATEMENT OF JOHN P. ROTH

Mr. ROTH. Thank you, Mr. Chairman. Chairman Shays, Mr. Kucinich, members of the subcommittee, thank you for the opportunity to speak with you about the current process for funding the global war on terror.

I have been in the Department of Defense for 32 years, 22 of these years with the Office of the Defense Comptroller. My principal role is to build a budget, whether it is the baseline budget for the Department of Defense or a supplemental request. Drawing on this experience, I am happy to address the important questions raised in your letter of invitation.

To date, the Congress has appropriated approximately $382 billion for the Defense Department and the intelligence community for the global war on terror. As of April 2006, approximately $323 billion of this amount has been spent or obligated. The question of whether supplemental appropriations as opposed to baseline budgeting is the best vehicle for funding the ongoing cost of military operations in the time of war is, in fact, a fair one.

In 2001 the administration and congressional leaders worked together to provide supplemental appropriations as the most appropriate mechanism to fund the global war on terror. For our part, the Department can do it either way. However, because supplementals are prepared much closer to the time the funds will actually be used, they are a more accurate reflection of conditions on the ground. They are a more accurate prediction of what the cost of the war will actually be and, importantly, a process that allows quicker access to the funds at the time when they are needed most, and to make an important point, because, regardless of whether the war is funded through the supplemental appropriations or baseline budgeting, we must not lose sight of the fact that our first priority must be to give the men and women who put their lives on the line every day to protect our freedom what they need and when they need it.

The same is true of the bridge funding provided by Congress in recent years. Like the supplementals, they ensure that the U.S. forces have the support they need when they need it without the services having to resort to sub-optimal actions to cash-flow critical military operations.

As for the accuracy and reliability of information on the cost of war, the Department diligently and meticulously reports the cost of war to both Congress and to the Government Accountability Office. Congress has mandated nine distinct reports on the cost of the global war on terrorism. These include one biannual and seven quarterly reports to Congress, as well as the monthly report we provide to the GAO.

Approximately 10 briefings on the cost of war are generally given to Congress in the oversight committees every year. Indeed, as part of the process of defending the Defense budget, over 31,000 pages of budget justification and reports are provided to Congress every year; 475 different reports were provided in fiscal year 2006, alone.

So we take our role as steward of the taxpayers' money very seriously and we work to ensure that all cost of war information, both in the baseline budget and the supplemental, is as accurate and reliable as possible. Indeed, this seriousness has been borne out not only with respect to the cost of war, but by the substantial progress the Department has made in business transformation and financial management.

Two consecutive reports by the Government Accountability Office have cited the Department's progress in business systems modernization efforts. The Office of Management and Budget recently raised the Department's progress rating for financial management from yellow to green, indicating that improvement efforts are proceeding according to plan.

So with that, Mr. Chairman, I conclude my formal remarks and I look forward to your questions. Again, I thank the committee for the opportunity to discuss these issues, and I am happy to respond to your concerns.

[The prepared statement of Mr. Roth follows:]

Testimony

of

John P. Roth
Deputy Comptroller
Department of Defense

before the

House Committee on Government Reform
Subcommittee on National Security,
Emerging Threats, and International Relations

Washington, D.C.
July 18, 2006

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Chairman Shays, Mr. Kucinich, members of the Subcommittee, thank you for the opportunity to speak with you about the current process for funding the Global War on Terror.

I have been in the Department of Defense for 32 years – 22 of those years with the Office of the Comptroller. My principal role is to build the budget, whether it is the base budget for the Department of Defense or a supplemental request. Drawing on this experience, I am happy to address the important questions raised in your letter of invitation.

To date, the Congress has appropriated approximately $382 billion for DoD and the Intelligence Community for the Global War on Terror. As of April 2006, approximately $323 billion of this amount has been spent or obligated.

The question of whether supplemental appropriations – as opposed to baseline budgeting – is the best vehicle for funding the ongoing cost of military operations in time of war is a fair one. In 2001, the Administration and Congressional leaders worked together to provide supplemental appropriations as the most appropriate mechanism to fund the Global War on Terror.

For our part, the Department can do it either way. However, because supplementals are prepared much closer to the time the funds will actually be used, they are a more accurate reflection of conditions on the ground, a more

accurate prediction of what the costs of war will actually be; and importantly, a process that allows quicker access to funds at the time when they are needed most.

And this is an important point. Because regardless of whether the war is funded through supplemental appropriations or baseline budgeting, we must not lose sight of the fact that our first priority must be to give the men and women who put their lives on the line every day to protect our freedom, what they need, when they need it.

The same is true of the bridge funding provided by Congress in recent years. Like the supplementals, they ensure that U.S. forces have the support they need, when they need it – without the Services having to resort to suboptimal actions to "cash flow" critical military operations.

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And, approximately 10 briefings on the cost of war are given to Congress every year.

Indeed, over 31,000 pages of budget justification and reports are provided to Congress every year; 475 different reports were provided in FY 2005 alone.

So, we take our role as steward of the taxpayer's money very seriously, and work to ensure that all cost-of-war information – both in the baseline budget and the supplemental – is as accurate and reliable as possible.

Indeed, this seriousness has been borne out, not only with respect to the cost of war, but by the substantial progress that Department has made in business transformation and financial management.

Two consecutive reports by the Government Accountability Office cited the Department's progress in business systems modernization efforts. The Office of Management and Budget recently raised the Department's progress rating from yellow to green, indicating that improvement efforts are proceeding according to plan.

With that, Mr. Chairman, I will conclude my formal remarks and look forward to your questions. Again, I thank the Committee for the opportunity to discuss these issues with you, and I am happy to respond to your concerns.

Mr. SHAYS. Thank you.
Mr. Kunder.

STATEMENT OF JAMES R. KUNDER

Mr. KUNDER. Mr. Chairman, Mr. Kucinich, members of the subcommittee, thank you for the opportunity to be here today.

First, let me just answer directly the question asked by the committee on numbers. Thus far, the U.S. Agency for International Development in Iraq and Afghanistan has received $9 billion for reconstruction assistance. In response to the direct question of what percentage has been obligated, in excess of 97 percent of that money has been obligated to this point.

The issue of supplemental funding, we try to maximize the amount of money put into the regular budget request, but also, as Mr. Roth just testified, there are times when additional extraordinary expenses arise, especially in highly changeable circumstances like Iraq and Afghanistan. For fiscal year 2007, we put the entire program budget at USAID in to the regular appropriations request.

The only amount that we added in the supplemental were those security costs for static and mobile security because we were unable to estimate those going on. But increasingly we are trying to put the bulk of the money into the regular appropriations request, but in these kind of highly variable environments it is virtually impossible to project the year out, as circumstances change both on the program and security side.

I would like to point out that Ambassador Tobias, the new Director of Foreign Assistance and AID Administrator is attempting on the State and AID side, as Brad Higgins said earlier, to come up with a new accounting system that will allow us additional ability to track global war on terrorism, anti-terrorism efforts. This program is still in development, as you can imagine. It requires a great deal of budgetary consultation.

But certainly, as that system is developed further, we look forward to sharing the ideas with the Congress and presenting those ideas to you, but it explicitly does attempt to break out from each of the existing funding categories development assistance, economic support fund, and so forth, that proportion of the money on the State and AID side that is going into the global war on terror.

In conclusion, I would just like to add one other comment. While naturally the focus of this subcommittee's questions today is on Iraq and Afghanistan, I think one of the complicating factors in examining the true cost of the global war on terror is certainly a number of programs supported by the Congress and implemented by USAID around the world we think are consistent with the global war on terror.

But these are programs, for example, to reform the education system in Indonesia or to look at broadcasting systems in Bangladesh or Egypt, or a number of capacity building programs in Mindenau to make government more responsive. We think those are also undermining terrorism and are part of the global war on terror but, of course, are much more difficult to account for because they also have a developmental and reconstruction impact.

Those are the points I would make at this point. I look forward to answering any questions the committee may have.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Kunder follows:]

TESTIMONY OF JAMES R. KUNDER
ASSISTANT ADMINISTRATOR FOR
ASIA AND THE NEAR EAST
U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT
BEFORE THE
HOUSE COMMITTEE ON GOVERNMENT REFORM
SUBCOMMITTEE ON NATIONAL SECURITY, EMERGING THREATS, AND
INTERNATIONAL RELATIONS
U.S. HOUSE OF REPRESENTATIVES
JULY 18, 2006

TESTIMONY OF JAMES R. KUNDER
ASSISTANT ADMINISTRATOR FOR
ASIA AND THE NEAR EAST
U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT
BEFORE THE
HOUSE COMMITTEE ON GOVERNMENT REFORM
SUBCOMMITTEE ON NATIONAL SECURITY, EMERGING THREATS, AND
INTERNATIONAL RELATIONS
U.S. HOUSE OF REPRESENTATIVES
JULY 18, 2006

Mr. Chairman, members of the Committee, it is an honor to appear before you. I welcome the opportunity to testify on behalf of the U.S. Agency for International Development (USAID). Today, I would like to describe to the Committee USAID's efforts to provide Congress with accurate and comprehensive budget estimates.

We, like the Department of State, work hand-in-hand with our Embassies and Missions to report on programs in Iraq and Afghanistan according to rigorous and detailed financial management standards. A great portion of our costs can be sufficiently projected and justified and are included in the President's annual budget submission. However, due to the volatile nature of the operating environments in Iraq and Afghanistan, many costs cannot be fully anticipated in advance, leading to the need to request funding through supplemental appropriations. To date, for Operation Iraqi Freedom and Operation Enduring Freedom, USAID has been allocated approximately $5.1 billion for Iraq and $3.9 billion for Afghanistan (excluding the FY 2006 supplemental). Virtually all of this funding has been obligated.

While supplemental funding requests have been necessary each year since the initiation of the Global War on Terror (GWOT), we recognize the oversight and budgeting challenges they present to Congress. With this in mind, we assure you that we are making every effort to regularize as much of the budget as is feasible. For example, USAID submitted its FY 2007 resource requirements for Afghanistan in the regular President's budget request, except for funding for static and mobile security for USAID personnel, which is very difficult to predict.

The GWOT requires the integration of all instruments of power. USAID estimates budgets for our portions of this battlefield drawing upon our previous experiences. For elections in Iraq, we costed-out the inputs required for success, which included 15,000 independent election monitors and nearly 1.5 million election publications detailing the new multi-district electoral system, the broadcasting of 11 political debates, and 743 town hall meetings reaching out to Iraqi voters on issues related to the new electoral law and polling procedures. We also budgeted for voting registration kits, printing and shipment

of voter registries, and voter education materials. Nevertheless, in spite of our best efforts to estimate costs, situations change, particularly concerning indirect costs associated with security. Supplemental funding allows us the flexibility to make the most accurate cost estimates as possible that will advance U.S. government strategic goals.

As you know, USAID's social, political and economic programs in many countries are counted among a series of tools for addressing the underlying conditions that foster terrorism. It is difficult to provide a precise cost estimate isolated for activities that benefit the development environment of a country and, in doing so, also counter terrorism. In many countries, the chronic failure of governments to provide key services has lead to a proliferation of alternative providers—many of whom are inimical to U.S. interests. By improving government services in key countries, USAID advances GWOT goals. For example, USAID is implementing a basic education program in Indonesia which has improved the quality of education for nearly one million students to date.

Outside of Iraq and Afghanistan, we have not yet perfected the science of disaggregating funding specifically for counterterrorism where USAID's programs also address development challenges. But we are making efforts to do so. To better harmonize and track funding, State and USAID are in the process of implementing a new budget process initiated by the Office of the Director of Foreign Assistance that allows for direct accounting of activities designed to deny terrorist sponsorship, support and sanctuary; delegitimize terrorist ideology; and enhance government capability to fight terrorism. We look forward to sharing the details of this new budgeting system as it evolves and is put into practice.

Whatever vehicle is used to request funding, whether it is the supplemental or base budget, USAID has always been transparent with the Congress and public on the purpose of the funding and the expected results. USAID provides a robust budget justification to the Congress. In addition, our website contains a lot of information about USAID programs in Iraq, Afghanistan, and other countries supporting GWOT efforts. USAID also regularly briefs Congress on our programs—both current ones and those for which we are requesting funding. We welcome your feedback on these efforts.

In conclusion, I want to assure you that USAID is taking every measure it can to ensure that U.S. government resources are used effectively and transparently. I believe that with Congress's continued support, USAID will be able to make a significant impact in the Global War on Terror.

Mr. Chairman, thank you for offering me this opportunity to discuss USAID's role in the Global War on Terror with your Committee. I welcome your questions.

Mr. SHAYS. Thank you.
Dr. Marron.

STATEMENT OF DONALD B. MARRON

Dr. MARRON. Thank you, Mr. Chairman, Congressman Kucinich, members of the subcommittee. It is a pleasure to be here today to talk about the accuracy and reliability of cost estimates for the war on terrorism.

CBO estimates that since September 2001 the Congress has appropriated $432 billion for military operations and other activities related to the war on terrorism. About $393 billion was allocated to the Department of Defense and about $40 billion was appropriated for diplomatic operations and foreign aid. CBO estimates that of these amounts $290 billion has been appropriated for operations in Iraq.

You will notice that each of the witnesses today brings with them their own different sets of numbers and the estimates for these various measures will differ somewhat, and I think that illustrates the fact that there is a certain degree of judgment that has to go in when estimating this, that the data are not speaking uniquely with a single voice, and that, depending on the judgments the estimators make, we sometimes get different numbers.

CBO has frequently been asked to estimate the future costs of operations in Iraq and the war on terrorism. Last week, for example, CBO released a report requested by Congressman Spratt, the ranking member of the House Budget Committee, in which we estimated the cost of two Iraq scenarios that he specified. Those two scenarios would imply that additional cost for Iraq would be somewhere in the neighborhood of $200 billion to $400 billion over the next 10 years.

Now, estimating future war cost is always difficult because of uncertainty about the pace and scale of future military operations. However, better estimates could be provided to the Congress if more information was available. Let me just give a few examples.

First, the DOD's supplemental budget requests for the war on terrorism have typically been accompanied by much less justification than its regular requests. Such limited information is not always sufficient to understand how DOD develops its budget requests.

Second, the DOD's monthly obligation reports on the war on terrorism also provide only limited information. These reports, for example, provide little guidance on how some of the funds were obligated. For example, in fiscal year 2005 a significant fraction of the obligations were reported in various categories that were listed as other, which didn't provide sort of enough detail for us to really understand what was driving those and to understand in particular whether those costs were likely to be repeated in the future.

The reports also do not include obligations for classified activities, which CBO estimates have been at least $25 billion to date.

Finally, obligation reports would be more useful if they contained some information on the pace of operations, such as troop levels, flying hours, vehicle miles in a given month. Such information would be very useful in analyzing monthly cost variations.

Third, funds for Iraq and the war on terrorism were reported in the same appropriation accounts that fund the regular non-war budget. This makes it difficult to sort out how much is actually spent, how much actual outlays are on war-related activities and distinguishing that from the non-war.

Fourth, CBO frequently has difficulty obtaining the monthly reports on war obligations and other data. For example, the Agency often receives that information months after the data are officially approved for release. This could be addressed by establishing a standard, more comprehensive distribution list for the war obligation reports and other data. It would also be helpful to have access to the contingency operations support tool, the cost model that DOD uses to formulate its supplemental requests.

A final, broader issue involves the timing of budget requests. Since fiscal year 2001, funding for activities in Iraq and the war on terrorism has been provided through a combination of partial year bridge appropriations enacted near the beginning of the fiscal year and mid-year supplemental appropriations. Some have suggested that, to better assist in planning future Defense budgets, DOD should include the entire fiscal year's cost of activities in Iraq and the war on terrorism in its regular budget request.

That approach would have both positive and negative consequences. On the positive side, including war costs in the regular request would give the Congress more time to debate and modify the budget request for those activities and to balance those costs against other budget priorities. Also, fully funding those operations at the beginning of the fiscal year would help DOD avoid any potential funding issues that might arise from delayed enactment of mid-year supplemental appropriations.

On the negative side, budgeting for activities in Iraq and the war on terrorism in combination with the regular budget request could result in less clarity about which funds go to war-related activities and which were intended strictly for peacetime activities. In addition, submitting the request with the regular budget could lead to less accurate cost projections, given the long lead times involved.

Thank you. I would be happy to answer any questions.

[The prepared statement of Dr. Marron follows:]

CBO TESTIMONY

Statement of
Donald B. Marron
Acting Director

Issues in Estimating the Cost of Operations in Iraq and the War on Terrorism

before the
Subcommittee on National Security, Emerging Threats, and International Relations
Committee on Government Reform
U.S. House of Representatives

July 18, 2006

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CONGRESSIONAL BUDGET OFFICE
SECOND AND D STREETS, S.W.
WASHINGTON, D.C. 20515

Mr. Chairman, Congressman Kucinich, and Members of the Subcommittee, I appreciate the invitation to appear before you today to discuss the accuracy and reliability of cost estimates for operations in Iraq and the war on terrorism. My statement is based on the Congressional Budget Office's (CBO's) analyses of and research on this issue over the past few years. CBO has been asked, on a number of occasions, to determine how much has been spent and how much might be spent in the future for those activities. Most recently, CBO estimated the future costs of military operations in Iraq under two different scenarios at the request of Congressman Spratt, the Ranking Member of the House Committee on the Budget.[1]

This testimony will briefly discuss appropriations and obligations to date for operations in Iraq and the war on terrorism. It will also offer an overview of budgeting and reporting issues.

Appropriations and Obligations to Date

Since September 2001, the Congress has appropriated $432 billion for military operations and other activities related to Iraq and the war on terrorism (see Table 1). About $393 billion of that sum was allocated to the Department of Defense (DoD).[2] Because some of those funds are designated for classified purposes, about which little information is publicly available, CBO cannot provide a precise estimate of the amounts obligated to date. However, CBO concludes that DoD has obligated almost all of those funds, with the exception of the roughly $66 billion appropriated in the most recent supplemental (Public Law 109-234, Emergency Supplemental Appropriations Act for Defense, the Global War on Terror, and Hurricane Recovery, 2006). That judgment is based on an analysis of obligation reports provided by DoD.[3]

In addition to appropriations for military operations, the Congress has appropriated about $40 billion for diplomatic operations in and aid to Iraq, Afghanistan, and other countries assisting the United States in Iraq and in the war on terrorism.[4] About half of that amount ($21 billion) has been appropriated for the Iraq Relief and Reconstruction Fund, of which just over 90 percent has been

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1. Congressional Budget Office, *Letter to the Honorable John M. Spratt Jr. on the Estimated Costs of U.S. Operations in Iraq Under Two Specified Scenarios* (July 13, 2006).

2. The $393 billion in appropriations for the Department of Defense includes about $12 billion in funding for indigenous Iraqi and Afghan security forces. That funding was shown separately in CBO's July 13 report for Congressman Spratt.

3. The most recent reports provided by DoD cover obligations through April 2006.

4. The $40 billion amount includes about $5 billion in funding for indigenous Iraqi and Afghan security forces, which was shown separately in CBO's July 13 report for Congressman Spratt.

Table 1.

Estimated Budget Authority for Operation Iraqi Freedom and the War on Terrorism, Through Fiscal Year 2006

(Billions of dollars, by fiscal year)

	2001	2002	2003	2004	2005	2006	Total
Department of Defense	14	17	80	88	77	116	393
Foreign Aid and Diplomatic Operations	*	1	8	22	3	4	40
Total	**14**	**19**	**88**	**111**	**81**	**120**	**432**

Source: Congressional Budget Office.

Notes: * = Less than $500 million.

Numbers may not add up to totals because of rounding.

Estimates are based on analyses of appropriation acts and the Department of Defense's budget documentation.

obligated to date. On the basis of information from the Department of State, CBO estimates that most of the remaining $19 billion has been obligated.

Estimating the Cost of War

DoD estimates future war costs using a combination of cost models, surveys of damaged and destroyed equipment, and analyses of actual costs incurred to date. DoD's principal model for estimating war costs is the Contingency Operations Support Tool (COST), which was developed by the Institute for Defense Analyses. That model uses cost factors derived from actual expenditures for prior contingency operations to estimate operation and support costs for deploying units.[5] However, the model is not used to estimate the full cost of repairing or replacing damaged or destroyed equipment or expenses necessary to restore units and materiel to predeployment conditions; such costs are estimated separately by each of the military services. Those estimates, together with the operation and

5. According to 10 U.S.C. 101(a)(13), a "contingency operation" means a military operation in which members of the armed forces are or may become involved in military actions, operations, or hostilities against an enemy of the United States. It can also mean an operation in which reserve-component members are called to active status or any other national emergency declared by the President or the Congress.

support estimates produced by the COST model, provide a basis for DoD's estimates of necessary funding.

The actual obligations incurred for military operations in Iraq and the war on terrorism are tracked by the Defense Finance and Accounting Service, which issues monthly reports on financial obligations for each of the major ongoing operations (Iraqi Freedom, Enduring Freedom, and Noble Eagle).[6] The reports also show obligations by the year in which the funds were appropriated, as well as by military service.

Budgeting and Reporting Issues

CBO has been asked by the Congress on several occasions to estimate the future costs of operations in Iraq and the war on terrorism. Estimating war costs is always difficult because of uncertainty about the pace and scale of future military operations. However, better estimates could be provided to the Congress if more information was available on costs incurred to date. In particular, CBO has identified four main concerns regarding the current process of budgeting and cost reporting for operations in Iraq and the war on terrorism.

Supplemental Budget Requests and Obligation Reports

DoD's supplemental budget requests and the monthly obligation reports issued by the Defense Finance and Accounting Service often do not provide enough detail to determine how DoD develops its budget requests and how funds for operations in Iraq and the war on terrorism have been obligated. The $440 billion requested by DoD for its regular activities in fiscal year 2007 was supported by very detailed justification documents. By contrast, DoD's most recent supplemental request, which totaled about $68 billion, was accompanied by relatively little backup material. For instance, it included only five pages for operation and maintenance costs, even though those costs constituted almost half (about $33 billion) of the request.[7]

DoD recently delivered to the Congress justification material for $50 billion requested by the Administration as part of its proposed 2007 budget to cover the cost of operations related to Iraq and the war on terrorism for the first part of that fiscal year. Because the documentation was only recently delivered and is in draft

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6. Operation Enduring Freedom includes military operations in and around Afghanistan and other overseas counterterrorism activities. Operation Noble Eagle refers to homeland security missions, such as combat air patrols over major metropolitan areas, undertaken by DoD in response to the terrorist attacks of September 11, 2001.

7. Among many other things, operation and maintenance includes funding for such things as contractor support, fuel, spare parts, depot maintenance, base operations, and transportation.

form, CBO cannot comment on the specifics of that material at this time. However, upon initial inspection, it appears that the material is more detailed, at least in some respects, than such documentation provided in the past.

The monthly obligation reports also provide limited information. According to those reports, about $84 billion was obligated for military operations in Iraq and the war on terrorism in fiscal year 2005. Of that amount, 25 percent ($21 billion) was allocated for purposes described as "other." Little information was provided to suggest how the funds were obligated. Without a better understanding of those expenditures, it is difficult to estimate whether such costs will be incurred in future years. The reports also do not include obligations for classified activities. On the basis of conference reports for various supplemental appropriation acts, CBO estimates that those costs are at least $25 billion. In addition, the obligation reports would be a more useful source of information if they contained some information on the pace of operations—such as troop levels, flying hours, or vehicle miles—in a given month. Such information would be useful in analyzing monthly cost variations.

Timing of Budget Requests

Since fiscal year 2001, funding for activities in Iraq and the war on terrorism has been provided through a combination of partial-year appropriations (sometimes referred to as bridge appropriations), which are enacted near the beginning of the fiscal year, and midyear supplemental appropriations. If the bridge appropriations run out before enactment of the midyear appropriations, DoD can pay for war-related expenses using funds meant for its regular activities besides war, which are then reimbursed upon enactment of the midyear supplemental. In the event the midyear appropriations are delayed and funds for DoD's regular activities begin to run out, DoD has some options. One option would be to use its authority to transfer funds among various appropriation accounts (such as transferring funds from procurement accounts to operation and maintenance accounts), although that authority is limited. In addition, DoD could invoke the Feed and Forage Act (41 U.S.C. 11), which allows the President to obligate funds without an appropriation for the purpose of sustaining troops in the field. That authority was invoked immediately after the terrorist attacks on September 11, 2001, although ultimately it was not used because the Congress quickly provided the necessary appropriations.[8]

Some analysts have suggested that, to better assist in planning future defense budgets, DoD should include the entire fiscal year's cost of activities in Iraq and

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8. The authority of the Feed and Forage Act is limited to obligations for items meant to sustain troops in the field, such as clothing, subsistence, fuel, quarters, transportation, and medical supplies. It cannot be used to purchase additional weapons or for support of military hardware.

the war on terrorism in its regular budget request. That approach would have both positive and negative consequences. On the positive side, including war costs in the regular request would give the Congress more time to debate and modify the budget request for those activities. Also, fully funding those operations at the beginning of the fiscal year would help DoD avoid any potential funding issues that might arise from delayed enactment of midyear supplemental appropriations. On the negative side, budgeting for activities in Iraq and the war on terrorism in combination with the regular budget request could result in less clarity about which funds would go to war-related activities and which were intended strictly for peacetime operations. In addition, submitting the request at the beginning of the fiscal year could lead to less accurate cost projections because the budget must be submitted in February (eight months prior to the start of the fiscal year).[9]

Tracking Actual War-Related Obligations and Outlays

Regardless of when the funds for Iraq and the war on terrorism are provided, they are recorded in the same appropriation accounts that fund the regular nonwar budget, making it difficult to sort out how much is ultimately spent on war-related activities. For example, the Congress appropriated about $218 billion to DoD's operation and maintenance accounts for fiscal year 2006. Of that amount, about $72 billion was appropriated for war-related activities and about $146 billion was appropriated for DoD's regular operating costs.

The standard budget execution reports submitted to the Office of Management and Budget do not delineate between those war and nonwar expenditures, making it difficult to determine how much has actually been spent for activities related to Iraq and the war on terrorism. The Defense Finance and Accounting Service issues monthly reports that track war-related obligations, but, as indicated earlier, those reports do not include obligations for classified programs and do not provide detail on the pace of operations.

Distribution of Data and Information

CBO frequently has difficulty obtaining monthly reports on war obligations and other data. Often the agency receives that information months after the data are officially approved for release. That problem could be addressed by establishing a standard, more-comprehensive distribution list for the war obligation reports and other data. It would also be helpful to have access to the COST model that DoD uses to formulate its supplemental requests or to the data and methodology underlying it.

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9. Much of the agencies' budget preparation occurs long before the February budget submission.

Mr. SHAYS. Thank you, Dr. Marron.

Ms. Belasco.

STATEMENT OF AMY F. BELASCO

Ms. BELASCO. I would like to submit my full statement for the record.

Mr. SHAYS. It will be submitted for the record. You know what? If you would allow me, just so I don't forget, let me just take care of that business. I ask unanimous consent that all members of the subcommittee be permitted to place an opening statement in the record and that the record remain open for 3 days for that purpose. Without objection, so ordered.

I ask further unanimous consent that all witnesses be permitted to include their written statements for the record. Without objection, so ordered.

Mr. KUCINICH. Mr. Chairman, I ask unanimous consent to put the working papers in the record, the Stieglitz Report.

Mr. SHAYS. It is Joseph——

Mr. KUCINICH. Stieglitz, the Nobel-laureate.

Mr. SHAYS [continuing]. Stieglitz we will put in the record, without objection. It is dated February 2006.

[The information referred to follows:]

07/18/06 - 2:00 p.m.
Sub. National Security
2154 RHOB

Submitted for the Record.
by Congressman Dennis Kucinich
(Ohio)

NBER WORKING PAPER SERIES

THE ECONOMIC COSTS OF THE IRAQ WAR:
AN APPRAISAL THREE YEARS AFTER THE BEGINNING OF THE CONFLICT

Linda Bilmes
Joseph Stiglitz

Working Paper 12054
http://www.nber.org/papers/w12054

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1050 Massachusetts Avenue
Cambridge, MA 02138
February 2006

Paper prepared for presentation at the ASSA meetings, Boston, January 2006. The views expressed here are solely those of the authors, and do not represent those of any institution with which they are currently affiliate, or with which they have been affiliated in the past. The views expressed herein are those of the author(s) and do not necessarily reflect the views of the National Bureau of Economic Research.

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The Economic Costs of the Iraq War: An Appraisal Three Years After the Beginning of the Conflict
Linda Bilmes and Joseph Stiglitz
NBER Working Paper No. 12054
February 2006
JEL No. H5

ABSTRACT

This paper attempts to provide a more complete reckoning of the costs of the Iraq War, using standard economic and accounting/ budgetary frameworks. As of December 30, 2005, total spending for combat and support operations in Iraq is $251bn, and the CBO's estimates put the projected total direct costs at around $500bn. These figures, however, greatly underestimate the War's true costs. We estimate a range of present and future costs, by including expenditures not in the $500bn CBO projection, such as lifetime healthcare and disability payments to returning veterans, replenishment of military hardware, and increased recruitment costs. We then make adjustments to reflect the social costs of the resources deployed, (e.g. reserve pay is less than the opportunity wage and disability pay is less than forgone earnings). Finally, we estimate the effects of the war on the overall performance of the economy. Even taking a conservative approach and assuming all US troops return by 2010, we believe the true costs exceed a trillion dollars. Using the CBO's projection of maintaining troops in Iraq through 2015, the true costs may exceed $2 trillion. In either case, the cost is much larger than the administration's original estimate of $50-$60bn. The costs estimated do not include those borne by other countries, either directly (military expenditures) or indirectly (the increased price of oil). Most importantly, we have not included the costs to Iraq, either in terms of destruction of infrastructure or the loss of lives. These would all clearly raise the costs significantly.

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NOT TO BE QUOTED WITHOUT THE PERMISSION OF THE AUTHORS

THE ECONOMIC COSTS OF THE IRAQ WAR:
AN APPRAISAL THREE YEARS AFTER THE BEGINNING OF THE CONFLICT[1]

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Kennedy School, Harvard University

And

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Three years ago, as America was preparing to go to war in Iraq, there were few discussions of the likely costs. When Larry Lindsey, President Bush's economic adviser, suggested that they might reach $200 billion, there was a quick response from the White House: that number was a gross overestimation.[2] Deputy Defense Secretary Paul Wolfowitz claimed that Iraq could "really finance its own reconstruction," apparently both underestimating what was required and the debt burden facing the country. Lindsey went on to say that "The successful prosecution of the war would be good for the economy."[3]

Many aspects of the Iraq venture have turned out differently from what was purported before the war: there were no weapons of mass destruction, no clear link between Al Qaeda and Iraq, no imminent danger that would warrant a pre-emptive war. Whether Americans were greeted as liberators or not, there is evidence that that they are now viewed as occupiers. Stability has not been established. Clearly, the benefits of the War have been markedly different from those claimed.

So too for the costs. It now appears that Lindsey was indeed wrong—by grossly underestimating the costs. Congress has already appropriated approximately $357 billion for military operations, reconstruction, embassy costs, enhanced security at US bases and foreign aid programs in Iraq and Afghanistan. This total, which covers costs through the end of November 2005, includes $251bn for military operations in Iraq, $82bn for Afghanistan and $24bn for related foreign operations, such as reconstruction, embassy

[1] Paper prepared for presentation at the ASSA meetings, Boston, January 2006. The views expressed here are solely those of the authors, and do not represent those of any institution with which they are currently affiliated, or with which they have been affiliated in the past.
[2] OMB Director Mitch Daniels is reported to have said that Lindsey's estimates were "very, very high." Both he and Secretary of Defense Rumsfeld estimated the costs in the range of $50-60bn, some of which they believed would be financed by other countries.
[3] *Wall Street Journal,* September 15, 2002.

safety and base security.[4] These costs have been rising throughout the war. Since FY 2003, the monthly average cost of operations has risen from $4.4bn to $7.1 bn – the costs of operations in Iraq have grown by nearly 20% since last year (whereas Afghanistan was 8% lower than last year).[5] The Congressional Budget Office has now estimated that in their central, mid-range scenario, the Iraq war will cost over $266 billion more in the next decade, putting the direct costs of the war in the range of $500 billion[6].

These estimates, however, underestimate the War's true costs to America by a wide margin. In this paper, we attempt to provide a range of estimates for what those costs have been, and are likely to be. Even taking a conservative approach, we have been surprised at how large they are. We can state, with some degree of confidence, that they exceed a trillion dollars.

Providing even rough order of magnitude estimates of the costs turns out to be very difficult, for a number of reasons. There are standard problems in cost allocation; there are future costs associated with the Iraq war that are not included in the current calculations; there are marked differences between social costs and prices paid by the government (and it is only the latter which traditionally get reflected in the cost estimates); and there are macro-economic costs, associated both with the increase in the price of oil and the Iraq war expenditures.

Consider, as an example, accounting for the value of the more than two thousand American soldiers who have died since the beginning of the war, and the more than sixteen thousand who have been wounded. The military may quantify the value of a life lost as the amount it pays in death benefits and life insurance to survivors – which has recently been increased from $12,240 to $100,000 (death benefit) and from $250,000 to $500,000 (life insurance). But in other areas, such as safety and environmental regulation, the government values a life of a prime age male at around $6 million, so that the cost of the American soldiers who have already lost their lives adds up to around $12 billion[7].

The standard estimates of the death costs also omit the cost of the nearly one hundred American civilian contractors[8] and the four American journalists that have been killed in Iraq, as well as the cost of coalition soldiers, and non-American contractors working for US firms.

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[4] Congressional Research Service Report for Congress, "The Cost of Iraq, Afghanistan and Enhanced Base Security Since 9/11", Amy Belasco, Defense Specialist, October 7, 2005. This covers funding in P.L.107-117, 107-206, 1207-115,108-7,108-11,108-106,108-199,108-287,109-13,108-447, and the recent FY 2006 Continuing Resolution (109-77) which provides $45bn for the 6-week period starting 9/30/05. DOD will need additional funds to cover the rest of the year.

[5] Ibid.

[6] The CBO estimated costs for the period of 2005-2014 under three scenarios. The estimates were $179 bn, $266bn, and $392bn, respectively. We have conservatively used their middle scenario. CBO 2005.

[7] Government agencies have estimated the value of a life at $6.1m (Environmental Protection Agency), and $5.5m (Department of Transportation). The value of a life for victims of 9/11 were estimated in a range from $2-$11million.

[8] Although the actuarial value of those lives should, presumably, have been included in the contractors' bid price when undertaking the contract.

The military values the cost of those injured by what their medical treatment costs and disability pay; and current accounting only reflects current payments in disability, not the present discounted value of (expected) future payments; a full cost analysis includes both the present discounted value of all future payments, as well as the difference between the disability pay and what the individual might have earned—and even this ignores the enormous compensation that would have been paid for pain and suffering had this been a private injury.

Costs of recruiting have increased enormously—and even after the war ends, there is reason to believe that compensation will have to be increased, including for Reserves and National Guard. Many Reservists, particularly those who are older, supporting families and established in their careers, underestimated the risks of being called to fight a war abroad and the ability of the government to force them to extend their tours of duty and even to serve second and third tours. The majority of these Reservists have suffered a significant loss in wages due to serving in Iraq. By the same token, wages currently paid the military almost surely represent an underestimation of a fair market wage, given what individuals would have needed to make them willingly undertake the job in Iraq. In fact, we know from the wages being paid by contractors performing similar work what the free market wage for such services are, and they are a multiple of what the American military get paid[9].

Even determining the current "direct" expenditures turns out to be a difficult task.[10] The Administration has provided a number, based on the current costs of operations in Iraq. We are interested here in finding the *total economic cost*, the value of the resources used, and it is not always clear that standard accounting and budgetary figures reflect that. For instance, the faster depreciation or destruction of equipment already owned by the government is clearly part of the cost of the war. Standard cost allocation procedures would attribute a substantial fraction of the overhead in the Pentagon to the War; by devoting its attention to Iraq, it has less time to work on other issues, to prepare for other problems.

A true costing of the war would focus, of course, on the incremental cost; to the extent that the actual War substitutes for expensive "war games," the incremental cost is less than the actual money spent. In our analysis we have subtracted the direct savings, such as policing the "no-fly" zone in Iraq, from the cost of the war.

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[9] For example, experienced security guards working for Blackwater Security, who guarded senior officials in the Coalition Provisional Authority, were earning up to $1000 per day. The majority of such guards were former members of the military.

[10] A recent report by the Government Accountability Office (GAO-05-767) states that the Defense Department has "lost visibility" on over $7bn of funding and reports several cases where obligations exceeded appropriations in 2004, including $4.3 bn in Army operation and maintenance. A recent report by the Congressional Research Service cites the difficulty of tracking Pentagon expenditures in Iraq, because (unlike the State Department and other agencies), DOD does not allocate funds by operation or mission until after the fact. "Defense Department witnesses periodically give average monthly costs or 'burn rates' for Iraq and Afghanistan but DOD has not provided Congress with a complete or consistent record showing those rates over time or total amounts for each operation each year". CRS, 10/7/05.

This paper attempts to provide a more complete reckoning of the costs of the Iraq War than have previously been provided, using standard economic and accounting/budgetary frameworks. Of course, a final tally will have to wait the end, and even the President has made it clear that there is no clear end in sight. And even then, it will be years before we can be sure about whether our estimates of future costs—increased costs of recruiting or payments for disability or the health care costs of the injured veterans—were accurate.

Of necessity, the numbers, especially of future expenditures, are estimates, and we have tried to avoid a false sense of accuracy by rounding our numbers from the more precise estimates provided by econometric and statistical studies, when those are employed. We provide several sets of numbers. A "conservative" estimate that we think is *excessively* conservative. We realize that the numbers provided here may be controversial. They provide a picture of costs that is much larger than that which has been provided by the Administration, especially before the War. We also provide a second estimate, which, while still conservative, is more reasonable. We refer to this as our "moderate" estimate.

Our estimates, for instance, assume that we have 136,000 troops stationed in Iraq in 2006. The Administration has recently announced a troop reduction, from 160,000 due to the pre-election build-up, to 140,000, a number which is still larger than the numbers employed in our analysis.

We have not been able to quantify many of what may turn out to be the most important costs of the Iraq venture. There is a value in military preparedness, and it is the reason for investing so heavily in defense. By most accounts, America's ability to engage in a second front at the current time is greatly diminished. At the beginning of the War, there was a great deal of talk about winning the hearts and minds of those in the Middle East. Recent opinion polls reflecting public opinion in the Arab world show that exactly the opposite has happened. Some American businesses have even claimed that anti-Americanism spawned by the Iraq War has had an effect on their sales and profits. America's credibility has been diminished: if some time in the future another American President were to claim that he had solid evidence based on intelligence that there was a threat, that evidence is more likely to be treated with skepticism. America has always prided itself in fighting for human rights; but America's credentials have been tarnished by Abu Ghraib and Guantanamo. These are among the many costs of the Iraq War that we do not attempt to quantify, but which should clearly be counted in any assessment of the Iraq War.

Nor have we included in this paper any of the costs borne directly by other countries, either directly (as a result of military expenditures) or indirectly (as a result of the increase in the price of oil.) Most importantly, we have not included the costs of the war to Iraq, either in terms of destruction of property (infrastructure, housing) or the loss of lives.[11] Clearly, including these would increase the cost of the war substantially—perhaps by an order of magnitude.

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[11] We have not included the cost of the deaths of coalition soldiers and contractors, nor of the Iraqis themselves. Even the most conservative estimates put the loss of life at a multiple of that of the United

The paper is divided into two parts. In the first, we provide an estimate of the "direct" expenditures, and provide adjustments to reflect the true social costs of the resources deployed. The second provides an estimate of the macro-economic costs; the effects of the War on the overall performance of the economy, taking into account both the effects of the expenditures themselves and of the increased price of oil, some of which at least should be attributed to the War.

I. Budgetary Costs to the US Government

The budgetary costs of the war reflect the huge scale of operations that are being undertaken. For the first half of 2005, there were over 200,000 US military personnel stationed in Iraq and Kuwait (which serves as a staging ground for Iraq). To date, over 550,000 troops have served in Iraq in a combined total of approximately one million tours of duty[12].

The costs of the war in Iraq that have been reported in the media have almost exclusively focused on one type of cost – the $251bn in cash that the government has spent on combat operations since the invasion of Iraq in March 2003. This is an important element of the financial cost but it is only the tip of a very deep iceberg.

Currently the US is spending about $6bn per month on operations in Iraq. However, there are additional costs to the government – over and above this number. These include disability payments to veterans over the course of their lifetimes, the cost of replacing military equipment and munitions which are being consumed at a faster-than-normal rate, the cost of medical treatment for returning Iraqi war veterans, particularly the more than 7000 servicemen with brain, spinal, amputation and other serious injuries, and the cost of transporting returning troops back to their home bases. . The Defense Department, for which expenditures not directly appropriated for Iraq have grown by more than 5% (CAGR) since the war began, has also spent a portion of this increase on support for the war in Iraq, including significantly higher recruitment costs, such as nearly doubling the number of recruiters, paying recruitment bonuses of up to $40,000 for new enlistees and paying special bonuses and other benefits, up to $150,000 for current troops that re-enlist. Another cost to the government is the interest on the money that it has borrowed to finance the war.

Although it is difficult to estimate these costs precisely, we can use current and expected troop deployment to make a reasonable projection of the likely costs. Looking purely at direct budgetary costs to the taxpayer, we estimate that the total cost of the Iraq war is in the range of $750 billion to $1.2 trillion, assuming that the US begins to withdraw troops in 2006 and maintains a diminishing presence in Iraq for the next five years. We have looked at the budgetary cost both including and excluding the cost of interest on the debt.

States, with some estimates putting the numbers in excess of 30,000, or even 100,000. Of those, over 3000 Iraqi deaths have been among Iraqi military and police who are supporting coalition forces.

[12] Many troops have served two or three tours of duty.

We have also adjusted this cost for economic factors, as outlined in section two. Under any reasonable set of assumptions, the cost of the war *even without* considering the macroeconomic costs – is more than double the current number provided by the Administration.

We have estimated the budgetary costs using two scenarios. Both scenarios are based on the troop deployment projected by the Congressional Budget Office.[13] Our "Conservative" scenario assumes that all troops will be withdrawn from Iraq by 2010, and that all interest on the debt borrowed to finance the war will be repaid within five years. Under this scenario we count the long-term costs of disability pay and health care for veterans over a twenty-year period, even though most of the troops in Iraq are between ages 21-28 and are likely to live far longer. We have taken the present value of all cash flows at a 4% discount rate. Even under this conservative scenario, the direct costs to the government are likely to exceed $700 bn. (See figure 1).

Under a second, "Moderate" scenario, we have used CBO's assumption that a small but continuous US presence in Iraq continues through 2015. This has implications for the projected number of casualties and the length of involvement by the Defense Department. This scenario also assumes that the US budget will remain in deficit for the next 20 years. This would raise the cost of the war to over $1.2 trillion. Both scenarios exclude the cost of operations in Afghanistan – estimated to be approximately $82 bn to date and consuming $1bn per month. ,

Figure 1: Budgetary Cost of the Iraq War ($BN)

	Conservative	Moderate
1 Spent to date	251	251
2 Future spending on operations	200	271
3 VA costs	40	57
4 Cost for Brain injuries	14	35
5 Veterans disability payments	37	122
6 Demobilization costs	6	8
7 Increased defense spending	104	139
8 Interest on debt	98	386
Total	**750**	**1,269**

[13] US Congressional Budget Office, *Estimate of War Spending FY 2005-FY2015*, Feb 1, 2005.

Assumptions for Figure 1 "Total Cost of War in Iraq to the US Government".

1. **Spending to date on combat and support operations:**

The total spending to date, as of December 30, 2005 is $251 billion. This includes funds appropriated specifically for Iraq in Emergency supplemental appropriations in April 2002, November 2003, August 2004, April 2005, and the Continuing Resolution of September 2005, which covers the first 6 weeks of FY 2006. This money includes funding for combat operations, basic troop deployments and logistics, deployment of National Guard and Reserves[14], food and supplies, training of Iraqi forces, weapons, munitions, supplementary combat pay, reconstruction[15], and payments to countries such as Jordan, Pakistan and Turkey. This also includes the payment of $500,000 in "death gratuity payment" and life insurance to the survivors of the 2156 fatalities in Iraq during this period. We have not included the costs to the Defense Department for planning the invasion in the months prior to the invasion, which the Congressional Research Service has estimated at $2.5 bn[16]

2. **Future spending on combat and support operations.**

We have estimated the cost of future operations to be proportional to the number of troops scheduled to be deployed in Iraq from 2006-2010. We have estimated the current number of troops *stationed* in Iraq as 160,000, using the number cited by the Pentagon. Future troop deployment figures are based on recent forecasts by the Congressional Budget Office, which predicts that troop levels in 2006 will be reduced to 136,000. The CBO has forecast troop levels through 2015, but in the conservative scenario we are assuming that all troops are out of Iraq by 2010. However, this approach almost certainly underestimates the actual cost of military operations, because the Pentagon will hire contractors to replace some portion of the activities performed by troops who are withdrawn.[17] In our moderate scenario, we have assumed that the US maintains a small troop presence until 2015, that we increase the number of contractors as troops decline, and that casualties continue, proportional to troop deployment...

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[14] Approximately 40% of the US troops serving in Iraq have been drawn from the National Guard and the Reserves, particularly the Army Reserves. Currently some 56,000 National Guardsmen and Reservists serve in Iraq. Additionally, over 60,000 people have been recruited to "backfill" domestic positions in the Guard and Reserves that are vacant because the others are in Iraq. The direct additional cost of mobilizing these individuals is $3 billion per year. We have assumed that participation of the Guards and Reserves remains constant at 40%.

[15] Congress appropriated $18.4bn – an unprecedented sum- for Iraqi reconstruction in September 2003. This funding was specified for purposes including school construction, sewerage, sanitation, repair of the electrical grid and other civilian projects. To date, most of the money spent has been diverted to military projects, including training bomb squads, training Iraqi security forces, constructing prisons, purchasing armored cars, and of the 3600 projects completed, some 25% of funds were spent on security. Money has also been diverted to pay for the elections (source: Special Inspector General for Iraqi reconstruction). The Administration has recently announced that it will rescind its request for remaining reconstruction money.

[16] CRS, 10/7/05, Ibid.

[17] Currently there are 20,000 – 25,000 private military contractors operating in Iraq, representing some 60 contracting firms. Experienced US soldiers can earn up to several times their military salary working for high-end contractors, in some cases up to $1000/day. (IPS, 2004).

3. **Additional Veterans Administration medical care costs for returning veterans.**

As of December 2005, over 16,000 military personnel have been wounded in Iraq since March 2003, of whom 96% were injured after the official combat operations ceased (since May 1st, 2003). Due to improvements in body armor that protect the core body, there has been an unusually high number of soldiers who have survived with major injuries, such as brain damage, spinal injuries, and amputations. According to the Pentagon and other sources[18], about 20% of those injured have suffered major head or spinal injury and an additional 6% are amputees. Another 21% suffered serious wounds that prevented them from returning to the military, including blindness, deafness, partial vision and hearing impairments, nerve damage and burns. In addition, more than half of the 550,000 US troops who have served in Iraq have served two or three tours of continuous duty under stressful, grueling conditions. Some 20,000 soldiers have been prevented from leaving the service by the government's "stop-loss" policy, which requires troops to extend their tours in case of emergency. It is perhaps not surprising that the surgeon general of the Army reported, in July 2005, that 30% of US troops have developed mental health problems within 3-4 months of returning from Iraq. To date, more than one-third of returning veterans have used the VA system for health ailments.

The number we include here represents a conservative estimate of the additional costs to the Veterans Administration due to providing medical care and other benefits (such as rehabilitation, retraining, purchase, fitting and replacement of prosthetic devices, and counseling -- but not including disability, housing, educational or loan payments) to returning Iraqi War veterans (other than those with brain injuries). The costs of treatment could be substantial. The VA had originally projected that 23,553 veterans returning from Iraq would seek medical care last year, but in June 2005, the VA revised this number to 103,000. The VA also is now responsible for providing care to an estimated 90,000 National Guards, who previously were not eligible for VA services. To meet these unforeseen demands, the VA appealed to Congress for an emergency $1.5bn in funding for FY 2005. The VA is likely face a shortfall of $2.6 billion in 2006[19]While not all the additional health care expenditures may in fact be directly linked to the Iraq war, it will be difficult not to provide the requested medical care. We assume that this need will continue and increase to $3bn as the veterans return home, and that the VA will require this additional level of funding added to its base budget.[20] (We expect that this figure is significantly understated, considering that The Veterans Administration is already facing a shortfall in funding to meet its existing obligations[21].)

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[18] Wallsten and Kosec, AEI-Brookings Working Paper 05-19, September 2005, estimates 20% with serious brain injuries and 6% amputees. They estimate 24% with other serious injuries. (We use 21% with other serious injuries based on the latest Pentagon numbers).

[19] Institute for Policy Studies, 2005

[20] See the discussion in the next section for an alternative methodology, which focuses on the *direct* costs of the Iraq injured.

[21] Former VA Secretary Anthony Principi said that the VA will need $600bn over the next 30 years to meet its existing obligations for health care, education, pensions and housing loans – but this figure did not include the Iraqi war veterans. It also does not include additional funding for capital needs, including construction and repairs of VA facilities, that have

The additional cost of providing benefits to Iraqi war veterans will become a major challenge for the VA. In our conservative scenario we have estimated that all troops are withdrawn by 2010 and these costs for 20 years; in the moderate scenario we have assumed that troops continue to be deployed through 2015 and these costs continue throughout the lifetime of the veterans (40 years).

4. Medical treatment for brain injuries.

There is a special category of health care expenditures that go beyond those included in the above calculation—for those with brain injuries. To date, 3213 people -- 20% of those injured in Iraq -- have suffered head/brain injuries that require lifetime continual care at a cost range of $600,000 to $5 million[22]. The government will be required to commit resources through intensive care facilities, round-the-clock home or institutional care, rehabilitation and assisted living for these veterans.

For the conservative estimate, we have used a midpoint estimate of a net present value of $2.7 million over a 20 year expected survival rate for this group, which is about $135,000 per year, yielding a cost of $14 billion. This amount seems low for brain-injured individuals who will require round-the-clock care in feeding, dressing and daily functioning. For the moderate estimate, we use a higher cost estimate ($4m) and assume longer life duration for a total cost of $35 billion. In both cases we assume that the number injured will rise in a manner consistent with the duration of the conflict.

5. **Disability pay for veterans**

Veterans of the Iraq war are eligible to claim disability pay and benefits, ranging up to a maximum of about $44,000 per year, under a complex formula administered by the Veterans Administration. It is important to note that that Congressional intent for disability payments is to "compensate for a reduction in quality of life due to service-connected disability payment of this disability". The benefit is intended to "provide compensation for average impairment in earnings capacity" – but it does not require the veteran to actively seek employment nor is it offset against post-military civilian earning. The principle dates back to the Bible at Exodus 21:25, which authorizes financial compensation for pain inflicted by another.[23]

Veterans are awarded claims based on the percentage of disability they can demonstrate; in gradations (0-100%) though it is possible to have a 0% disability percentage across multiple conditions and still qualify a veteran for some disability pay. The presumption for disability compensation is tied to symptoms that appear within a period of time after service. There are numerous programs that provide benefits depending on the situation, including disability compensation, specially adapted housing grants, medical benefits

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[22] Wallsten and Kosec, AEI, The Economic Cost of the War, 2005 and Department of Defense estimates for number of wounded.

[23] VA Disability Compensation Program, *Legislative History*, VA Office of Policy, Planning and Preparedness, December 2004

with higher priorities, vocational rehabilitation, service-disabled veterans life insurance, dependency and indemnity compensation (paid to surviving spouse and children if a veteran dies of an illness or injury contracted while on active duty, or dies of such after retirement).[24]).

We have estimated the amount of claims that the government will need to pay based on a projection of the rate of claims based on the Persian Gulf War. The government currently pays $2 billion annually in support of 169,000 claims, or an average of $11,834 per claimant. (Hartung, 2004) The total number of claims for that war exceeded 200,000, or more than one-third of the troops deployed, despite the fact that the war lasted 4 weeks with 148 dead and 467 wounded. Many of those claims were related to the exposure to depleted uranium during the Persian Gulf conflict, and included ailments such as memory loss, sleep problems, Lour Gehrig's disease, poor concentration, and joint problems. Congress has established a "presumption of service-connection" for any health problems linked to "exposure to possible nerve agents and other toxins present in the Persian Gulf conflict and vaccinations against biological war hazards in preparation for the Persian Gulf.[25]"

In the Iraq conflict, more depleted uranium was used in the bombing of Baghdad than in the Persian Gulf conflict;[26] therefore the Iraq war veterans will be easily eligible for disability claims for any health problems that they can link to exposure. As we noted earlier, more than one-third of returning veterans have used the VA system for health ailments. We have estimated that those with serious injuries would receive the maximum disability benefits from the VA, those with medium-serious injuries would receive half those benefits ($22,000), and one-third of the remaining forces would receive the average benefit awarded to the Gulf War veterans, or $11,834. This sums to an annual payment of $2.3 billion. In the conservative scenario we have estimated this payment over 20 years; in the moderate scenario we have assumed that these payments continue over the lifetime of the veteran, so until 2045.

6. Cost of demobilization.

The Pentagon has announced plans to reduce troop levels from their current force of over 160,000 to around 140,000 in the next year, and we have assumed that this withdrawal will continual gradually as outlined by the CBO. This will in itself require direct payments of $6-10bn for the transportation and demobilization of troops, returning them to their home bases, or civilian roles (in the case of Reserves).

7. Increased defense spending

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[24] This principle is cited in numerous legal cases in which juries award compensation for injury. .

[25] In 1994 Congress passed the Gulf War Veterans Benefit Act, which legislated a presumption of service connection for an undiagnosed illness that occurred within an unprescribed time frame, taking into account the Gulf War Syndrome. This time frame period was extended in 2001 to include any disabilities associated with the Persian Gulf War service that may appear through Dec 31, 2011. (VA Disability Compensation Program, Ibid).

[26] William Hartung, "The Cost of War"2004, Taxpayers for Common Sense

Since 2002, the total appropriations for the Defense Department have increased from $310 bn to $420bn, representing a total cumulative increase of $325bn. Portions of the FY 2002, 2003, 2004 and 2005 appropriations bills, as well as FY 2003 and FY 2004 transfers, have been appropriated for Iraq. In total we estimate that 30% of the $325 increase has been devoted to Iraq. This figure covers increased military pay, research and development, recruitment, operations and maintenance and replacement of equipment. According to Pentagon estimates, the military is wearing out equipment at a rate that is 4-5 times the rate of usage in non-combat situations[27]. Additionally, CBO has estimated that the military will require some $100bn in replacements over the next five to ten years. (Much of this funding has not yet been requested)[28] and GAO has referred to the shortfall in funding for repairs, replacements and procurements[29] and the confusion between determining emergency supplemental and ordinary funding needs...

In our estimates, we have attributed one-third of the increase in Defense spending to Iraq, minus the savings from no longer policing the no-fly zone to the Pentagon. Savings from the no-fly zone have been estimated to be from $11 to $15bn per year.[30] Given that the Department is highly focused on the outcome of the war in Iraq, we estimate that up to one-half of the increase in the defense spending may be related to Iraq, but we have used only 30% of the spending in our conservative and moderate scenarios.

In addition, this increase reflects the military's increasing difficulty in recruiting troops and officers at all levels since the beginning of the Iraq conflict. During 2005, the Army was below target for most of the year, and actually lowered its targets in order to achieve them[31]. There were shortfalls in the Army National Guard, Army Reserves, and Marine Reserves. Applications to West Point and the US Naval Academy also fell between 10-25% from previous years. The military has responded to this challenge by hiring thousands of additional recruiters, increasing its national advertising campaigns, offering sign-up bonuses of up to $40,000 for new recruits, offering higher retirement and disability benefits, increasing the "death gratuity" to $100,000, and providing re-enlistment bonuses of up to $150,000 for experienced troops (who might otherwise leave the military to join private contractors who would pay even higher amounts). In further

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[27] Secretary Donald Rumsfeld said at a briefing on March 10, 2005 that US military equipment such as tanks, Bradley fighting vehicles and helicopters are being worn out at up to 6 times the peacetime rate. (Washington Post, 3/11/05)

[28] Scott Lilly, staff director of the House Appropriations Committee, said the Army would need more than $17.5bn to replace or repair worn or damaged equipment in the first year of the war. But the Army's request for depot maintenance and procurement was only about $2.2bn in the supplemental. "Pentagon's Request for Iraq includes money for troops and rewards", New York Times, 10/03/03. Additionally, Rep. Duncan Hunter, Chairman of the House Appropriations Committee, has cited figures that the Defense Department needs $90bn per year in annual modernizations and at present levels, is still $30bn short, based on CBO estimates. (Wall Street Journal, 5/03)

[29] The GAO has also referred to the shortfall in funding requests for military replacements. (GAO, "Global War on Terrorism: DOD Should Consider All Funds Requested for the War When Determining Needs and Covering Expenses."

[30] Wallsten and Kosec estimate savings from the no-fly zone at $32bn in the nearly 3 years since March 2003. John Amidon of the Air War College estimates the cost of policing the no-fly zone at $15bn per year.

[31] For example, the May recruiting target was originally 8050, but was lowered to 6706. Similar adjustments were made throughout the year.

efforts to boost recruitment, the Pentagon increased the maximum enlistment age from 35 to 42 and relaxed standards for appearance and behavior, making it more difficult to be fired. The cost to the military per recruit has increased from $14,500 in 2003 to $17,500 in 2005. (Pentagon). Hardship pay has been increased from $300 to $750 per month. We assume that the military will need to make these changes permanent, adding at least$1bn-$2bn per year into the permanent budget base. Additional increases include military pay raises, and the purchase of more expensive body armor for combat.

8. Interest Payments on Debt

Given that at the onset of the War, the country was already running a deficit, and no new taxes have been levied, it is not unreasonable to assume, for purposes of *budgeting*[32], that all of the funding for the war to date has been borrowed, adding to the already existing federal budget deficit. In the conservative scenario we assume that these funds are borrowed at 4% and repaid in full within five years. The moderate scenario assumes that the country continues to have a deficit over the next 20 years and therefore interest continues to accrue.

II. Costs of the War to the US Economy: Adjustments to the budgetary estimates

A second way to measure the cost of the war is to examine its *economic* cost. Economic costs differ from budgetary costs in three ways: (a) costs are borne by others (than the federal government and those fighting in the war), and these are obviously excluded from the budgetary costs *to the federal government*; (b) the prices paid by the government do not reflect full market value; and (c) economic costs do not include interest payments (which can be viewed just as transfer payments), but do include long run impacts on the growth of the economy. For instance, in the days of the draft, pay provided soldiers were a vast underestimate of their opportunity costs. Health care costs borne by soldiers and their families are examples of costs borne by others.

Here, we focus on the loss of productive capacity of the young Americans who have been killed or seriously wounded in Iraq, and the loss of civilian wages that would have been earned by those called back to duty in the Reserve forces.

There are some "problematic" items within the budgetary costs, most notably expenditures on veterans *not* linked with the Iraq war. The best way to think of this is as part of deferred compensation, and therefore, while the "categorization"—repairing human damage as a result of the war—is incorrect, it is still part of the cost of the war.

Once again we have estimated the costs under two scenarios. In the conservative case, the adjustments add $187 bn onto to budgetary cost – raising the cost to $839 bn, even when subtracting the entire cost of interest payments. In the moderate case, the economic adjustments increase costs by $305 bn. Even if we deduct the cost of interest, the cost of the war under this scenario exceeds $1 trillion. But these calculations ignore the fact that

[32] An *economic analysis* is somewhat more complicated, as the discussion in section IV will make clear.

some of the resources deployed in the war could have been used to promote economic growth, and that there are a broad range of macro-economic costs, the effect of which, as we shall show in the next section, is to increase the economic costs of the war by a significant amount.

Figure 2: Adjustments to Budgetary Numbers to Account for Economic Costs ($BN)

	Conservative	Moderate
1 Spent to Date	3	8
2 Economic Cost of Reserves	3	9
3 Economic Cost of Fatalities	23	29
4 Loss due to Brain Injuries	34	48
5 Loss due to Other Serious Injuries	30	64
6 Loss due to Other Injuries	18	26
7 Less veterans disability payments	(12)	(28)
8 Increased depreciation of military hardware	89	149
Net Adjustment	**187**	**305**

The cost of the war to the United States, *before* taking macroeconomic factors into account, can therefore we estimated under a variety of assumptions to fall between $700bn and $1 trillion dollars, as shown in Figure 3.

Figure 3: Projected Cost of the Iraq War ($US bn) without macroeconomic costs

Scenario	Budgetary cost (without interest)	Budgetary Cost (inc. interest)	Cost with Economic Adjustments[33]
Conservative	**652**	**750**	**839**
Moderate	**884**	**1269**	**1189**

Differences between assumptions for economic and budgetary models.

1. Economic Cost of Reserves.

As we noted earlier, the US force in Iraq is composed of 40% the National Guard and Reserve forces. Many of these men and women normally work in critical "first responder" jobs in their local communities, such as firemen, policemen and emergency medical personnel. More than 210,000 of the National Guard's 330,000 soldiers have served in Iraq or Afghanistan, and the average length of Guard mobilization is 480 days[34] It is difficult to measure the cost of this deployment in purely economic terms because

[33] Budgetary cost without interest+economic adjustments
[34] IPS, Ibid.

there is a large unquantifiable cost in terms of the loss of these "first responders" to emergencies, including the value of the "insurance" of having these people ready to respond to emergencies. This was clearly seen in the Hurricane Katrina debacle, where 3000 Louisiana National Guardsmen and 4000 Mississippi Guardsmen were stationed in Iraq when the hurricane hit. According to the Institute for Policy Studies, some 44% of US police forces have some of their ranks deployed in Iraq. The loss of these services in Katrina and elsewhere clearly has had large budgetary and economic costs. We do not directly measure either the economic costs of the loss of "insurance" or the economic and budgetary costs arising from reduction in first responder capabilities (which may have been considerable.)

Still, there are some quantifiable economic costs that go beyond those noted earlier in our budgetary analysis. In the budgetary model, we included (as part of operating costs) the additional cost to the government of hiring replacements for those sent to Iraq, which is around $3bn per year. In this model, we have subtracted that sum from the total cost of operations but added in the economic cost of the difference between the civilian wages that these individuals would earn in their regular occupations and the lower wages they typically earn in the Reserves. Scott Wallsten and Katrina Kosec (AEI/Brookings, 2005) have calculated that Reserve soldiers earn about $33,000 per year as civilians. They estimate that the opportunity cost of using Reserve troops at current levels is $3.9 billion to date. We have adopted that figure into our conservative assumptions. In our moderate model, we have increased the pay per Reservist slightly to $46,000, taking into account the fully loaded cost of benefits, particularly for those reservists who are in police and fire departments and receiving 60-100% benefits.[35]

2. Economic Cost of Military Fatalities.

The budgetary model only incorporates the payments made to individuals as a result of death. Had these individuals been killed in a car accident or a work related accident (other than military) there would have been much larger payments, reflecting the economic costs of the losses.

Although it is impossible to translate the value of a life into purely monetary terms, the government commonly uses this approach and determines the "Value of statistical life" or "VSL", based to some extent on the value of foregone earnings and contributions to the economy. This method is also widely used by insurance companies and other private sector concerns. In this study, we have estimated the VSL of each US military and contractor fatality as of December 2005. According to the Pentagon casualty reports, this

[35] It is apparent (evidenced by increased difficulties in recruiting) that individuals did not fully appreciate the risks they faced when joining the reserves, so that the wage received does not reflect adequate compensation for those risks. This is particularly true because of the stop-loss policy which requires troops to extend their tours, with some 20,000 having in fact been prevented from leaving their service at their scheduled dates. A full adjustment of the economic costs would include appropriate compensation for the risks taken. See below.

is 2156 military fatalities and approximately 100 contractors.[36] We have projected these forward according to the two different scenarios described earlier.

We have not taken into account number of Iraqis who have been killed in the conflict, estimates of which range from 30,000 (the number estimated by President Bush in December 2005), to a 100,000 estimated by the British Lancet. We have also not counted the several hundred casualties among coalition countries, of which about 100 were British soldiers.

There are a wide range of VSL values in use. In our conservative scenario, we have adopted the standard set by the U.S. Environmental Protection Agency, $6.1 million per life. However this is only an approximation. The value of a young life may be determined to be higher than average, based on an estimate of foregone earnings (Viscusi and Aldy, 2005[37]). Juries frequently award much higher amounts in wrongful death lawsuits, and some have reached as high as $269 million. [38] We have used the number $6.5 million in our moderate scenario. In projecting the number of fatalities and casualties forward, we have assumed that these would be proportional to the number of troops deployed in Iraq, based on the average number of casualties per month to date. However, even this is a conservative estimate, since the number of casualties has been increasing.

3. Economic cost of contractor fatalities.

There have been about 100 US contractors killed in Iraq since March 2003 (as well as some non-US contractors, mostly working for western companies.) In this model we have only included the US contractors, and extrapolated the numbers according to the two different war scenarios. We have used the VSL of 6.1 million and 6.5 million, respectively, for the conservative and moderate models. However it should be noted that in many cases, the contractors were highly skilled, highly paid specialists, working on reconstruction projects such as fixing the electricity grid and oil facilities. We have not counted their true loss to the success of the project in Iraq, or the fact that their high casualty rate has made it more difficult and more expensive for western contractors to higher replacements to perform these jobs.

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[36] In the case of the contractors, one might argue that their wages (already included in the analysis) includes compensation for the risk of the loss of life, so that the value of the loss of these 100 contractor lives should be subtracted (reducing the overall cost of the War by some $600 million.)

[37] The "peak" age for VSL may be 29, in terms of lost earnings potential, with a VSL between $5.9 and $7.5 (Viscusi, and Aldy, NBER Working Paper 10199, 2003)

[38] There have been hundreds of large jury awards (ranging from $2m -$269 m) in wrongful death suits over the past five years. These include the awards of $112 to Elizabeth and John Reden of New York for a malpractice case in which their daughter suffered brain damage (2004) and $43 in Louisiana in 2001 for Seth Becker, a 24-year old who needed both legs amputated after an injury he sustained while working for Baker Oil Tools. In both of these and many other cases the amount awarded was determined primarily on the basis of the cost of round-the-clock medical care for life that the injured person would require. The $269m award was for Rachel Martin, a 15-year old Texas girl who died in 1998. In most cases the plaintiffs receive less than the total award, typically about 10%.

4. Economic cost of the seriously injured.[39]

Earlier, we described the budgetary costs of health care and disability for the seriously injured. The wounded contribute significantly to the cost of the war – both in a budgetary sense (in the form of lifetime disability payments, housing assistance, living assistance and other benefits from the Veterans Administration), and in an economic sense. The budgetary expenditures discussed earlier underestimate the true economic costs for three reasons: (a) they do not include adequate compensation for "pain and suffering," of the kind that would have been provided, for instance, had those suffering injuries been hurt in an automobile accident; (b) they do not include additional health care expenditures by the parties themselves, their families, or other government agencies; and (c) perhaps most importantly, they do not include the loss of economic services. On the other hand, they do include health care expenditures that may not be directly a consequence of the war. However, as we noted earlier, we are treating this as part of the deferred compensation, and therefore it *is* both a budgetary and an economic cost.

In their recent study of the economic costs of the war, Wallsten and Kosec used a "value of statistical injury" to estimate the cost of the wounded. This value represents what people are willing to pay in order to avoid being injured. They applied this value to the number of injured personnel, according to the severity of their injuries and the average cost of treatment over its lifetime. They calculated total net present value of injuries at $18.2bn to date, and $48bn through 2015, using a 5% discount rate. [40]

The Wallsten and Kosec study is quite thorough and we have used their estimates of the number and type of wounds, and lifetime treatment costs. However, they probably underestimated the total cost of the wounded because they only assigned an amount to the 26% with brain injuries and/or amputations. We have included additionally the cost of the 21% of personnel (5545 people, as of December 2005) with other serious wounds. Such injuries would include wounds from shells, explosions, gunfire, mortar, landmines, grenades, firearms and infections, resulting in conditions such as blindness, partial blindness, deafness, partial deafness, cardiac injury, facial deformation, burns, multiple broken bones, nerve damage and mental breakdown. We have deducted the veterans' disability payments from all these individuals.

We have estimated that personnel with serious injuries (including brain injuries) receiving full disability payments will essentially be lost to the economy and therefore we

[39] One might argue that for those joining the army and reserves *after* the beginning of the War, the increased compensation already incorporates the (present discounted value of) loss in welfare from the increased injuries (deaths), and so including both item 10 from table 1 and items 2 and 4 from table 2 represents "double counting." Therefore, it may be argued, we should subtract $5.3 (conservative; $8.76 in moderate case) from the total. However, there is no reason to believe that those enlisting have a good sense of the actual risks (there is no evidence that the armed forces provides accurate information to the enlistees) and the increased compensation reflects no just the increased probability of injury and death, but also the stop loss provisions which did not allow individuals to leave the services at the scheduled time. In any case, the basic pattern of results is unaltered.

[40] This is based on their "midpoint" scenario. Their high estimate is $74bn

should assign them a VSL similar to the deceased, of $6.1m. In the Conservative case, we have estimated that those who were wounded during the conflict, but returned to the military will suffer some impairment beyond the small amount of disability pay they may receive. We have very conservatively estimated that 20% of the total VSL would be an approximation of this impairment. Taken together, this adds approximately $70bn.

Under our moderate scenario, we have used a similar formula, but using an estimate of $6.5m for the VSL and assuming that there are more casualties, due to the longer duration of the conflict. Less disability payments this adds another approximately $110 bn.

There is another significant cost that we have not included, simply because we did not have the data to prepare a robust estimate. This is the degree of impairment that will be suffered by the other veterans – numbering some 160,000, or approximately one-third of the 550,000 veterans from the Iraq war – who will be eligible to claim some disability benefits. We believe that a significant number of these individuals will suffer substantial mental and physical ailments that will significantly reduce their earning potential and quality of life. If even 15% of these veterans were fall into this category, this alone would add another $30-35 bn to the economic cost of the war[41].

A conservative estimate of the risk premium individuals would require to be compensated for the injuries (beyond the loss of economic functionality and health care costs) could (with reasonable estimates of risk premia) double the total.[42] We have, however, omitted those numbers from the analysis.

5. Accelerated depreciation of military hardware.

There is only a slight difference in the estimate of the budgetary and economic costs associated with military hardware. The budgetary costs focus on replacement expenditures, the economic costs on the more rapid depreciation of hardware (than otherwise would have been the case.) In our conservative scenario, we have simply estimated straight-line 5-year depreciation for the $100m in military replacements estimated by the House Armed Services Committee and CBO, over the next five years. This is in line with the DOD's assessment that equipment is being used up at 5 times the normal rate of utilization in peacetime. We are assuming that the Pentagon will incur at least an additional $25bn in replacements through 2015, in the moderate scenario.

[41] Assuming 20% of the VSL for 24,000 individuals.

[42] Individuals are willing to pay insurance premia that are typically 60% to 120% of the value of the loss. In the case of the loss of limbs and other major bodily injuries, the risk premia are likely to be considerably higher.

III. The Macro-economic effects of the War in Iraq

As large as the direct costs—current and future—are, the macro-economic consequences may even be several times larger.[43] There are at least three major sources of macro-economic consequences: (a) the increase in the price of oil; (b) the increase in defense expenditures; and (c) the increased insecurity that has followed from the way that the war has been pursued.

In ascertaining the magnitude of these macro-economic effects, there is a standard problem: the counterfactual, what would the world have looked like, but for the war in Iraq.

Security

Consider the issue of security. The bombings in Madrid and London have only exacerbated a growing sense of insecurity. Would matters have been even worse had there been no war? One of the stated objectives of the war was to enhance the sense of security (to make sure that the war on terrorism was fought *there,* not here.) It is conceivable that the Middle East would have been even more unstable than it is today. But especially on the basis of what we know today—Iraq did not have weapons of mass destruction, and it did not have the capacities to develop them quickly – this seems unlikely, Contrary to the assertions before the War by the Administration, Iraq (with its highly secular regime) was not working with Al Qaeda, and was not a training ground for insurgency. Unfortunately, the disorder that has followed the war has provided a place where such training is going on today.

The costs of this insecurity are potentially huge.

(a) Individuals are risk averse, and there is thus a direct quantifiable cost associated with the increase in risk.
(b) The response to security threats has been to create significant barriers to the free flow of people, goods, and services. The Administration champions the virtues of free trade and the benefits from lowering trade barriers, even when those barriers are already low. But increased border security (including airport security, the reporting and registration requirements of the bioterrorism act, etc) are trade barriers; not only are there direct costs associated with administering these security measures, there can be significant macro-economic effects of the reduced flow of goods and services. A special category of costs is associated with the significantly reduced flow of students to the U.S., especially in areas of science and technology, where we have become very dependent on these "imports." (Many have stayed and made large contributions to the economy.)

[43] We provide here preliminary estimates of the costs so far, and what those costs might be expected to be under various scenarios. We do not provide what would have been a reasonable estimate of the costs at the time that the United States went to war. Given the Administration's attempt to minimize the expected costs, it is not surprising that they did not take into account all of the costs discussed in this section.

(c.) Increased risk is bad for business; it lowers investment, and over the long run thus has supply side as well as demand side effects.

Calculating these costs—and particular, the *incremental* costs associated with the Iraq War (beyond the costs which would otherwise be associated with the War on Terrorism)—is sufficiently difficult and problematic that we do not provide any estimates here. But it means that the numbers reported below almost surely underestimate the total macro-economic effects.

Oil

The price of oil is significantly higher today than it was before the War in Iraq. Even as the country went to war, it was recognized that it might have effects on the global oil market. Some of the remarks of those in the Administration seem to suggest that it may have even been a factor driving the country to war. Larry Lindsey is reported to have said, "the best way to keep oil prices in check is a short, successful war on Iraq..."[44]

The higher price of oil brings costs and benefits. Profits of the oil companies have increased enormously.[45] It is the one group (besides certain defense contractors) that has clearly benefited from the war. (Though popular discussions of the still not-clear motives for going to war often focused on oil, there is so far no reason to suppose that these benefits to one of the President's "constituencies" played an important motivation.) Here, we are concerned with the costs to the overall economy of these high oil prices.

First, however, we have to ascertain to what extent has the increased price (from $25 a barrel **before** the War to around $50 today—ignoring the spike associated with Katrina when prices rose to $60) been a result of the war itself.[46] Again, the question is, what is the counterfactual? What would the price have been had there been no war? To what extent is the rise in price due to the war, and to what extent is it due to other factors?

Future markets provide some insight. Before the war, they were forecasting that oil prices remain in the range that they had been, $20 to $30. Futures markets take into account growth in demands in China and elsewhere as well as changes in supply. They do so on the basis of "business as usual," that is, on the basis that nothing out of the ordinary happens. The war in Iraq was the most notable event, and it is hard to identify

[44] *Wall Street Journal,* September 15, 2002

[45] In 2005, four of the ten most profitable corporations in the world are oil and gas companies – Exxon-Mobil, Shell, BP and Chevron Texaco. In 2002, only one of the top 10 most profitable corporations was from the oil and gas industry. Source: The Forbes Global 2000,
http://www.forbes.com/2005/03/30/05f2000land.html
http://www.forbes.com/2002/03/27/forbes500.html

[46] Oil price averaged $23.71/barrel during 2002. In run up to the war, price rose to $32.23 by February 2003 (war began on March 20, 2003). One has to interpret a significant part of the run up of costs prior to the war to the war itself—an increase in stockpiling in response to worries about supply interruptions. The price averaged $27.71 in 2003, $35.90 in 2004 and rose to $49.28 by June 2005. After Katrina, prices have stayed relatively high. As we argue, part of the cost of the War is the reduction in the capability of responding quickly to these supply shocks.

any other which can be given as much credit for significant change in demand or supply (apart from Katrina). Some might blame the high demand for oil from China. But China has had two decades of robust growth, and its growth in 2004 was stronger than many market analysts had anticipated earlier; but global growth in 2005 (of around 4%) is clearly not particularly unusual. Markets are supposed to anticipate and respond to changes in demand by increasing supply. Errors in one year are quickly corrected in the next.

What is striking is that present prices are significantly higher than what most analysts believe is the long run price, and futures markets expect that such prices will persist for at least another two years. [47] That is, costs of extraction in Iraq (apart from the security concerns), Saudi Arabia, and elsewhere in the Middle East are much lower than $40, and at $40 there are many alternative sources (shale, tar sands) with a large supply elasticity. The question is, why has there not been this normal supply response. We suggest that the War in Iraq provides the critical explanation.

Had there been no war, and had price increased, the international community could have allowed Iraq to expand production, and this would have brought down the price. But it is more likely that production elsewhere, including and especially elsewhere in the Middle East, would have increased. The instability in the Middle East which has been brought about by the Iraq War has increased the risk of investing in that region; but because costs of extraction are so much lower than elsewhere, it has not provided a commensurate supply response elsewhere. If stability is restored, then prices will fall, and these investments elsewhere would turn a loss.[48]

In addition, there is the fact that oil production in Iraq has plummeted since the war. Even though Iraq is not an oil producer on the scale of Saudi Arabia and Russia, Iraq did produce around 2.6m barrels per day (a similar level to Kuwait, Nigeria and the UK) on the eve of the war. Now production has dropped to 1.1million barrels per day. The insurgency has sabotaged refining capacity and truck drivers have refused to transport oil from the north, due to the threat of insurgents[49].

Though we believe, accordingly, that the best estimate of the cost of Iraq on oil prices is a very large proportion of the $25 a barrel or more increase in the price of oil (and looking forward, we can extrapolate this cost for the next two years), we provide a conservative calculation based on the assumption that only 20% of that amount--$5—is due to Iraq. In our moderate estimate, we assume $10 is due to Iraq.

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[47] Futures market predicts the price to remain mid $60 range during 2006 and 2007 and then fall in 2008

[48] The increase in the price immediately after the war can be partially directly attributed to Iraq, as what it had been supplying to the world markets under the oil-for-food program was greatly diminished (by almost 1 mbd). Oil prices had, of course, increased even before the war, in anticipation of these effects, so that the costs of the war began even before the war itself.

[49] Iraqi Oil production statistics from Pearson Education. Iraq produced 3.5 million barrels per day in 1990, prior to the Gulf War, and is said to have one of the world's greatest oil reserves.

Figure 4: Impact of Oil Prices

Year	Total Crude Oil Import (Thousand Barrels Per Day)	Total Import Per Year (Billion barrels)	Refiner Acquisition Cost of Crude Oil, Imported ($/Barrel)	Total Cost of Oil Import (Billion US$)
2000	11459.3	4.19	27.7	116.2
2001	11871.3	4.34	22.0	95.3
2002	11530.2	4.22	23.7	99.8
2003	12264.4	4.49	27.7	124.0
2004	13145.1	4.81	35.9	172.7
2005*	13415.5	4.91	47.9	234.7
2006**	13952.1	5.11	57.4	292.3
2007**	14510.2	5.31	65.0	344.3

*Average for the first 9 months of 2005. The total import cost is for the 12-month period using the 9-month average
**Assuming 4% growth in 2006 and 2007[50]

Given U.S. imports of roughly 4.75 to 5.0 billion barrels a year, a $5 per barrel increase translates into an extra expenditure of approximately $25 billion ($10 would be $50 billion). Americans are, in a sense, poorer by that amount.

In a neoclassical model that assumes full employment of all resources, this would be the principle effect on national income. If the economy continues to use all of its resources fully, gross output remains unchanged; only what is paid for inputs of oil has increased, so that value added (GDP) is reduced commensurately.[51]

Assuming that a $5 price increase persists for 5 years, this generates a conservative estimate of $125 billion. For our moderate estimate, we use a $10 price increase, but more plausibly, assume it extends (as future markets believe) for at least 6 years. That generates a cost of $300 billion.

This supply side approach assumes that if the price increase is reversed, the damage is over. To put it another way, this simple model implies that if first the price goes up by $10 for one year, and then down by $10 by one year (from its baseline), and then is restored to its previous level, there is no cost. This is wrong. There is a cost to this volatility. The technology, for instance, that is best adapted to one set of prices will not be that appropriate for another. And the costs can be significant. This is consistent with

[50] Data compiled from Energy Information Administration, Department of Energy, U.S. Government, http://www.eia.doe.gov/emeu/international/petroleu.html#IntlProduction

[51] That is, simplifying, if we write $GDP = vL + \pi$, where π is profits, v is real wages, and L is employment, then $\partial GDP/\partial p = M + v\partial L/\partial p$, where p is the price of oil and M is imports. The last term is the effect of the price of oil on the amount of labor individuals wish to supply, which we assume is negligible. Note that when there is a large change in price, the effect is measured by $\Delta p\ M^*$, where M^* is some number between the level of the actual imports and what the imports would have been, had the price of oil not increased. Given the low short run elasticity of the demand for oil, the difference may be small.

macro economic studies that show large asymmetries between the impacts of increases and decreases in oil prices.[52] Thus this analysis of a five-year period of high prices, which assumes that the only cost is the increased transfer abroad, provides a significant underestimate of the true economic costs. We have not, however, provided an estimate of this additional cost.

Global Income and Price Effects

The value of national income is affected by the prices of other goods the country imports or exports, and these too can *indirectly* be affected by the increase in the price of oil. If, for instance, a global increase in the price of oil leads to a decrease in the price of other commodities (because of a global slowdown), then America is thereby better off. These effects are complex and likely in any case to be small.

There may be some commodities that the United States exports in which it has market power. In that case, we take firms as setting the price of exports to maximize profits. An oil price shock lowers income of buyers of American products, shifting the demand curve over to the left. The income effect (at least for a small perturbation) is just the change in profits at the old price. If markets are fairly competitive, the effect is small, but especially in areas of the New Economy where mark-ups are large, the losses in income can be significant. We have not, however, directly tried to estimate the magnitude of these effects.

Most macro-economic analyses, however, assume that there are more than just these (neoclassical or) supply side effects. This is especially important when the economy is operating below full employment. We noted that with the increase in oil prices, Americans are poorer; they have that much less to spend on other goods—including goods made in the United States. There will be a reduction in aggregate demand, and the reduction in aggregate demand caused by an increase in oil prices is likely to result in a lower level equilibrium output.

The macro-economic counterfactuals

The net effect depends on the macro-economic state of the world and how policy makers respond. If the economy is already in a world in which there is excess supply (demand constrained), then we need to focus on how monetary and fiscal authorities respond to stimulate demand. If the economy were in a state of excess demand, then the dampening of demand would lower inflationary pressure, but would leave output largely unaffected. Unfortunately, the post Iraq war world is one in which there has been excess supply (demand constrained output) in all of the major economies.

Monetary policy response is determined by two offsetting factors. The oil price increase generates some inflationary pressures, and especially among central banks focusing on inflation, this leads to higher interest rates, exacerbating the slowdown of the economy. On the other hand, *if* central banks focus on aggregate demand and unemployment, it is

[52] See, e.g. Rodriguez, 2005

conceivable that monetary policy could offset the adverse effects of oil price increases. If they fully offset the effect, then the *only* effect would be the transfer effect described earlier.

Fiscal policy typically does not adjust quickly enough to stabilize the economy (and the effect of built-in automatic stabilizers is reflected in the multipliers discussed below). Again, there are two effects. For countries with fixed expenditures, then the increase in the oil price means that there is less to be spent on domestic goods, and that exerts a downward effect on the economy. On the other hand, for countries running active countercyclical fiscal policies, the slowdown in the economy could be offset by such policies.

With Europe's Central Bank focusing on inflation, the higher inflation resulting from higher energy prices most likely contributed to higher interest rates *than they otherwise would have been*, and thus a further weakening of the economy. Fiscal constraints (the growth and stability pact) has also meant that fiscal policy could not respond; on the contrary, increased government expenditures on energy meant there was less to spend on domestically produced goods and services, again contributing to the weakening of aggregate demand. In short, for Europe, the contractionary effects including policy responses are greater than without them.

In Japan, with interest rates close to zero in any case and fiscal policy stretched to its limits, probably little policy response can be attributed to the oil price increase.

The United States is the most problematic. It appears that fiscal policy has not been closely related to the short run cyclical state of the economy. (The worsening of the fiscal position of the United States may have contributed to the resolve by some moderate Republicans not to cut taxes or expand expenditures as much as they otherwise would have done.[53] In this sense, the oil price increase has probably had a negative effect on cyclical fiscal policy, i.e. the multipliers are larger than they would be if fiscal authorities took a "neutral" stance.) So too for monetary policy: the increased inflationary pressure from the high oil prices would, if anything, led to a tightening of monetary policy in response to the high oil price, leading to a larger multiplier.

We have not carried out a full global general equilibrium analysis, but rely instead on results of standard macro-economic models. These suggest an "oil multiplier" of around 1.5 (achieved over two years).[54] [55]Thus, assuming that the economy remains below its

[53] The tax cut of 2003 occurred roughly contemporaneously with the War in Iraq. It does not appear that the War played any significant effect either in support or opposition to its passage; though it is likely that had the magnitude of the expenditures been identified, it might have weighed against the tax cut.

[54] One-year multipliers are typically smaller, but our concern is with the total impact, not the timing of the impact (the focus of most short run GDP forecasting models.) See Blinder and Wescott, 2004, based on model simulations from Global Insight, Inc. simulation results supplied August 9, 2004 (results with a monetary policy reaction function engaged and disengaged were essentially the same); and Macroeconomic Advisers, LLC simulation results supplied August 2, 2004.

[55] Increased expenditures on oil can adversely affect consumption (as households have less to spend on other goods), investment (as firms, other than producers of oil, see profits decrease from what they

potential over the period of analysis, and focusing on the total impact (not the timing), our conservative estimate is increased to $187 billion, and our more reasonable estimate to $450 billion. These models too have no feedback from exports.[56]

Global effects

There are some studies, however, which obtain much larger results. The IMF's models yield results with longer lags, but with full effects that are almost 4 times as large.[57]

One of the standard studies, that of Hamilton, estimates that *in the past* a 10% increase in the price of oil has been associated with a 1.4% decrease in GDP. A $5 increase in the price of oil thus implies a lowering of GDP by 2.8%, or approximately ($300 billion) *per year that oil prices remain at that level.* A five-year price rise would generate costs of $1.5 trillion. Hamilton's analysis is consistent with an oil price multiplier that is much larger than the earlier studies.

There are two possible explanations of the large discrepancies in results. The first has to do with the analysis of global general equilibrium results, and can be seen most sharply in the context of a "counterfactual" which has governments maintaining a fixed level (or percentage of GDP) deficit. In the standard model, what limits the multiplier are leakages, income which is not spent "domestically," but is taken out of the system, and spent abroad, or by government. In both cases, the feedback of income into further expenditures stops. But if we take a global equilibrium approach, then the money spent abroad is part of the system. If we include government endogenous expenditures as part of the system, then as taxes are taken out of disposable income, government spends the increased revenues, just as if the individual himself had spent them. (There can be even "negative" leakages; if the government maintains a fixed deficit to GDP ratio, a stimulus—such as a fall in oil prices—leads to a higher GDP, and so an increase in government expenditures. Thus, for a global closed economy, the multiplier increases from $1/s(1-t) + t$, in which taxation reduces the multiplier, to $1/(s(1-t) - d$, where taxation increases the multiplier (where s is the savings rate, t the tax rate on income, and d the allowable deficit to GDP ratio) Thus, if $d = 0$, $s = .2$ $t = .25$, the multiplier increases from 1/.4 to 1/.15, i.e. it increases by a factor of almost 3. [58]

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otherwise would have been), and government expenditures on domestically produced goods (as with budget constraints, there is less to spend on these). Impacts on households are, for instance, marked. Median household expenditures on gasoline and home heating have increased about 5% of household income. Given the low (zero) level of savings, this can be expected to translate into an equivalent reduction in expenditures on other goods.

[56] While these models predict the effects are not fully felt for two periods, they also predict that the effects are felt even after the prices come down. Our calculations ignore the timing of the impacts. Oil price shocks have effects that are different (and presumably greater) than many other shocks, since they adversely affect all of the advanced industrial countries simultaneously.

[57] See International Monetary Fund, "The Impact of Higher Oil Prices on the Global Economy," Dec. 8, 2000, prepared by Research Department staff under the direction of Michael Mussa; cited in Blinder and Wescott.

[58] $Y = (1-t)(1-s)Y + tY + dY + I + X - mY$, since $G - tY = dY$, so $Y = I + X/(s(1-t) + m - d$

(Of course, we need to model the oil exporting countries as separate from the oil importing countries, and spending a substantially smaller fraction of the income on American goods than Americans would. If Saudi expenditure and savings patterns were identical to those of Americans, then the change in the price of oil would simply be a change in the distribution of income, but have no affect on aggregates, besides the supply side effects originating from the higher price of oil. We have slightly overestimated the negative effects on American GDP by assuming that there is no feedback from increased Saudi income back to the United States.)

If we further include future consumption generated by extra savings, then even savings does not constitute a leakage, so long as over the prevailing time horizon, the economy remains in a demand constrained situation. In short, leakages are much, much smaller, when multiyear aggregate incomes are calculated. These dynamic feedbacks are even present in first year income. Thus, increased savings this year leads to increased wealth next year, and that increased wealth leads to increased output (if output is sensitive to demand). But rational consumers will realize this[59]; their lifetime income has gone up, and so too will there current consumption. In calculating the cost of the War, we are concerned not just with the impact today, but the impact in all future years. Calculating the total multipliers requires assessing the fraction of future periods in which it is reasonable to assume that demand constraints will be binding.[60] [61]

In the periods at hand, Europe, the United States, and Japan were all demand constrained throughout the relevant time, and government expenditures were very much constrained by the level of revenues (especially in Europe). In the very short run, it was clear that such constraints were not perfectly binding in the U.S., but government expenditures were tempered from what they otherwise would have been by the looming deficit. This is clearly true for the states and localities (which make up a third of total expenditure) but even true at the Federal level. Accordingly, we believe a multiple period multiplier that is substantially in excess of that generated by the partial equilibrium American models (generating, as we have noted multipliers around 1.5) is warranted. Numbers of the order of magnitude generated by the IMF model are totally reasonable, but to stay on the conservative side, we use a much smaller multiplier of 2 as our (conservative) "moderate" estimate. (We even believe the very large multipliers implicit in Hamilton's study are not implausible.)

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[59] See Neary and Stiglitz, 1983

[60] When supply constraints are binding, individuals may displace consumption to other periods, so the net effect may be not much different from that which would prevail if demand constraints were always prevailing.

[61] Consider a simple two period model in which there is not the second feedback, but in which increased savings this period does lead to increased consumption next period. Then the two-period ($Y_1 + Y_2$) multiplier associated with increased investment the first period is, instead of 1/m (where $m = s(1-t)$), $(1 + \alpha(1+r))/m$, where α is the marginal propensity to consume out of wealth. In a simple life cycle model with no bequests, where the only reason to save is for consumption in "the" future period(s), $\alpha = 1$, so the multiplier has more than doubled.

However, we do believe that great care must be used in employing studies based on the impact of earlier oil price shocks. Changes in the structure of the economy, the nature of the policy responses, and the state of the economy (the extent to which it was at or near full employment) can have large effects on the full response of an oil price increase. Earlier increases occurred at a time when the global economy was already facing inflationary pressures (the U.S. from trying to ignore the fiscal costs of the Vietnam War.) Under doctrines of monetarism, there were large responses—excessive-- to the inflation resulting from the oil price shock. Globalization has put greater downward pressure on prices, so today, inflation is much more benign. Monetarism has been discredited, and even if de jure or de facto inflation targeting has meant that some countries put excessive focus on inflation, including the inflation generated by high oil prices—and thus monetary policy exacerbates the contractionary pressures of oil--it does so less than it did in the earlier oil price shocks.

Thus, while we believe that these global general equilibrium effects are significant, and should raise the multiplier considerably about 1.5 or 2, given the uncertainties associated with these global general equilibrium effects, we do not include them in our conservative estimate. For our "moderate" estimate, we use a 6-year impact and a multiplier of 2. We believe, however, that a substantially larger multiplier might be justified.[62]

Budgetary costs

The most difficult to estimate macro-economic costs are those associated with the increased expenditure. If we were not spending the money on the war, would we be spending it on something else? Would we have cut back spending, and had a smaller deficit? Would we have had the same deficit, but just more tax cuts?

But this is only part of the counterfactual analysis. How would the Federal Reserve have responded to the different macro-economic situation? Would it have dampened or exacerbated these effects?

These are standard questions in *incidence analysis*, in which public sector economists attempt to ascertain the consequence of one policy or another. One standard methodology focuses on *expenditure switching*: it is assumed that the government simply substitutes Iraq expenditures for other expenditures (some defense, some non-defense). This is the methodology upon which we focus here.

Another methodology focused on *marginally balanced budgets*, where taxes are assumed to increase in tandem (from what they otherwise would have been; there may still be tax cuts, but they are somewhat smaller than they otherwise would have been.) The Bush Administration seems undeterred in its commitment to make its tax cuts permanent, unaffected by the War, but Congress is showing some sensitivity to the size of the deficit.

[62] For instance, the IMF study cited earlier with much larger multi-year multipliers, near 4, would be associated with a total impact of $1.2 billion over 6 years.

A third methodology assumes that the increased expenditure leads to higher deficits. We comment on the implications of this at the end of this section.

The expenditure switching methodology focuses on two critical differences between expenditures on the war in Iraq and other public expenditures, such as investments in research, infrastructure, or education. The first is that the *domestic content and leakages* differ. Consider, for instance, a $1000 spent to hire Nepalese workers to perform services in Iraq. There is no "first round" effect on domestic GDP, and little impact on subsequent rounds (only to the extent that the Nepalese contractors buy goods made in the United States). By contrast, a $1000 spent on university research in the United States has a full $1000 first round impact, and high impacts in subsequent rounds. While "multipliers" associated with different kinds of expenditures are known to differ, there may be few expenditures with a lower multiplier than those in Iraq.

There are no data on the basis of which to provide accurate estimates of the differences in multipliers and leakages. Assume, however, that in the case of normal investment expenditures (like university based research) the first round and subsequent rounds of expenditure have a leakage of .67, generating an overall multiplier of 1.5. (The numbers are chosen to be deliberately very conservative.) By contrast, if the first round expenditure for Iraq is three-fourths that amount (again a conservative number, since it may well be much less) and leakages are the same thereafter, then the overall multiplier is 1.1. Switching $500 bn (over the years of the war) to domestic investment would have resulted in increased GDP by $200 bn.

(For some of the long run costs referred to in the first section of this paper, there are not likely to be large differences in multipliers. The increased disability and health care costs of Iraq War veterans are likely to have multipliers similar to that for investment expenditures. That is why we have conservatively focused on the impact of switching only $500bn.)

The second major difference is impacts on long run output. Investments in the public sector yield high returns, and so output would have been higher in the future. Expenditures on the Iraq war have no benefits of this kind. As a result, output in the future will be smaller. Assume, for instance, that of the direct costs of the war estimated in the previous section $500 billion[63] were put into investments yielding conservatively a 6% real return on the investment, and using a (conservative) 4% discount rate, the present discounted value of the lost income is $750 billion.[64]

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[63] Obviously, it is conceivable that far more than $500 billion out of the nearly $1 trillion in Iraq expenditures switch to investment.

[64] 6% is the certainty equivalent return. Investments in government research have been shown to have much higher rates of return. The natural discount rate to use (for discounting certainty equivalents) is the real T-bill rate, which in recent years has been close to zero or negative. Historically, it has been around 1.5%. The present discounted value of lost income of an investment I yielding a return of g at a discount rate of r is Ig/r, i.e. a "multiplier" of g/r. We have been conservative in choosing a low g and a high r, generating a multiplier of 1.5. The standard cut-off for government projects is 7%, and research yields are even higher. Using a value of g= .07 and r = .015 yields a multiplier of 4.67, which is substantially higher. In the case at hand, with forgone investment of $500 billion, the PDV of future lost income is $2.3 trillion.

If the government had, instead, simply let the deficit grow, one would have to calculate the additional growth costs of that deficit. The additional deficit could, for instance, crowd out private investment, and calculations similar to those just performed would provide an estimate of the cost, somewhat larger than the costs estimated above.[65]

Other macroeconomic costs (stock market, housing)

Higher oil prices and higher interest rates to which the oil prices give rise also have effects on asset values. To the extent that these effects are greater than just the current year effects on profits, they suggest a persistence of the consequences that our previous analysis did not fully take into account, and the existence of large non-linearities. This is evident in the industries that are particularly sensitive to oil prices, like the airline industry, where many firms face the prospect of bankruptcy.

The surge in corporate profits in the last couple of years has not been accompanied by an increase in stock prices of the magnitude that would have been expected. Robert Wescott[66] estimates that the value of the stock market is some $4 trillion less than would have been predicted on the basis of past performance. Assuming that the major factor contributing to that is the increase in oil prices, and that 20% of that increase in oil prices is due to Iraq leads to a cost of some $800 billion. This is several times the increase in the direct energy costs over the next few years. This may reflect the fact that we have grossly underestimated the effects by limiting our analysis to six years; or to the fact that there are large non-linearities.[67] But this decrease in corporate wealth does imply that consumption was lower than it otherwise would have been, with the attendant multiplier effects.[68]

Note that it would be double counting to both count the value of the investment (the opportunity cost) and the value of the benefits that would have been generated by the investment. In a world with perfect markets and no costs to raising taxes, presumably there would be no difference between the discount rate and the marginal return to investment, in which case, the value of the investment would be equal to the present discounted value of the benefits generated by it. In the public sector, however, it is clear that there are often large discrepancies. A relatively modest investment in levees in New Orleans would have saved hundreds of billions of dollars.

[65] If the private investment yields a return of 8%, and we discount at the rate of 4%, then the $500 billion of displaced investment has a PDV costs of $1 trillion, or $500 billion in excess of the direct costs. If the United States borrows the full amount abroad, and there are no effects on the interest rates at which the U.S. can borrow, then there is no displacement effect, and the only costs are the direct costs already estimated. At the same time, the deficit-financed expenditures will give rise to a positive aggregate demand effect. $500 billion of expenditures, in the assumptions given earlier, would have an additional multiplier effect of $50 billion. Note that in the case of full deficit financing, in the moderate scenario, the total budgetary impact is $1.185 trillion; if just 25% of this displaces private investment, the estimated macro-economic costs would be greater than under the expenditure switching analysis.

[66] Personal correspondence

[67] For example, bankruptcy exerts a strong non-linearity. Some key American industries (automobile, airlines) have been pushed near bankruptcy as a result of oil prices.

[68] Similar issues arise in the case of housing. Though there has been a boom in housing, presumably if the costs of operations were lower, the demand for housing services would have been higher, and prices would

Uncertainty about future oil prices also has a dampening effect on investment. Firms do not know what technology is appropriate for the economic environment that will prevail, and respond to that uncertainty by postponing investment. This has both an effect on aggregate demand and aggregate supply in the short run. Again, we have not estimated the magnitude of these effects

Summary

The macro-economic costs are potentially very large; possibly even a multiple of the direct costs. Clearly, though ensuring supply of oil was one of the sometimes stated or inferred goals, the risks of Middle East instability that might result was often noted as one of the main risks of the venture. What has happened is certainly within the range of predicted consequences to the price of oil[69]; and experiences in the 1970s should have made us aware of how large the macro economic consequences could be. In short, while large, when adjusted for the larger size of the economy today, they are, we believe, totally plausible.[70]

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have been still higher. We have not estimated the value of the implied reduction in the value of housing *from what it otherwise would have been.*

[69] See, in particular, Nordhaus [2002].

[70] For most of the analysis, we have assumed that there has been excess capacity in the economy, i.e. the economy during the period of concern has been operating below its potential. This is evidenced not only by figures on capacity utilization and by the fact that the employment ratio (fraction of working age population working) is significantly below the level of the 90s. Even the unemployment rate is significantly higher than the 3.8% reached in the 90s (and there appeared to be no significant inflationary pressures even at that unemployment rate.) The factors that have led to a decrease in the NAIRU, including the competitive supply of goods from abroad, have continued to operate, so that there is every reason to believe that the NAIRU remains far lower than current unemployment rates. (See Stiglitz, 2000). Stagnation and declines in real wages, higher than normal levels of "disability," and large numbers of individuals claiming to be working part time involuntarily are consistent with this view of significant weaknesses in the labor market, i.e. significant potential for increasing incomes without generating increases in inflation. Our analysis assumes that potential output will exceed actual output for (in the conservative scenario) the next two years. This is consistent with most forecasts which see a slowing of growth to between 3.25% and 3.5% in the period 2006-2008, particularly as consumption growth is dampened from its unsustainable levels fueled by rising real estate prices and low interest rates. Even if productivity growth slows from the 3% that marked the nineties, these rates are not sufficient to overcome the "jobs deficit" created in 2001-2003. In any case, even our "moderate" estimate projects that had oil prices not been as high, output would have been higher by amounts that are a fraction of the estimated gap between potential and actual output.

Figure 5: Macro-economic effects ($ billion)

Impact	Conservative	Moderate
Oil price increase		
Transfer (supply side) effect	125[71]	300
Aggregate demand[72]	62	150
Global General Equilibrium		150
Budgetary impacts		
Expenditure switching		200
Growth impacts (PDV)		250
Total	**187**	**1050**

We therefore estimate that the total economic costs of the war, including direct costs and macroeconomic costs, lie between $1 and $2 trillion, as shown in Figure 6.

Figure 6: Total Economic Costs of the Iraq War ($BN)

Scenario	Conservative	Moderate
Direct costs	839	1189
Macroeconomic	187	1050
	1026	**2239**

List of Omitted Costs

Defense and destruction costs

- Costs of planning war[73]
- All costs borne by other countries, including Iraq
  - Military costs
  - Destruction of property
  - Loss of life
- All costs of increased insecurity[74]
  - Increased costs of cross border flows
  - Reduced investment
- Consequences of Loss of credibility
- Value of reduced capability of responding to national security threats elsewhere in the world

[71] Conservative: $5 barrel for 5 years; moderate: $10 barrel for 6 years
[72] Conservative: (multi-year) multiplier of 1.5; moderate: (multi-year) multiplier of 2
[73] Estimated at $2.5 billion
[74] Other than the indirect impact of increased insecurity in impeding oil supply response

Value of reduced capability of responding to domestic situations in which the National Guard or the Reserves might have been called upon (as in New Orleans)

Macroeconomic costs

- All costs of increased insecurity[75]
    - Increased costs of cross border flows
    - Reduced investment
- Indirect aggregate demand effects (as a result of reduced incomes in trading partners)[76]
- Costs of oil price volatility
    - Including on investment
    - Costs of bankruptcy[77]
- Reduced demands as a result of anti-American sentiment
- Consequences of losses of asset values (arising from increase in oil prices or otherwise)
    - Equity markets
    - Housing
- Consequences of tighter monetary policy as a result of increased inflation[78]
- Consequences of worsening fiscal position
    - As a result of increased government expenditures on oil[79]
    - As a result of increased expenditures on the war[80]

Other costs

- Costs of risks borne by individuals[81] (including compensation that would be required to make them willingly bear risks)
- Economic Cost of impairment to earnings potential and quality of life for veterans who claim partial disability (est. 160,000) but were not wounded during the conflict
- Health care costs not borne by the government.

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[75] Other than the indirect impact of increased insecurity in impeding oil supply response
[76] Other than as reflected in higher multiplier in "conservative" case
[77] Other than as reflected in the multiplier analysis. The multiplier analysis focuses on demand side effects bankruptcy costs are more correctly viewed as supply side effects (not included in the standard neoclassica model.)
[78] Other than as reflected in multiplier analysis
[79] Other than as reflected in multiplier analysis
[80] In the "Conservative" scenario. In the "moderate" scenario, we perform an expenditure switching incidence analysis, which provides a number that may partially reflect these costs.
[81] Other than as reflected in increased recruitment costs

IV. Concluding Remarks

The most important things in life—like life itself—are priceless. But that doesn't mean that topics like defense, involving the preservation of our way of life and the protection of life itself, should not be subject to cool, hard analysis of the kind for which economics has long earned a reputation.

Take the decision of when to go to war. Here, economic analysis employs the concept of *option value*. Even if one thinks war is inevitable or highly likely, there is a question of timing because there are costs and benefits to postponement. The enemy may be better prepared, but so may we. Normally, one goes into such a war under the presumption that one is going to win, and therefore a critical issue is managing the post-war occupation. Without adequate preparation, weapons may easily fall in the hands of insurgents—as in fact they did—enormously increasing the occupation costs. With adequate armor, fewer American troops are likely to be injured or killed. As even the Secretary of Defense has admitted, in the rush to war, there was not time to provide adequate protection for the troops, protection that clearly the richest country in the world could have afforded and that its citizens would have expected.

Economists also think about the *value of information*. In this situation, postponing war might have allowed us to gather better information with which to judge whether Iraq posed a real threat. This is not, as Americans say, Monday morning quarterbacking: there were already strong suspicions regarding our sources of intelligence on Iraq's alleged weapons of mass destruction. More time would have enabled the verification of this evidence. The value of this information would have been enormous. The possibility of war later on would have still been an option. Tens of thousands of lives would have been spared, and hundreds of billions of dollars saved.

All of this leads to economists' constant urging that politicians undertake a *cost benefit analysis* before undertaking any project—especially one with as significant consequences as war. This can and should be done even if certain elements of the costs and benefits are hard to value.

If Congress had been informed of the range of costs, perhaps if they had been told that the costs might exceed a half trillion, or a trillion dollars, perhaps, in the end, they would have made the same decision. But perhaps they would have been a bit more cautious in making that decision, looked a little harder at the evidence, thought differently about how best to conduct the war.

We have not attempted in this paper an overall assessment of whether the war was conducted in the most cost efficient manner, i.e. whether, given what has been achieved (however that is defined), those objectives could have been achieved at lower costs. We have taken the expenditures, as they have occurred, not as they might have been. The Administration has explicitly tried to fight the war on the cheap, that is limit direct commitments of American troops, even shortchanging body and personnel armor. In violating the Powell doctrine, this may be one of those instances of "penny wise-pound

foolish". Certainly, the long run costs to the individuals and to society of the individuals who died or were badly maimed (not to mention the additional costs of recruitment) far exceed the savings from not purchasing better body protection. Many observers believe that the manner in which the War was conducted led to the extended insurgency, which too has greatly increased cost.

Though we have suggested that many of the costs were within the range of what could have been anticipated, we have not sought in this paper to ascertain whether on the basis of the information available, the Administration could have made more reliable estimates. We do not address the question of whether the disparity between the predicted numbers and the actual numbers is a result of a deliberate attempt of the Administration to mislead the American people on the cost of the war, or of incompetence, going to War with information of low reliability and with best estimates that were far from the mark. In response to accusations about the existence of weapons of mass destruction and the connection with Al Qaeda, the Administration has been adamant that it did not intentional deceive the American people; it prefers charges of incompetence to those of malevolence. We have not attempted to ascertain the relative role of each in the failure to provide the American people with an accurate cost of the venture. At the very least, though, honesty would have required laying out the various scenarios, even if it attached low probabilities to those that in fact turned out to be the case.[82]

Americans could, and should have asked, are there ways of spending that money that would have enhanced our long run well being—and perhaps even our security—more. Take the conservative estimate of a trillion dollars. Half that sum would have put social security on a firm grounding for the next seventy-five years. If we spent even a small fraction of the remainder on education and research, it is likely our economy would be in a far stronger position. If some of the money spent on research were devoted to alternative energy technologies, or to providing further incentives for conservation, we would be less dependent on oil, and thereby more secure; and the lower prices of oil that would result would have obvious implications for the financing of some of the current threats to America's security. While we may not know what causes terrorism, clearly the desperation and despair that comes from the poverty that is rife in so much of the Third world has the potential of providing a fertile feeding ground. For sums less than the direct expenditures on the war, we could have fulfilled our commitment to provide .7% of our GDP to help developing countries—money that could have made an enormous difference, for the better, to the well being of billions today living in poverty. We could have had a Marshall Plan for the Middle East, or the developing countries, that might actually have succeeded in winning the hearts and minds of those in the Middle East.

[82] An excellent example of the kind of analysis that could and should have been provided is that of Nordhaus (2002), who lays out various scenarios. The CBO and the House Budget Committee provided some estimates. Nordhaus points out, however, that they did not include scenarios involving extended engagement, occupation, and reconstruction.

What is clear is that the Administration's original estimates were strikingly low.[83] Would the American people have had a different attitude towards going to war had the known the total cost? Would they have thought that there might be better ways of advancing the cause of democracy or even protecting themselves against an attack, that would cost but a fraction of these amounts? In the end, we may have decided that a trillion dollars spent on the War in Iraq was better than all of these alternatives. But at least it would have been a more informed decision than the one that was made. And recognizing the risks, we might have conducted the War in a manner different from the way we did.

Hamid Rashid, Robert Wescott, Joshua Goodman and Kwang Ryu made important contributions to the results reported here, which are gratefully acknowledged.

[83] It is of interest that our "moderate" estimate is not dissimilar to Nordhaus' "high (protracted and unfavorable) case, $1.9 trillion. His estimate of direct military spending, occupation, and reconstruction was $745. However, he did not include a number of the long run costs (such as health costs and disability benefits and increased recruiting costs), nor the adjustments between economic and budgetary costs noted in section III. His estimate of the direct impact on oil markets (the transfer effect) was $778 billion, which we believe to be more accurate than estimate of $300 million (in the moderate case), which was deliberately chosen to be conservative. He uses a "macro-economic oil" multiplier that is similar to ours, but because he (realistically) assumes a large oil price effect, he obtains a larger macro-economic effect. He does not include any "growth investment/displacement" or "expenditure switching" effects in his analysis. Nordhaus' historical analysis puts some perspective on the magnitude of the expenditures: the projected direct expenditures in Table 1 are comparable to those of the Vietnam War ($494 billion), somewhat greater than the Korean war ($336 billion) and more than twice as large as World War I ($190 billion).

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Mr. SHAYS. You have the floor, ma'am.

Ms. BELASCO. Chairman Shays, Ranking Member Kucinich, and distinguished members of the subcommittee, my name is Amy Belasco and I am a Specialist in National Defense at the Congressional Research Office.

This hearing addresses an important oversight issue. How can Congress get accurate and reliable projections of the cost of the global war on terrorism? Projecting future costs depends on having accurate records of past costs and on understanding how those costs may change as troop levels or the pace of operations change.

I would like to make several points about this issue. The Department of Defense has not shared with Congress estimates of how all the funds appropriated for each of the three operations that make up the global war on terrorism—and that is Operation Iraqi Freedom, Operation Enduring Freedom that funds Afghanistan and other counter-terrorism operations, and Operation Noble Eagle for enhanced base security. DOD has not provided individual estimates for these operations of how moneys have been and are likely to be spent.

CRS was unable to resolve some discrepancies in DOD's war cost information. DOD has also not identified for Congress the planning assumptions that underlie its requests, for example, the number of troops deployed. That also drives future costs. DOD also does not record the outlays associated with war spending that are necessary to verify war expenses.

Another point is that war funding for procurement may make it possible to reduce DOD's regular budget because equipment is being replaced sooner than planned.

Finally, to minimize problems in financing war operations, options could include funding most operational costs up front or submitting future war requests in February with the regular budget.

While it is sometimes difficult to project these costs because of the uncertainties of war, it is not impossible, particularly in the 5th year of operations.

In response to numerous congressional inquiries and in the absence of administration figures, CRS estimated the cost of military operations, reconstruction, foreign aid, embassy operations, and veterans health care since the September 11th attacks for the three operations. Of the $437 billion appropriated thus far through fiscal year 2006, CRS estimates that $319 billion or 73 percent is for Iraq, $88 billion or 20 percent is for Afghanistan and other counter-terrorism operations, and $26 billion or 6 percent is for enhanced security, and about $4 billion CRS could not allocate.

In addition to this $437 billion, the administration's fiscal year 2007 budget includes a $50 billion placeholder figure to cover the first part of war costs, although a formal request has not been submitted. With that $50 billion, the total for the global war on terror would reach $487 billion, and the total for all of fiscal year 2007 is likely to exceed $500 billion based on this year's costs.

Of the $437 billion appropriated through fiscal year 2006, CRS estimates that about 90 percent, or $397 billion, is for the Department of Defense, with the remainder for foreign aid, diplomatic operations, and VA medical costs.

As of March 2006, CRS estimates that about $302 billion of these DOD funds are obligated and $95 billion is unobligated. Of those unobligated funds, CRS estimates they would be split $71 billion for Iraq, $12 billion for Operation Enduring Freedom, and $2 billion for enhanced security.

CRS found both strengths and weaknesses in DOD's ability to estimate and track war costs. DOD uses a fairly sophisticated model to estimate the specific expenses for each military operation that are in addition to its normal operating costs, and those costs reflect assumptions about troop levels, the pace of operations, and support costs. The Defense Finance Accounting Service [DFAS], then tracks these expenses by recording when contracts are signed and people are due to be paid, but does not capture whether funds are ultimately spent, i.e., whether they result in outlays.

Nevertheless, CRS found several discrepancies and gaps in DOD's war cost information, including cases where obligations appear to exceed available budget authority and cases where budget authority has not been spent. DFAS reports also do not capture about $7 billion in budget authority that CRS and I believe also GAO believe was appropriated for war, and the DFAS reports also do not track the cost of intelligence that is managed outside of the Defense Department and the cost to equip new Army modular units in fiscal year 2005 and 2006 that was included in supplementals.

For Congress to evaluate future war estimates, it would be useful for DOD to fill in two significant gaps in war cost information: tracking outlays and identifying troop levels. First, DOD cannot currently identify whether the obligations reported by the Defense Finance Accounting Service are ultimately spent or how much of those are spent and where they are spent—in other words, the outlays. This is the cost DOD's war funds and baseline regular appropriations are mixed in the same accounts and war funds cannot be separately identified. Without outlay data, DOD cannot verify expenses, nor can Congress identify how war expenses affect the budget deficit.

Second, in its testimony DOD generally identifies only the number of troops in country at particular times, which run roughly 140,000 in Iraq and about 20,000 in Afghanistan, or about 160,000 altogether. This number does not include all deployed military personnel supporting these operations in neighboring countries or those who are conducting other counter-terrorism operations such as those in Djibouti or the Philippines. Future costs depend on the total number of deployed personnel, rather than those in country.

CRS found several estimates of the total number of deployed troops in 2005 for Operation Enduring Freedom and Operation Iraqi Freedom, which ranged from about 230,000 to 300,000.

Conducting oversight of how costs change as troop levels change depends on having accurate data on past, current, and future troop levels.

Distinguishing war and peace costs is another important issue. DOD now receives substantial amounts of funds for war-related procurement. Some of these moneys are for unanticipated new requirements such as additional armored Humvees. Other funds, however, are to equip new Army modular units, to replace war-

worn equipment, which is known as reset, and to upgrade equipment. Since DOD's plans already call for transformation or modernization of its forces, this war-related procurement may also meet these needs. For this reason, it may be that DOD's regular budget could be reduced because equipment is essentially being swapped out sooner than planned.

There is a couple of key things that are needed to build war funding requests and to provide oversight over those requests. Options for improving oversight could include directing DOD to estimate by operation, by category, and by year how all appropriated funds are or will be spent. DOD could also identify its planning assumptions such as troop levels that drive costs in previous and new requests. DOD could also estimate overall and annual reset and upgrade plans and potential offsets within its regular budget.

Finally, Congress could choose to direct DOD to set up separate appropriation accounts for each operation so that war appropriations, obligations, and outlays can be accurately identified.

Finally, the subcommittee asked me to look at what the effect is of supplemental requests on war funds.

Mr. SHAYS. If you could kind of bring it to a conclusion, how much more do you have there?

Ms. BELASCO. I am sorry?

Mr. SHAYS. How much more in your testimony?

Ms. BELASCO. One paragraph.

Mr. SHAYS. OK.

Ms. BELASCO. Since September 11th, the administration has submitted supplemental requests for war funds well after the fiscal year is underway. Although this allows DOD to estimate costs based on later data, it reduces visibility on annual costs. If war costs were submitted with the regular budget, DOD could then submit adjustments later.

To ensure that the Army and Marine Corps were not faced with difficulties in meeting costs midway through the year, Congress could consider options such as appropriating three-quarters of the day to day operating funds at the beginning of the fiscal year and a minimal amount of procurement funds, or about $45 billion, remains unobligated.

Thank you for inviting me.

[The prepared statement of Ms. Belasco follows:]

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Until released by
House Government Reform Committee

STATEMENT OF

AMY BELASCO

SPECIALIST IN NATIONAL DEFENSE

CONGRESSIONAL RESEARCH SERVICE

BEFORE THE

COMMITTEE ON GOVERNMENT REFORM

SUBCOMMITTEE ON NATIONAL SECURITY, EMERGING THREATS AND INTERNATIONAL AFFAIRS,

HEARING ON

GLOBAL WAR ON TERRORISM: ACCURACY AND RELIABILITY OF

COST ESTIMATES

JULY 18, 2006

Introduction

Chairman Shays, and distinguished members of the subcommittee, I am Amy Belasco, a Specialist in National Defense at the Congressional Research Service (CRS). It is my pleasure to discuss the important oversight question of this hearing: How can Congress get accurate and reliable projections of the cost of the Global War on Terror (GWOT)? This testimony is based on my work on defense budget issues at CRS as well as over 25 years of experience in the executive and legislative branches.[1]

Although projecting war costs is a difficult task because of uncertainties of war operations, doing so would help the Department of Defense request an appropriate amount of funds, help Members of Congress monitor and assess requests and their fiscal impact, and help the public understand the scale of U.S. involvement in Iraq, Afghanistan and other global war on terror operations today and in the years to come.

As requested, this testimony addresses:

- the availability and accuracy of war cost estimates of GWOT and its three individual operations;
- distinguishing war from baseline costs;
- potential ways to improve estimates;
- the effects of relying on supplemental and bridge funds; and
- DOD's ability to finance war operations until passage of supplementals.

In response to numerous Congressional inquiries and the absence of figures from the Department of Defense (DOD), CRS developed estimates of the cost of the three operations launched since the 9/11 attacks:

- Operation Enduring Freedom (OEF), covering Afghanistan and other Global War on terror (GWOT) operations ranging from Djibouti to the Philippines;
- Operation Noble Eagle (ONE), providing enhanced security at military bases; and
- Operation Iraqi Freedom (OIF), for the continuation of counterinsurgency and stabilization operations in Iraq.

These figures build on DOD data and use estimates to fill in gaps and resolve discrepancies and uncertainties that CRS encountered. CRS is prepared to modify these estimates based on better or more complete information. I'll briefly summarize these estimates.

Based on CRS research, I'll then discuss several ways that Congress could improve visibility and oversight of GWOT costs including requiring the Department of Defense to

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[1]Much of this information is drawn from CRS Report RL33110, *The Cost of Iraq, Afghanistan, and Other Global War on Terror Operations Since 9/11*, 6-16-06, first issued by CRS in October 2003,entitled *Defense Funding by Mission For Iraq, Afghanistan, and Homeland Security: Issues and Implications*.

- allocate all GWOT budget authority (BA) appropriated since 9/11 by fiscal year, operation, and war reporting expense categories with a comparison to obligated and unobligated balances;
- provide Congress with the key planning assumptions that drive costs including troop levels, operating tempo indicators, mix of active and reserve force, and other metrics;
- provide Congress with an estimate of total and annual investment requirements distinguishing between reset or repair and replacement of war worn equipment, equipment for newly-structured modular units, upgrades, and military construction; and
- track war outlays by segregating GWOT budget authority for each operation into new accounts separate from DOD's regular accounts.

Cost of the Global War on Terror Since the 9/11 Attacks

Through the FY2006 supplemental that was enacted in mid-June of this year, CRS estimates that Congress has appropriated about $437 billion for military operations, base security, reconstruction, foreign aid, embassy costs, and veterans' health care for the three operations initiated since the 9/11 attack. This amount is in addition to DOD's appropriations in its baseline or regular budget.

In its FY2007 budget, the Administration included an additional $50 billion to cover war costs in the first part of the fiscal year, but has yet to submit a formal request. For this reason, the $50 billion is essentially a 'placeholder' figure. The FY2007 defense authorization bills (H.R. 5122/S. 2766) and budget resolutions of both houses (H. Con Res. 376/S. Con Res 83), and the House-reported version of the Department of Defense appropriations (H.R.5631) all include $50 billion for war costs. The authorization and appropriation bills allocate that total to specific appropriations accounts.

If that $50 billion is added to appropriations through FY2006, cumulative war appropriations would reach $487 billion through about the first half of FY2007. It will likely cost some tens of billions more to cover all of FY2007 even if the United States withdraws some troops in the intervening months.

CRS Estimates for Each Mission

Estimated Total Appropriated By Operation. Of the $437 billion appropriated through FY2006, CRS estimates that about:

- $319 billion or 73% is for Iraq;
- $88 billion or 20% is for Afghanistan and other operations;
- $26 billion or 6% is for enhanced security; and.
- $4 billion could not be allocated by CRS.

About $397 billion, or 91% of the $437 billion total, is for the Department of Defense (DOD). About $35 billion, or about 8%, is for foreign aid programs or embassy costs, and less than $1 billion, or 1%, is for medical care for U.S. veterans of Iraq and Afghanistan operations. In the remainder of this analysis, I'll focus on DOD spending.

Obligated and Unobligated Amounts. Of the $397 billion for the Department of Defense, CRS estimates that about $302 billion has been obligated and another $95 billion remains unobligated as of March 2006. Of the $302 billion in obligated monies, CRS estimates that funding is split among the three operations as follows:

- $219 billion for Operation Iraqi Freedom (OIF);
- $58 billion for Operation Enduring Freedom (OEF) and
- $25 billion for enhanced security or Operation Noble Eagle (ONE).[2]

CRS estimates of obligations may be larger than those reported by DOD because CRS includes some spending provided for GWOT that is not captured by Defense Finance Accounting Service reports.[3]

Of the $95 billion in unobligated funds as of March 2006, CRS estimates that:

- $71 billion is for OIF;
- $12 billion is for OEF; and
- $2 billion if for enhanced security or ONE.

Estimated Monthly Obligations in FY2005 and FY2006. On a monthly basis, CRS estimates that DOD obligations – or contractual and pay costs incurred – averaged $7.9 billion in FY2005 including about:

- $6.4 billion per month for OIF;
- $1.3 billion per month for OEF; and
- $180 million per month for enhanced security.

In FY2006, CRS estimates that DOD average monthly obligations may rise by about 20% to $9.7 billion per month altogether including about $8.0 billion for Iraq, $1.5 billion for OEF, and $180 million for enhanced security. This mainly reflects the 15% increase in DOD's annual appropriations for these operations from $102.5 billion in FY2005 to $117.6 billion in FY2006. Obligations for the first half of FY2006 are running lower than these estimates, particularly for investment, presumably because the Defense Department constrained spending until passage of the FY2006 supplemental.[4]

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[2]CRS used figures for intelligence spending included in Congressional reports and estimated the split between Iraq and OEF.

[3]DOD does not include intelligence funds managed outside of the department, which total over $20 billion between FY2003 and FY2006 based on figures in appropriations reports and DOD justification material. DFAS reports also do not include the cost of modularity.

[4]DOD appears to have held back on releasing all of the $50 billion available for FY2006 war funds in the FY2006 appropriations (Title IX, P.L.109-148)to cover costs until passage of a supplemental so that the services would tap peacetime funds slated to be spent at the end of the fiscal year to finance war costs; these funds would be replenished once the supplemental passed. Compared to FY2005, average monthly obligations in the first half of FY2006 were lower than for investment but higher for operational spending.

Strengths and Weaknesses in DOD Estimating and Tracking of War Costs

At your request, CRS assessed the accuracy of DOD estimates and tracking of war costs. Congress has generally appropriated funds for war for DOD in either traditional appropriation accounts or in centralized accounts from which funds are later allocated rather than tagging monies specifically for each operation – Operation Iraqi Freedom, Operation Enduring Freedom and Operation Noble Eagle.[5] Nevertheless, DOD has tools to estimate and track war costs by operation.

To develop its requests for war-related operational costs, the Department of Defense uses the Contingency Operations Support Tool or COST model that projects incremental war costs for specific types of military personnel and operation and maintenance activities based on planning assumptions for troop levels, operational tempo, rotation plans and other factors that drive costs for each operation.[6] The model includes support cost factors routinely used by the services (e.g., cost per flying hour) but can be adjusted to reflect the wartime pace of operations or wartime conditions. The war cost estimates generated by the model are in addition to DOD's regular operational costs; for example, special pays for operating in a war zone (imminent danger or hostile fire pay) or the cost of activating reserve personnel.

These types of cost cover about 70% of GWOT costs. DOD's Defense Finance Accounting Service (DFAS) then tracks obligations of funds by individual operation using submissions from the services in the same categories. Investment costs – for procurement, Research, Development, Test & Evaluation (RDT&E) and military construction costs are based on evaluation of service requests.

In recent years, DOD has made several changes to improve its reporting of war costs including expanding the number of reporting categories to gain greater visibility of costs, and including footnotes on monthly variances in costs. In developing its cost estimates, however, CRS found various discrepancies and gaps in DOD data.

Discrepancies between Budget Authority and Obligations. These gaps include the following mismatches between budget authority (BA) appropriated by Congress and obligations as reported by DOD:

- For FY2001- FY2002, the first year of GWOT operations, CRS found that obligations exceeded budget authority available by $1.2 billion;[7]

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[5]The only exceptions are funds appropriated directly to Afghan Security Forces Fund and Iraq Security Forces Funds in FY2005 and FY2006. In FY2001 and FY2002, DOD received most war funds in the Defense Emergency Response Fund (DERF) and in FY2003, in the Iraq Freedom Fund. In FY2001/FY2002, DERF funds were spent directly from the fund and in FY2002 and FY2003, funds were transferred by DOD from the DERF or IFF to individual appropriation accounts.

[6]DOD's financial regulations require the services to use this model to estimate incremental war costs; see DOD, *Financial Management Regulations,* Contingency Operations, Vol. 12, Chap. 23, Sept. 2005 http://www.dod.mil/comptroller/fmr/12/12_23.pdf. The COST model was developed in the mid-1990s to track the cost of Bosnia and other operations.

[7]CRS estimated budget authority at $31.4 billion and obligations at $32.6 billion; see **Table 1** in CRS Report RI33110, *The Cost of Iraq, Afghanistan, and Other Global War on Terror Operations Since 9/11,*

(continued...)

- The funding source for $2.5 billion in obligations for Iraq in FY2002, presumably for initial troop deployments, is unclear to CRS;[8]

- About $7 billion in BA appropriated in FY2003 is not reflected in reported obligations; that BA would have lapsed by now.[9]

- FY2004 obligations exceeded available budget authority by about $2 billion.[10]

Gaps in Reporting. CRS found that war execution reports from DOD's Defense Finance Reporting Service (DFAS) appear not to include over $30 billion in budget authority appropriated for the global war on terror between FY2003 and FY2006. This includes about $20 billion in intelligence funds, about $11 billion in the cost to restructure and create modular Army units, and about $1.6 billion of funds obligated in FY2005 to train Afghan and Iraqi security forces.[11]

Because Congress appropriated these funds for the global war on terror, CRS has made its own estimates of how these funds would be spent. DFAS reports do not include intelligence spending that is managed outside the department. These reports also did not capture obligations for training and equipping Afghan and Iraqi security forces in FY2005, though FY2006 obligations reports now cover these costs.

There has been some controversy about whether the cost of Army modularity should be considered a war-related cost (see below). Most of the differences between CRS and CBO estimates of war costs stem from whether intelligence and modularity costs are included.

Effects of War on Regular Operations. Although DOD's COST model may be fairly accurate in projecting war costs if the planning assumptions prove to be correct, the model does not

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[7](...continued)
June 16, 2006.

[8]A DOD table listing monthly obligations for FY2003-FY2004 shows $2.5 billion for Iraq from pre-FY2003 funds but does not identify the source.

[9]Both CRS and GAO concluded that about $7 billion in DOD's FY2003 regular appropriations bill that was designated for GWOT may or may not have been spent for those purposes; see GAO-05-767, *Global War on Terrorism: DOD Should Consider All Funds Requested for the War When Determining Needs and Covering Expenses*, September 2005 and GAO-05-882, *Global War on Terrorism: DOD Needs to Improve the Reliability of Cost Data and Provide Additional Guidance to Control Costs*, September 2005; and CRS Report; CRS Report RL33110, *The Cost of Operations in Iraq, Afghanistan and Enhanced Security*, by Amy Belasco, October 7, 2005.

[10]This may reflect some double-counting by CRS of intelligence funding because some intelligence funding for classified programs managed by the services may have been captured in DFAS reports. A recent press report suggested that the annual total of about $44 billion for intelligence spending is split between about 75% for national intelligence and 25% for military intelligence; see *Washington Post*, "Panel requires Annual Disclosure of Intelligence Budget," May 28, 2006; it is not clear whether this would be appropriated for war-related intelligence.

[11]OMB's FY2005 SF-133 reports show that $365 million was obligated in the Afghan Security Forces Fund and $1.285 billion in the Iraq Security Forces Fund; see OMB, FY2005 SG 133 Report on Budget Execution and Budgetary Resources (p. 1734- p. 1738 for Afghanistan and Iraqi Security Forces Funds; http://www.whitehouse.gov/omb/reports/sf133/FY_2005_SF_133s_w_Revis.pdf.

appear to capture offsetting reductions in peacetime costs because training does not take place or equipment repair is delayed when units and their equipment are deployed. DOD generally develops its peacetime budgets each year as if war operations were not going on. In recent years, Congress has reduced supplemental requests to take some of these offsets into account.

Distinguishing War Procurement and Baseline Costs

Congress may face a more difficult problem in distinguishing war and peace-related costs for investment than for operational funding. From FY2003 through FY2006, DOD received some $67 billion for war-related procurement, RDT&E, and military construction. Estimates from the services and elsewhere suggest that the future cost of reset is likely to be substantial.[12] Identifying whether procurement requests are appropriately categorized as war costs may be difficult in some cases because DOD decisions to restructure units or upgrade equipment may reflect peacetime transformation initiatives as much or more than wartime needs.

For example, some observers have questioned whether the cost of equipping and training new Army modular units and restructuring Marine Corps units should be considered war costs. In its requests, DOD contended that these costs should be funded with supplemental rather regular appropriations because the new units created would reduce stress on units and personnel, a major concern for both services. Based on extensive analysis, both RAND and CBO concluded that few of the units created are those that are most in demand, and, hence, that the amount of time at home for troops between rotations would not increase significantly with the restructuring. DFAS reports do not capture the cost of Army modularity. These costs are carried in DOD's regular appropriations in FY2007.[13]

Potential Offsets for War Procurement Funding. Another problem in distinguishing GWOT from regular costs is calculating how reset costs – to repair and replace war-worn equipment – could reduce DOD's regular requirements. To the extent that the services use supplemental funds to fix or replace equipment earlier than anticipated because that equipment has been more heavily used, peacetime requirements could be less in later years. In some cases, supplemental funding for Army and Marine Corps procurement accounts equals or is more than in the baseline budget. Yet DOD's requests for regular or baseline procurement funding have not declined. Presumably, DOD substitutes other less urgent repair or equipment requests for those funded with supplementals.[14]

DOD's wartime appropriations have also included considerable funds to upgrade equipment or improve force protection. The rationale for these requests is often not clear and appropriators have called for more extensive justification like that provided for DOD's regular requests. Defining war-related procurement requirements has proven difficult for the services with frequent changes in the number of uparmored High Mobility Mulitipurpose Wheeled Vehicles (HMMWVs) and body armor needed. It appears that recent supplemental appropriations for uparmoring and body armor may be funding equipment used in peacetime training of troops rather than deploying units.[15] Some might argue that such funds should be in DOD's regular budgets.

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[12]CRS Report RL33110, **Table 2**.

[13]DOD's regular appropriations FY2005 and FY2006 also included some funds for modularity.

[14]See CRS Report RL3110, *The Cost of Iraq, Afghanistan, and Other Global War on Terror Operations Since 9/11*, by Amy Belasco, June 16, 2006, p. 10.

[15] For example, the current Army requirement for body armor covers all active and reserve personnel.

Estimating Future War Costs

Having a reliable record of past war costs is a key element in predicting future war costs. Despite DOD's problems in tracking war costs, DOD has fairly sophisticated tools to predict future costs. For Congress to assess DOD requests and monitor war costs, it would be useful to have access to the planning assumptions that underlie cost estimates, particularly troop levels. As troop levels change, costs can be expected to change, though it may be difficult to predict by how much.

Inconsistent Estimates of Troop Levels. In testimony and in supplemental requests, the Defense Department generally identifies the number of troops in-country in Iraq and Afghanistan at a particular point in time. These estimates have ranged from 140,000 to 160,000 in Iraq and about 18,000 to 20,000 in Afghanistan for a total for both operations of about 158,000 to 180,000. These figures, however, do not include the number of personnel in neighboring countries supporting these missions and whose support is paid for with war appropriations.

CRS found several estimates of troop levels in 2005 for OIF and OEF from various DOD data sources including:

- about 300,000 deployed including 260,000 for OIF and 60,000 for OEF from DOD's Contingency Tracking System, almost double the number in-country;
- about 230,000 deployed including 207,000 for OIF and 20,000 for OEF from a standard DOD report;[16] and
- about 250,000 including 202,000 for OIF and 50,000 for OEF based on DFAS cost data.[17]

If Congress is to review how operational costs change as troop levels change, an accurate count of current and anticipated average troop levels in each fiscal year could be very useful. Such information is routinely provided in DOD's regular appropriation justification material. Some costs will be one-time or will change little as troop levels change and others will change in proportion to troop levels.

Lack of Reporting on War Outlays. Another key element in oversight of war costs and their fiscal impact are the amount of funds actually spent, or outlays. DOD does not track war-related outlays because wartime and peacetime funds are mixed in the same accounts. To gauge the effect on the deficit of war funding, outlay data is essential because the deficit reflects the difference between revenues received by the government and outlays or actual spending by government agencies.

Outlay data also show whether all obligations are ultimately spent. To track war-related outlays, the Defense Department would need to set up separate accounts, which would increase visibility but would also reduce DOD's flexibility to shift peacetime monies to fund war expenses while DOD is

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[16]Department of Defense, *Active Duty Military Personnel by Regional Area and By Country*, December 31, 2005; http://siadapp,dior,whs.mil/personnel/MILITARY/history/hst1205.pdf.

[17]See Table 7 in CRS Report RL3110, *The Cost of Iraq, Afghanistan, and Other Global War on Terror Operations Since 9/11*, by Amy Belasco, June 16, 2006.

awaiting passage of a supplemental. With war funding of about $120 billion annually and making up about one-fifth of all DOD budget authority, some might argue that separate accounts are justified.

Potential Additional Oversight Tools for Congress

To improve oversight of DOD war funding, several types of information could be useful to Congress including:

- an allocation by fiscal year, operation, and DFAS reporting categories of all GWOT budget authority appropriated by Congress since 9/11 with a comparison to obligated and unobligated balances;
- a comparison of key DOD planning assumptions that drive operational costs including troop levels, mix of active and reserve forces, operating tempo indicators, rotation plans, transportation metrics, and average support costs on which DOD based its request and actual experience for the past two fiscal years;
- an estimate of overall and year-by-year procurement and depot maintenance requirements (by appropriation account) distinguishing between reset, modularity, and upgrades, including the rationale for considering these to be war requirements, and decreases in the regular or peacetime budget due to earlier than anticipated funding;
- an estimate, justification, and project by project description of war-related military construction as is routinely provided in the baseline budget; and
- establishment of separate appropriation accounts for each operation so that war appropriations, obligations and outlays can be identified accurately.

This type of increased visibility on war costs could help Congress evaluate and monitor future changes in war costs including which costs are one-time or temporary (e.g. set-u- cost fof bases) and which costs are ongoing or recurring (e.g. replacing truck parts) and how quickly costs change as troop levels change and as contracting methods tighten in the fifth year of operations.

Effect of Supplemental and Bridge Appropriations and Cash-Flowing

Since 9/11, the Administration has submitted its supplemental requests for war funding well after the fiscal year is underway. After the Army almost ran out of funds in FY2004, Congress pressed the Administration to provide "bridge" funds in DOD's regular appropriation bill that would ensure that the military would have sufficient funds until a supplemental was submitted and passed later in the fiscal year. The Defense Department received bridge funds of $25 billion for FY2005 that was available in FY2004 and $50 billion for FY2006.

Pros and Cons of Supplementals. DOD argues that funding war using supplementals submitted halfway through the fiscal year allows the department to estimate costs more accurately because the request is based on more recent information and can better reflect the uncertainties of war operations. The Defense Department has also stated that requesting war funds in its regular

budget would increase the "baseline" budget and make it more difficult to withdraw those funds when the conflict is over.

Critics would argue that providing funds twice a year makes it more difficult to see annual costs. Also, if DOD submitted an annual budget for its war-related costs – identifying costs for each operation in separate accounts to ensure transparency – the expected annual cost of OIF and OEF would be apparent, and each year could be compared to the previous one. If war costs were submitted simultaneously with the regular budget, and with comparable justification material, GWOT expenses could be compared to regular expenses and it might be more apparent whether offsets were being taken for the earlier funding of requirements in reset.

To adjust for any changes 'on the ground,' the Administration could submit budget amendments with rescissions if costs were running lower than anticipated, or with additional requests if costs were running higher than anticipated. Although capturing and projecting war costs is more difficult than regular budgeting because of the uncertainty that is an inevitable result of ongoing military operations, it is not impossible.

Timing of Enactment of Supplementals

Although the Army and Marine Corps have recently had some difficulties managing funding while Congress was considering supplementals, DOD has various ways to finance war operations in the interim. DOD can tap bridge funds – equal to close to half a year's costs in FY2006 – in addition to using regular funds slated to fund the last quarters of the year to finance war costs temporarily. Once a supplemental is passed, these funds are replenished.

If DOD wanted to ensure that war operations could be financed more easily in case the Administration submitted its supplemental late or congressional consideration delayed passage, DOD could request sufficient military personnel and O&M funding in its bridge funds to cover three-quarters of the year, and request less procurement funds. In that way, day-to-day operating costs would be covered. DOD could also choose to transfer funds from procurement to operating expenses, particularly since there is currently about $45 billion in unobligated procurement funds..

In addition to bridge funding, DOD can temporarily shift funds from one service to another to cover war costs by using its transfer authority, recently raised to $5 billion. Thus even though managing war funding may be more difficult if supplementals are passed late in the year, DOD has a variety of tools to cope with this problem. For that reason, DOD was been able to finance or cash-flow war operations for over half of the fiscal year in both FY2005 and FY2006.

Mr. SHAYS. Thank you.

I am going to call on Mr. Kucinich, but I just would like to open with a question that won't be answered yet, but I would like to know where all of you agree and where you disagree in terms of what specific recommendations you would make, not just options, would make for improving our ability to understand what we are spending on each war—Iraq, Afghanistan, the general war on terrorism, and so on. So just as a bit of a heads-up.

Mr. Kucinich, you have the floor. We are going to do 10-minute questioning. With that I would give my colleague 10 minutes.

Mr. KUCINICH. I thank the gentleman.

To Mr. Roth, how many people at the Pentagon keep track of the actual cost of the war?

Mr. ROTH. Congressman Kucinich, I don't have a specific number in terms of number of people. Clearly, the costs of war are covered by various levels and various echelons, beginning in the theater, itself. Every unit that deploys to the theater has with it a financial management team that goes that includes budget folks, accounting folks, and auditors, as well. We have standing audit teams that go to Iraq and Afghanistan to monitor costs. Then up and down the chain of command, as well, the various commands that are in charge of those troops also monitor costs and track costs and provide data on the costs of war, all the way up to and including military departments and the Office of the Secretary of Defense.

Mr. KUCINICH. Do you have dozens or hundreds or how many?

Mr. ROTH. I would say it is at least hundreds.

Mr. KUCINICH. Hundreds; 200; 300; 400?

Mr. ROTH. Sir, it would be a guess to put any——

Mr. KUCINICH. See, this is where the problem begins, Mr. Chairman. This GAO report says "We have significant concerns about the overall reliability of Department of Defense's reported cost data." If this gentleman who worked there for 32 years, testifying on behalf of the people who are filing the figures, he doesn't even happen to know how many people are working on this. Then the GAO reports that they don't know about the reliability of the cost data.

There seems to be some problem here. This gentleman told this subcommittee—you cited chapter and verse of your absolute assurance of all the information you have given this Congress, and when you did that you created a picture of candor of the Department of Defense. I am wondering how that squares with the GAO report that says neither the Department of Defense nor Congress can reliably know how much the war is costing. Can you tell us how much the war is costing? How much is the war in Iraq, how much has it cost and how much will it cost the American people?

Mr. ROTH. The cost of Iraq through April has been $215 billion for the cost of DOD military operations. The cost of the other operations, as I testified in my statement, the cost of the obligations through April were $323 billion. So Iraq was $215 billion and the other operations are $108 billion. These costs were reported to us on a monthly basis. It is something we call the Cost of War Report that is processed through our accounting system and provided up the chain of command, beginning with the many hundreds of people—again, all I said was I couldn't put a specific point total to the

number of people, but there are hundreds of people that input the data all the way from the theater to the buying commands to support commands and the various other echelons of support.

We make every effort to make these reports as accurate as we possibly can. In our view they are, in fact—we diligently work to make them accurate and we work diligently to make them timely. Like any other process, we work to improve these reports. We look at——

Mr. KUCINICH. Are these estimates or actual costs?

Mr. ROTH. These are actual costs.

Mr. KUCINICH. Now, Mr. Walker, you have given this subcommittee a report that raises questions about the reliability of the Department of Defense's reported cost, and you say they include longstanding deficiencies in their financial management and the use of estimate instead of actual cost and the lack of supporting documentation. Now, how does that square with what Mr. Roth just said?

Mr. WALKER. Well, first, Mr. Kucinich, I think it is important to put this in context, and that is financial management is a high-risk area at the Department of Defense, has been for years, and it is likely to remain to be for several more years.

Mr. KUCINICH. Why?

Mr. WALKER. There are several challenges.

Mr. KUCINICH. Why?

Mr. WALKER. Well, several reasons. No. 1, they have thousands of legacy, non-integrated information systems that are capturing financial and other management information system at a very decentralized level involving multiple services and other units, and they have, in many cases, major keypunch errors, inconsistencies. This is a problem that exists well beyond Iraq. This is a fundamental problem with regard to Iraq.

With regard to global war on terrorism, part of it is what is the definition of an incremental cost associated with global war on terrorism, how consistently is that done. It is my understanding that some of the costs that are being reported are estimated costs, not actual costs.

Mr. KUCINICH. What is the difference between what you call an actual cost and what Mr. Roth calls an actual cost?

Mr. WALKER. Well, I will give you one example. Actual costs, trace it back to the payroll. We know exactly who got paid what and we know whether and to what extent it was an incremental cost associated with Iraq. My understanding is they can't do that. That is the difference between estimated and actual.

Mr. SHAYS. Could the gentleman yield just for a definitional term? We will give him time.

Mr. KUCINICH. Of course. Sure.

Mr. SHAYS. When we say incremental cost, we are saying we have added the war to the budget of the Department of Defense. In other words, they are already paid a certain amount. How much is a legitimate incremental difference that is designated or earmarked for Iraq. Is that what you mean by incremental?

Mr. WALKER. Correct. For example, Mr. Chairman, we had to mobilize a number of National Guard and Reserve troops. That is an incremental cost because of this operation. There are hazardous

duty pay and certain types of other pays they get paid because somebody is in Iraq or because they are in Afghanistan that they wouldn't otherwise receive other than those operations, so they are intended to be a cost that we would not have incurred but for the operation.

Mr. KUCINICH. Now, Mr. Walker, you made it a point to say that you created a pretty strong case that there aren't any cost controls. Given the fact that the cost controls are a problem, how much could the war in Iraq end up costing the taxpayers? Do you have any idea at all?

Mr. WALKER. We don't have adequate cost controls, and, in addition to that, we are debt financing all of this, so the real cost is actually more than whatever the short-term cost.

Mr. KUCINICH. Well, let's go into that for a minute. When you say we are debt financing it, you mean we are borrowing money from other places to pay for the war?

Mr. WALKER. Well, no, we are borrowing money in many cases from foreigners to pay for the war.

Mr. KUCINICH. That is what I mean. Now I will repeat the question. Since we are borrowing money from foreign countries to pay for this war, how much money has the United States borrowed from foreign countries to pay for this war?

Mr. WALKER. I wouldn't be able to tell you off the top. I will tell you that over 90 percent of our recent debt offerings have been purchased by foreign players. In fact——

Mr. KUCINICH. Would the GAO be able to provide for this subcommittee——

Mr. WALKER. I will be able to try to provide you what we can, Mr. Kucinich.

Mr. KUCINICH. I think that would be helpful so we know how much money we are borrowing from foreign countries to pay for this war.

Mr. WALKER. Again, that is overall, not necessarily for Iraq. It is with regard to total Government financing, rather than to separate it. It would be impossible to separate it out for Iraq.

Mr. KUCINICH. Right. I understand. However, since you made the case that we don't have reliable figures, that they are not doing very well at controlling costs, that there is longstanding deficiencies in their financial management system, that they are using estimates instead of actual cost, that there is a lack of supporting documentation, Mr. Walker, you have basically made a case for a ballooning cost of the war, and since they are borrowing money from other countries to pay for the war you have made the case that our borrowing from other countries is going to increase commensurately. Is that correct?

Mr. WALKER. There is a difference between our revenues and our expenditures, and to the extent that difference exists and to the extent that we have to go to others to finance it, then we are going to have to pay interest on that. There is no doubt about it. In fact, my understanding is that CBO has done some estimates showing with and without borrowing cost, if you will, not necessarily for this but for——

Mr. KUCINICH. You mentioned, Mr. Walker, that you keep track of costs, payroll for example. Now, what about with respect to con-

tractors? Isn't it true that, with respect to contractors, that you brought a report to this subcommittee that indicated that $9 billion, essentially about $9 billion, could not be properly accounted for?

Mr. WALKER. My understanding, Mr. Kucinich, and I want to double check this for the record, is that $9 billion may have been Iraqi money, not U.S. money. I want to double check that for the record.

Mr. KUCINICH. Is it OK to lose track of Iraqi money?

Mr. WALKER. It is not OK to lose track of any money, but there is a difference as to our audit authority.

Mr. KUCINICH. But it is a question of it is Iraqi money, but who was handling that money? Who was responsible for handling that money, Mr. Walker?

Mr. WALKER. I would like to provide something for the record. My understanding, it was a shared responsibility between the United States and the Iraqis, but——

Mr. KUCINICH. So half of the problem of losing track of $9 billion, at least half, had to do with your responsibilities, Mr. Roth? Who was responsible for that?

Mr. ROTH. I would have to answer for the record, sir. I am not aware of who was responsible for that $9 billion. I do not think it was the Department of Defense.

Mr. KUCINICH. Well, we know it is a provisional government, but we created that provisional government. It was under the direction of the United States at the time. Now, Mr. Walker, you know, you pointed that out in a report earlier.

I just want to say that I respect Mr. Roth's 32 years of service to this country, and I can't ask you to pay for the sins of a number of administrations, but one thing is for sure, though: we don't know what this war is going to cost. The Department of Defense has a notorious lack of accountability when it comes to taxpayers' funds. Now we are borrowing money. This is insane. We are borrowing money for foreign countries to pay for a war that we shouldn't have gotten into in the first place. I mean, unbelievable.

Mr. SHAYS. Mr. Burton, would you like time? You have the time?

Mr. BURTON. Mr. Walker, are there any other agencies of the Government that have trouble with their accounting systems?

Mr. WALKER. There are other agencies that have financial management problems, but none on the scale of the Department of Defense. It is not close.

Mr. BURTON. I understand, but we are in a war and wars cost a lot of money. But can you tell me how many agencies are having accounting problems?

Mr. WALKER. I will double check this for the record, but as I recall, Mr. Burton, from a financial audit standpoint, about 21 of 24 Federal agencies can successfully withstand an audit and get an opinion on their financial statements, overwhelming majority a clean opinion. The Defense Department, not just because of Iraq, because of other operations, is unauditable, and they, themselves, file an annual certification that says that they are unauditable. It has been that way for many years. That is not new, Mr. Burton. It has been that way since 1947 when it was created. And they are making some progress.

Mr. BURTON. Since 1947?

Mr. WALKER. Since 1947.

Mr. BURTON. When Truman was President?

Mr. WALKER. That is correct.

Mr. BURTON. Yes. Well, I imagine wars are kind of hard to keep track of as far as the expenditures are concerned, and I am sure that this is a continual problem, and I know that you will be making recommendations to the Defense Department to help them straighten this out. We obviously would like to have more accountability if it is possible.

The one thing that I know is I know that we don't know the total cost of the war and we probably won't for some time, but I do know what the cost will be if we lose the war. If we lose the war I know it will cost a lot more. It will cost people freedoms, it will cost people human rights, it will cause them all kinds of problems.

Winning the war against terror is something that we all have to face and we all have to realize it has to be won. I understand that there are accounting problems and I would like to see those accounting problems solved and I hope that the Defense Department will try to do a better job, but the one thing that I feel is extremely important is that every American knows what the stakes are.

We were attacked on September 11th; 3,000 people were killed. It was worse than what happened in Pearl Harbor back in the 1940's. We started a world war because of that, and that war, World War II, cost 50 million lives; 50 million people died in World War II. We started that war against Japan and Germany because they attacked us at Pearl Harbor, and more people died in the World Trade Center than died in Pearl Harbor.

I think the people of the United States need to realize that we can't afford to lose a worldwide war against terror. The terrorists have attacked in Spain, they have attacked in London, they have attacked in France, they have attacked in Latin America, they have attacked all over the place, and they are not going away. They are like cockroaches.

And it is a very insidious war. It is a war unlike anything we have ever seen. We had frontal attacks in World War II. We had frontal attacks in Vietnam. We had frontal attacks in Korea and in World War I. We had trench warfare. This is a very insidious thing. You have people walking around with bombs on their bodies and they come into a crowded shopping center or into a school bus and they blow it up and kill a bunch of people or they fly an airplane into a building, and they will do anything they can to destroy the things we believe in and our way of life.

While I am just haranguing on about the need to win the war, I don't want to be distracting from the purpose of this hearing. Obviously I would say to Mr. Roth and the Defense Department work harder. Make sure that you account for every dollar that you possibly can. I think everybody in this country, every taxpayer wants to know that the money is being well spent.

And I think that the Secretary of Defense wants to know where the money is spent and make sure that it is well spent. And I know that everybody is trying to do that job over there. If we haven't done as good a job as we should have since 1947, then we just have to try harder.

But the one thing that I would like to end my statement by saying is we cannot afford to lose the war against the terrorists, no matter what it costs, no matter what it costs.

I yield back my time.

Mr. SHAYS. Would the gentleman yield?

Mr. BURTON. I would be happy to yield.

Mr. SHAYS. He has about 5 minutes and 40 seconds.

I thank the gentleman for his statement and I happen to agree with it very strongly, but I still would like out of this hearing to do a better job of getting a handle on our expenditures. So what I would like to do is we have had different numbers, and they range from a higher level by CRS to a slightly lower level, $9 billion.

What would account, as you understand it, for the difference between GAO's estimates, say, and CRS's? The CBO estimate is $432 billion, GAO is $430 billion, and CRS's is $438 billion. Do we know what would account for that difference?

Mr. ROTH. Let me at least start, Mr. Chairman. First of all, let me make a comment here, because there have been a number of comments made here about the reliability and the accuracy of Defense data. We do, in fact, provide accurate data.

Having said that, we understand the need to improve the data that we have provided. We have in place a financial management improvement audit readiness plan that will address many of these issues that the GAO has identified in terms of audit readiness, improved accuracy and timeliness of data, and improved business practices. So I need to state for the record, sir, that the impression that DOD across the board does not, in fact, provide accurate data we would not subscribe to. That is not, in fact, the case.

Mr. SHAYS. The fact is, though—and this is the regretful fact—DOD has not had auditable accounts since basically the end of World War II, and it is a fact under every administration. Frankly, I thought that would be one of the things that Mr. Rumsfeld would have spent time on, but obviously it has gone in a different direction.

My testimony from the GAO is that you are making improvements. When you will get to auditable accounts and pass an audit will be, I don't know, I hope in my lifetime. It is why I used to vote against the Defense budget. I didn't want to vote for a Defense budget that wasn't auditable. I started voting for them when our men and women were on the firing line in Iraq.

That is my challenge there.

Mr. ROTH. Yes. We understand that.

Mr. SHAYS. But what I want to then say is, given that your accounts are not auditable, you can't account for the expenditures in DOD if you make certain assumptions? What? What enables? Why can we have confidence that the DOD numbers will be accurate as it relates to the war?

Mr. ROTH. We have confidence in the numbers because we have a substantial amount of oversight and a systemic way of looking at the numbers, reviewing the numbers, and doing, for example, a variance analysis on the numbers on a monthly basis. We do, in fact, oversee the numbers. We have confidence that the numbers are, in fact, correct. There are circumstances where we find that

people in the field, for example, made some mistakes in terms of transactions. Where we find that, we dutifully go out and correct those kinds of——

Mr. SHAYS. But, having said we have confidence in the numbers, we all—and maybe CRS and GAO would speak to this—we have to make assumptions about the incremental costs. What concerns me is we have a budget for DOD. It has men and women and equipment. But we then send men and women and equipment over to Iraq.

In one sense, the full cost of that general would have been paid whether he was in Iraq or somewhere else. That is what I think the answer to my question would have been. We have to make certain assumptions as to how much we attribute to the war and how much would have just been an ongoing expense.

Then you have the Comptroller General who has made the point there is a tale to this. There is a tale of health cost ad infinitum. There is a cost of equipment that has been, frankly, either destroyed or just worn out. And so we understand you won't get it perfect. Is there a process that you have, a scientific process that enables you to distinguish incremental costs?

Mr. ROTH. There is, Mr. Chairman. The definition of incremental cost, as Mr. Walker alluded to, as well, is very well defined. We have it outlined in our financial management regulations. The example you provide is actually a very good one.

When a military member goes to the theater on an assignment to take part in the contingency operation, the base pay of that military member is not, in fact, an incremental cost. You are absolutely correct, Mr. Chairman. That military member would be paid whether that military member were sitting in Fort Campbell here at home or whether that military member were sitting somewhere in Iraq. However, there are special pays that get activated when that member goes into the theater, things like imminent danger pay, hazardous duty pay, assignment pay.

Mr. SHAYS. Let me get into this, because the time is running out.

Mr. ROTH. OK. Those pays are incremental costs of the operation.

Mr. SHAYS. I didn't mean to leave out CBO, and so please feel free to jump in. Maybe you could just comment. Mr. Walker, you were nodding your head. If you would just comment, and then we will go to Mr. Waxman. Yes, Dr. Marron.

Dr. MARRON. Representing the middle number of your range, I will start out. Appropriations are, at some level, the easiest thing to track because you can track them at the moment that the laws pass Congress. They don't involve actions taken later on, primarily.

I believe the primary difference that occurs between the three numbers are some judgments about certain appropriations that happen not through that process but by transferring moneys from the regular budget. Essentially, CRS, CBO, and GAO have made different judgments about how much money on net was transferred from other accounts into activities associated with the war on terrorism.

Mr. SHAYS. Mr. Walker, do you want to just make a comment or should I go to——

Mr. WALKER. I think that is true. Some of our numbers are based on overseas costs, only. As has also been mentioned, you know, we don't have numbers with regard to some of the classified operations. And as has also been mentioned by someone else, there is supplemental funding that has occurred that is not for the global war on terrorism but is for Army modularity, which obviously wouldn't be in here and hopefully wouldn't be in anybody's cost.

Mr. SHAYS. Do you want to just make a comment?

Ms. BELASCO. If I have this correct, CRS and CBO are fairly close in terms of the moneys for Defense. For example, CBO is about $393 billion and CRS is $397 billion. As you said, those are basically how much moneys were transferred.

I don't actually know where DOD's number of $382 billion, if I am correct—is that what you said——

Mr. ROTH. Yes.

Ms. BELASCO [continuing]. Where that total comes from and why it is about $15 billion less than the CRS number. And GAO's number, if I have it correct, is $386 billion for Defense. Again, I don't know why that number is less.

Mr. SHAYS. Thank you.

Mr. Waxman.

Mr. WAXMAN. Mr. Chairman, before I ask any questions I want to comment on the statements made by our colleague, Mr. Burton from Indiana. We didn't start World War II. World War II was imposed upon us when the Japanese attacked Pearl Harbor, they invaded the United States, and when Nazi Germany declared war against the United States. It was not a war of choice; it was a war we were forced into.

We were attacked on September 11, 2001. No one can argue that Saddam Hussein led that attack on us. That attack was from Osama Bin Laden and Al Qaeda. There was almost unanimous vote of the Congress and support of the American people to go to Afghanistan to root out Osama Bin Laden and the Al Qaeda and to overturn the Taliban that gave them a place from which to operate.

The war in Iraq is a war of choice. It is the only war of choice that this country has ever taken, and it was a war based on many false premises. I know our chairman thinks this is a noble war. I don't think it ought to be confused with a war against terrorists who would strike us. I think it was a war against the Iraqi people based on the assumption that Saddam Hussein had weapons of mass destruction which he did not have, based on the assumption he was an imminent threat to us, which he was not, and based on a desire by people in this administration to redo the whole Middle East by the idea that we were going to invade Iraq and transform them into a different reality.

Well, it has come home to us that the easy war we thought we were going to engage in was not so easy after all.

If we look at what we were told not by the space Defense auditors, not by OMB, and not by the Budget Office about what this war would cost us, because this hearing is about estimating costs for the Iraq war, Mr. Van Hollen already referred to this in his opening statement but let me just repeat it: Paul Wolfowitz, not an auditor but a Deputy Defense Secretary, said that the cost of the

Iraq war, "We are dealing with a country that can really finance its own reconstruction and relatively soon."

And Andrew Natsios, the Director of USAID, said on Nightline that the most the United States would spend on reconstruction was $1.7 billion. The head of the Office of Management and Budget, working for President Bush, Director Mitch Daniels at the time the war started, said total cost would be between $50 billion and $60 billion. And White House economic advisor Lawrence Lindsay, giving perhaps the highest estimate, said the that cost would be between $100 billion and $200 billion.

But now we know, as Mr. Walker testified last week, that we have already spent more than $300 billion in Iraq, and the Bush administration is now seeking over $100 billion more for next year. Well, these administration estimates were off not by just a little but substantially by orders of magnitude.

I want to put this in some perspective. People think that Congress adopts a budget, and in adopting the budget we set out our priorities for spending. If we are in a war we have to set that out. We have to set out our priorities for revenue raising in order to spend, and we try, the people think, to balance that budget so that the amount of money we spend is equal to the amount of money that we take in, except under some rare circumstances where we have to go out and borrow that money.

Well, I don't think people running this Government care how much this war may cost because they assume we can just borrow it. They are not going out and raising money to pay for it. In fact, this administration, at a time when we are borrowing money to fund this war, is giving tax breaks to billionaires. It has never been the situation where this country has ever been at a war when we have said to people we are going to give you tax breaks.

But we are not giving people tax breaks alone, we are giving those at the very top tax breaks. We are saying to them you don't have to make a sacrifice to help fund this war. We are going to send our volunteer Army, men and women, they are the ones who will make the sacrifice. And when you come back to the United States your children and grandchildren will be paying for this war in higher taxes and a lower quality of life, because it doesn't matter, we are borrowing it.

I think it was Vice President Cheney that was credited with saying deficits don't make any difference. We can go out and borrow the money. They don't make any difference. What he was talking about, I believe, is that they didn't make any difference politically because people didn't mind at the moment that the costs were going to be passed on to future generations.

Democrats have always believed that you pay as you go along. You decide on these priorities. You actually make a budget. You try to stay with it. There are costs that you can't anticipate, but there are costs you can anticipate and there are costs you try to control.

But the Republicans running the Government in Washington today want to say that this noble cause can be paid for by future generations and by the sacrifices of young men and women who are the ones on the front line.

Now, these cost estimates that we have had been way off. Mr. Roth, my question for you as the Defense Department witness, and

an auditor, as well: how much does the administration currently estimate that the war in Iraq will ultimately cost the American people, if you can give us such a figure?

Mr. ROTH. Congressman Waxman, we in the Defense Department have not attempted to project a cost beyond the current fiscal year. Given the unpredictability on certainty of the costs, I don't have any basis to develop any detailed analysis beyond this year. So what we normally do is provide the detailed justification material to support the supplemental request when it comes to Congress. Beyond that period of time, that is, in fact, why we have argued supplemental appropriations are, in fact, an appropriate way to finance that. We don't have a sound basis to come up with an estimate beyond the current fiscal year.

Mr. WAXMAN. Well, when the war started the administration's response is that we are taken by surprise, they never anticipated any insurgency, they thought they could reconstruct Iraq with no worries about security. That argument, of course, is ridiculous, and they should have known it because General Shinseki warned the administration that they would need several hundred thousand troops, and he was ridiculed for his candor.

And the former President Bush, President Bush's father, after the first Gulf war explained his decision not to invade Baghdad by warning that a U.S. occupation would result "incalculable human and political cost, that there would be no viable exit strategy, and the United States could still be an occupying power in a bitterly hostile land." Well, how could we have been taken by surprise? People were telling this administration, they were telling the American people what to expect, and yet President George W. Bush, Secretary Rumsfeld, even Secretary of State Colin Powell all bought into the idea that it was all going to work out well and we could do this on the cheap.

How could the Defense Department, in trying to make estimates of cost, fail to anticipate the cost of battling the insurgency, Mr. Roth? Do you have any idea how they came to that conclusion that they couldn't, they didn't have to figure out cost for battling an insurgency when the war started?

Mr. ROTH. Again, Congressman Waxman, in terms of when we build the budgets, there is no basis to say in terms of battling the insurgency as separate and distinct cost element along those lines, so, sir, I don't have any insightful comment to make on that.

Mr. WAXMAN. Well, even when we look at the experience of the past 3 years and we look at the amount of money that has been wasted, the Bush administration still pays the money. For example, in Haliburton's $2.4 billion oil contract in Iraq the Pentagon's own auditors identified over $263 million in excessive and unsubstantiated costs. Those were the auditors working for the Pentagon, and the administration ignored their own auditors and paid Haliburton 97 percent of these charges, and then paid Haliburton award fees and bonuses on top of that.

I just feel, Mr. Chairman and my colleagues, this has to stop. We owe it to the American people who are paying for this war and to the troops who are giving their lives for it that we have to stop the waste, fraud, and abuse, and we have to fight against the terrorists that threaten us in a smart and informed way, not one where we

are seen to be wrong at every turn, so much so that we can't even figure on what the costs are going to be from 1 year to the next.

I yield back the balance of my time.

Mr. SHAYS. I thank the gentleman.

I would recognize Mr. Platts and ask if he would just yield me a speck of his time and I can return in favor.

Mr. PLATTS. Certainly, Mr. Chairman. I yield to the chairman.

Mr. SHAYS. Thank you.

Mr. Roth, I find your answer really very surprising, and I just want to say that your statement needs to be very accurate for the fact you are speaking before Congress and you are under oath. I don't think you meant to imply that there have been no estimates of what this war will cost in the future, because that is your answer.

Mr. ROTH. Sir, I have not participated in any effort to forecast the cost into the future.

Mr. SHAYS. Are you aware——

Mr. ROTH. What we do is we prepare——

Mr. SHAYS. I understand what you said.

Mr. ROTH. We prepare the cost estimates in support of our budget.

Mr. SHAYS. There is no one in DOD that is trying to estimate what the cost will be if we have this number of troops or if we have this number of troops? There is no estimate of those potential costs?

Mr. ROTH. I am not aware of any estimates in terms of trying to forecast future force levels because due to the unpredictability of the nature of the war and these kinds of things. I am not aware of any effort.

Mr. SHAYS. I think Congress has asked DOD to do that. Am I wrong, Dr. Marron or Ms. Belasco? Haven't we asked them to give us a projection of future costs?

Ms. BELASCO. There was a statutory requirement for that and DOD sent in a letter—I think it was actually an OMB letter—saying that they couldn't give any estimates for, I think, fiscal year 2006 to fiscal year 2012 because of the uncertainty. They were supposed to ask for—the requirement was that they had to submit an estimate unless the President submitted a waiver saying that for national security reasons they couldn't do it. They never submitted the waiver; they just sent a letter in saying they couldn't do it.

Mr. SHAYS. Mr. Walker, could you enlighten us on this?

Mr. WALKER. We have recommended that they attempt to do that, but my understanding is they have not endeavored to do it to date.

Mr. SHAYS. Well, I have used a minute of my colleague's time, slightly more than that, but I find that beyond comprehensive, frankly. As President of the United States and as a Congress, we would want you to be able to tell us what will be based on this number of troops, based on this scenario, based on this scenario, and I can't believe that we would not have asked you to do it and I can't believe that we would not expect you to do to it.

I thank the gentleman for yielding.

Mr. PLATTS. Thank you, Mr. Chairman. I appreciate your hosting this hearing. I think it is very important.

I want to try to focus on I think what we are really after, which is the accuracy of what we know and the financial management of DOD and Department of State and all agencies involved in the global war on terror, because, while I think it is safe to say that we can't predict with any great certainty what next year or the following year will be on the war front from a strategic military standpoint, but what we can predict with more certainty is our ability to compile and accurately report the dollars appropriated and ultimately expended, and even there though we are going to have uncertainty.

I guess the way I would say it is we can with certainty say we are going to be not very exact because of DOD problems and financial management. That is what I want to get into here, which I think is what we are really after.

General Walker has been with us in our Subcommittee on Financial Management a number of times, and DOD's efforts of reform that have been going on for several years, and that is really where I want to maybe take the discussion a little bit.

I will start with Mr. Roth. One, I appreciate all of your testimonies and your service and your different capacities and Mr. Roth at DOD. OMB about a year ago put out their A–123 regulations regarding internal controls to all departments and agencies, a deadline of June 30th of this year to bring forth your plans, to have them done, and to report on those plans as part of the financial audit information in November.

I was wondering if you can give us an update on where DOD stands in complying with the A–123 regulations on internal controls, because, as the subcommittee chair for Financial Management, it seems like I keep coming back to if we want, as we talk about in the title here, accurate and reliable cost estimates, we start at the bedrock, which is internal controls, because if you don't have those in place you may have numbers, but whether they are accurate or not you never know. So where does DOD stand with A–123 compliance?

Mr. ROTH. I will have to provide for the record specifically where we are with A–123 compliance, per se. But, having said that, let me say we have in place a financial improvement and audit readiness plan that we put into place in December 2005. This plan does, in fact, address improving internal controls, dealing with material weaknesses, and ensuring our fiscal stewardship, and so it lays out in a very systemic, a very integrated way a plan to address these kinds of deficiencies and to achieve on an event and performance basis in improving our overall financial management stewardship.

And so already to date there are a number of success stories in areas like military pay, in areas in terms of reducing our material weaknesses. For example, during 2005 our material weaknesses were decreased from approximately 47 to 34. Of those material weaknesses, the financial weaknesses were reduced from 17 to 13. So we do, in fact, have a very systemic plan. We track it on a monthly basis. We do periodic reviews. And we have in place a very comprehensive plan to deal with all the kinds of weaknesses that others have identified and all the kinds of improvements that are necessary to bring us into an auditable condition.

As far as where we stand on the 123, per se, I will have to provide that for the record.

Mr. PLATTS. If you could provide that to the subcommittee for the record, I think the fact that DOD is not even able to be audited, let alone get even a qualified opinion, goes to the whole issue here of these accurate and reliable cost estimates.

Mr. PLATTS. That plan is in place, Mr. Walker. I am not sure, has GAO reviewed and commented on the plan that was referenced and how they are moving forward with it? Are you aware?

Mr. WALKER. We have seen several. I don't know that we have seen the latest. I will followup with my staff and provide something for the record on that, Mr. Platts.

Mr. PLATTS. And, Mr. Roth, how about your IG? I know that the DOD IG has been very involved in these issues. Are they involved in reviewing that plan and the headway you are making and commenting on the progress?

Mr. ROTH. Well, it is a plan that has been vetted throughout the Department of Defense, and all the stakeholders, if you will, and all the interested parties have looked and have taken part in preparing that plan. It, for example, was a key. The development of that plan and the fact that we have that plan or are making progress along the lines of the kinds of efforts and initiatives that are outlined in the plan did, in fact, lead, for example, the Office of Management and Budget, as I alluded to in my statement, to change our progress rating under the Presidential management agenda in financial management from yellow to green. It was in large part because of the existence of this plan and the fact that the Department is, in fact, carrying out the plan and is, in fact, achieving many of the goals that are outlined in that plan.

Mr. PLATTS. One of the challenges at DOD has been every different component having its own financial management system and there was an effort to tally those, and the last count I saw we were at 3,000 and counting, in different systems, and so the ability to bring all the information together was very difficult. Where do we stand in that effort of trying to unify the various agencies, components within DOD to have a unified reporting system that is able to better communicate across the lines?

Mr. ROTH. Along those lines, sir, we are implementing a standard financial language throughout the Department. This is going to be a new accounting structure that will enable the Department to manage our costs, value assets, for example, forecast future needs, develop better historic trends, and the like, and so we are in the process of trying to address those kinds of issues to try to put the overall financial information system, the overall accounting system on a more common denominator, more common language kind of a basis.

Mr. PLATTS. Is there a timeframe for when we can expect that to be in place, that common language?

Mr. ROTH. I will have to get back to you. I will have to provide that for the record. I don't have that date right here.

Mr. PLATTS. I would appreciate that.

I appreciate the effort that is being made at DOD and, in fact, Secretary Rumsfeld, September 10, 2001, gave a very important speech at DOD about business systems modernization. The events

of September 11th happened the next day and kind of overtook the importance of that message. That being said, he has reasserted that message, you know, numerous times in trying to bring the DOD into a financially accountable department, but it seems that each time we have had hearings that it is always something in the works. We are not seeing an actual outcome achieved, as opposed to something in the works.

Mr. Walker, your assessment of where we are with this systems improvement of getting that ability to communicate within the Department in a more uniform fashion?

Mr. WALKER. The latest plan that I have seen is clearly superior to the last plan. It is a lot more realistic in its approach. It doesn't set, at least the financial management portion of it doesn't set arbitrary timeframes for an end gain to get a clean opinion. It is focused on specific line items and specific entities, so I think that is a clear plus. But, you know, candidly, it is going to take them years to get to where they need to be.

Last thing, Mr. Platts, I think is important, if you wouldn't mind, is why do you care about cost? I mean, ultimately you are going to have to do what you have to do, but there are several reasons why I think the chairman has asked for this. I mean, one, you need to exercise your oversight responsibilities, which you are trying to do with regard to the funding and the accountability for the funding.

Second, you have to have a decent cost accounting system in order to review the justification for resource requests, whether they are part of the baseline or the supplemental or anything else. Third, ultimately you want to try to get a sense for what this is going to cost us longer term. You have to have timely, accurate, useful information in order to accomplish those objectives. That is why it is important.

Mr. PLATTS. Final question before I run out of time. Mr. Roth, an issue that we looked at and GAO again has been a proponent of is a chief management officer in the Department to allow us to have more continuity within DOD to get to this end goal that we are all after. Has the Department looked further at that proposal from GAO? And, if so, where does it stand?

Mr. ROTH. The Department is on record as saying that a chief financial management officer is not something that we will endorse. That said, I mean, we feel, we have in place strong management controls led, you know, from the most senior echelons of the Department to deal with the business transformation, business modernization kinds of efforts, to try to improve our business systems and our financial management systems and the like, and so we think we do, in fact, have adequate systems in place. We do, in fact, think we have an adequate architecture in place to deal with those kinds of issues.

Mr. PLATTS. Mr. Walker, I am glad to let you respond as long as the chairman will let you.

Mr. WALKER. If it is OK, Mr. Chairman, it is very important.

No. 1, our recommendation was not with regard to chief financial officer. They have a chief financial officer. It was a chief management official to be responsible for the overall—taking a more stra-

tegic, integrated, and consistent approach to the business transformation process.

For the record, I might note that the Defense Business Board, which advises Secretary Rumsfeld and Deputy Secretary England, recommended for the establishment of a chief management officer at the principal undersecretary level two level recently, and this week I will be speaking with representatives of another entity that has been charged by the DOD to conduct a separate study on this issue, as per congressional direction. I also know that one of the world's largest consulting firms is going to, within the next few weeks, come out recommending this, as well. So I think the jury is still out.

Mr. PLATTS. Thank you, Mr. Walker, and thank you, Mr. Chairman. Sorry for going over.

Mr. SHAYS. That is all right. We are going to give the gentleman from Maryland an additional minute and a half, so he will have 11½ minutes.

Mr. VAN HOLLEN. Thank you, Mr. Chairman. Again, thank you for holding this hearing. Thank you all for your testimony here today. Mr. Roth, I think you are bearing the brunt of the questions for the simple reason that most of the moneys are spent in the Defense Department, and, as you say in your testimony, your principal role is to build the budget, whether it is a base budget for DOD or a supplemental request.

If I could just underscore this issue which has come up in numerous hearings, and Mr. Walker has underlined that on behalf of the Government Accountability Office, with respect to DOD's record, whether you are at war or not war, and financial management, my understanding is since 1990, when GAO first instituted its risk/high risk watch, agencies that would be on a watch list for poor financial management, Defense Department has been on there.

It is not enough for people to say we have a lot of costs because we are at war at this particular time. The fact of the matter is that has been the record there for many, many years, whether we are in conflicts or not in conflicts, and this Congress bears a fair amount of responsibility for making sure we have the adequate oversight. I know the chairman of this subcommittee has said it is one of the issues he wants to address going forward.

Second, just to pick up on another point you made, Mr. Walker, which is that one thing we want to get a hold of, obviously, is the accuracy of expenditures already made. We should be able to do that if we have good accounting records. But the purpose of this hearing is not just to count dollars spent. The purpose of this hearing in the memo sent out by the chairman is one sentence: the purpose of hearing is to examine the accuracy and reliability of cost projections for the global war on terror. I already talked about the fact that I think we should desegregate that umbrella, Afghanistan, Iraq. I know we are going to get the numbers, but we are talking about accuracy of cost projections.

Now, we had some very good testimony from our representative from CRS, Ms. Belasco, who outlined a number of pieces of information that would be very useful for the Congress to have so we can try and have our independent arm reach some conclusions about these costs.

Now, Ms. Belasco, you in your testimony talk about at least four major items of information that would be useful to get from the Defense Department. I guess my first question to you, have you requested the Defense Department provide you with this information?

Ms. BELASCO. Well, periodically over the years I have asked, for example, for troop levels, but in general it is very hard to get information out of the Department of Defense, so I in many cases just resorted to sort of backing into estimates of my own or using published sources. I mean, I have gotten some information, some data base runs on troop levels, but when there are inconsistencies I can't resolve the inconsistencies. And as I think Dr. Marron said from CBO, part of the problem is in DOD's justification material for its supplementals there are basically no details about what drives the cost.

Mr. VAN HOLLEN. Let me stop you there, Mr. Roth, and just ask you: is DOD reluctant to provide the Congress with this information? Let me ask you some specifics. One of the categories, for example, that Ms. Belasco mentioned in her testimony, providing Congress we key planning assumptions that drive cost, including troop levels. Let me ask you, when you put together your budget projections for the past supplemental and other request, you make some estimate of troop levels, do you not?

Mr. ROTH. Yes, we do.

Mr. VAN HOLLEN. Are you opposed to providing Congress with that information?

Mr. ROTH. No, and we have in the past. We have discussed it with our oversight committees on many occasions.

Mr. VAN HOLLEN. All right. You provide that in advance for the purposes of budget projections, or just the current troop levels?

Mr. ROTH. Just the current troop levels.

Mr. VAN HOLLEN. We are talking about budgeting now. I mean, the whole purpose of this hearing is to try and get a handle on what future costs are going to be, so my question to, and this is—you know, I understand, thanks for telling us how many troops the United States has on the ground in Iraq, but when it comes to budgeting, which is what this hearing is all about, we need to get the best estimates. I guess my question to you is: are you opposed to providing Congress with your estimates of troop levels going forward?

Mr. ROTH. Certainly not, Congressman. Let me amend—misconstrue what I meant by current. We provide the basis for the cost estimates. When we send a budget up, whether it is a supplemental, baseline budget, or any other kind of a budget, we will, in fact, engage in a dialog, as we always do, with the oversight committees in what drives those cost estimates, and so we do, in fact, provide the data that is requested of is in terms of what was the basis of the cost estimate and anything else that drives the cost estimate that we have provided.

Mr. VAN HOLLEN. Do you have an opportunity to hear the testimony of Ms. Belasco with respect to the specific items that would be helpful?

Mr. ROTH. Yes.

Mr. VAN HOLLEN. Are you opposed going forward then with making sure that CRS has that information in a timely manner?

Mr. ROTH. Certainly, we are not opposed to providing the information for people to understand where our cost estimates come from.

Mr. VAN HOLLEN. OK. And when you put together, for example, the current supplemental, you made certain assumptions about troop levels going forward, did you not?

Mr. ROTH. We made certain assumptions concerning the cost within that supplemental, yes.

Mr. VAN HOLLEN. OK. Well, I mean, did you have any assumptions regarding the number of troops on the ground which would be a variable, cost variable, right?

Mr. ROTH. Yes, it would.

Mr. VAN HOLLEN. OK. Let me just go back, because I think that part of this is trying to get a sense of cost going forward, and there is also an accountability piece to this. I do want to get some sense of the assumptions that were made at the very beginning going forward. Are you aware of the fact that Mitch Daniels, the former head of OMB, estimated the cost of the war at the outset to be between $50 billion and $60 billion?

Mr. ROTH. I am not conversant with that estimate.

Mr. VAN HOLLEN. OK. Are you aware of any Pentagon estimates—and there was a Wall Street Journal article from back in September 2002. There were numerous articles leading up to the war where people were trying to get a handle on the cost. It was said in those articles that $50 billion was the number coming out of the Pentagon. Can you confirm that was a working number in the Pentagon?

Mr. ROTH. No, I cannot.

Mr. VAN HOLLEN. So you are in charge of putting together the budgets at the Pentagon; is that right?

Mr. ROTH. Yes.

Mr. VAN HOLLEN. OK. But you have no idea where that number came from; is that correct?

Mr. ROTH. No, sir. No, I do not.

Mr. VAN HOLLEN. All right. But in your capacity as the person who puts together budgets, you did have to make some assumptions about the cost of the war, did you not?

Mr. ROTH. Yes, we did.

Mr. VAN HOLLEN. OK.

Mr. ROTH. Let me explain, if I could just take 1 minute real quick to explain.

Mr. VAN HOLLEN. OK.

Mr. ROTH. When we build the budget estimate for the contingency operations, we work very closely with combatant commanders, with the joint staff, with the war fighters, with the services who actually incur cost to develop these cost estimates, and those include assumptions concerning logistics support, obviously troops on the ground, that is a major driver of it, rotations, troops going in, troops coming out, these kinds of things.

And so these are long, iterative processes. We get a lot of criticism sometimes within the building how long and painful the process is, but we work very carefully with all the stakeholders, all

those who have some interest and would incur some of those costs and try to get the subject matter experts, whether they be personnel people, logisticians, medical people, whoever, all the kinds of costs that go into this.

And so the cost estimate you ultimately see in a supplemental budget request reflects the result of this iterative process in terms of developing a cost estimate for a given time period to say over the next 12 months this is what we forecast to be the cost of supporting the contingency operation for the year.

Mr. VAN HOLLEN. All right. Well, let me ask you, were you a part of the budgeting process at the time we went into Iraq?

Mr. ROTH. Yes, I was.

Mr. VAN HOLLEN. OK. What was your cost estimate at that time for that year? In other words, the year ahead. In other words, when you said we are going in, here are the assumptions we are making, because, as you have said, you have obviously got to make certain assumptions. I think everyone understands that there is no absolute certainty here, but people putting together budgets usually put together sort of a range in terms of their projections. So my question to you is: when we went to war in Iraq what was the cost range that you at the Pentagon put together for purposes of budget?

Mr. ROTH. The first budget I recall—and if it is different I will correct you for the record—the first budget I recall that we explicitly asked for money for Iraq, the total supplemental in that fiscal year was fiscal year 2003, and the total supplemental request for that year was $62.5 billion.

Mr. VAN HOLLEN. But I think I am asking you a little different question, and maybe nobody did it. I understand what your supplemental request was. My question is different. My question is: was there any estimate ever put together as to what the cost of going to war in Iraq would be? And if so, I am trying to find out what assumptions were made.

And if you are going to tell me there was no estimate, I mean, we know Lawrence Lindsay had an estimate. His was $100 billion to $200 billion. We know that people in the administration like the Deputy Secretary said that is off the mark, that is too high. We know Mitch Daniels said that is "very, very high." So obviously Mitch Daniels had an idea of what the war would cost. Obviously, Lawrence Lindsay had an idea of what the war would cost.

What is confusing is how the President's chief economic officer, chief economic advisor, and the head of OMB could have ranges of what the war would cost, but the people who were going to bear the primary cost in terms of budget, the Defense Department, didn't have a similar figure. If you did have a figure, I am interested in knowing what it was.

Mr. ROTH. My office did not make any attempt to do a multi-year estimate of what the cost of the war might be. Again, we focused on providing the supporting material for the given supplemental at the time.

Mr. VAN HOLLEN. Did you make any assumptions about——

Mr. SHAYS. Would the gentleman just yield a second?

Mr. VAN HOLLEN. Yes.

Mr. SHAYS. It is just because it is the term, and I want to make sure we are on record. When you say "your office," did any other office——

Mr. ROTH. I am not aware of any. My point is I am not aware of any, sir.

Mr. VAN HOLLEN. Just for clarification, so you are not aware of any estimates put together in the Department of Defense with respect to the cost of the war in Iraq; is that right?

Mr. ROTH. For a "total cost of the war?"

Mr. VAN HOLLEN. At the outset.

Mr. ROTH. No, sir.

Mr. VAN HOLLEN. So, again, that $50 billion, you have no idea where that came from?

Mr. ROTH. No, sir, I do not.

Mr. VAN HOLLEN. When you did your budgeting, you are saying you just assumed, what, that the war would go on indefinitely, or that it would just go on for the period of the supplemental? I mean, here's the issue. I think the chairman has been very diplomatic here, because what we are saying, as I understand it, is the best way to get a sense of the cost going forward is to do some analysis, No. 1, of what the cost actually has been to date, but also to get some sense about how good and reliable our cost estimates have been to date and our projections so we can make any corrections in how we are projecting cost going forward. And what we are hearing really is that when it comes to sort of the long-term costs, or when it came to trying to put together a number at the outset about what the total cost would be, there wasn't anything done. Is that right?

Mr. ROTH. Again, not that I am familiar with. No, sir. I mean, again, what we did is cost out the plan for a certain period of time as it was outlined to us by the commands and by the war fighting staff, and that is what we did.

Mr. VAN HOLLEN. Mr. Chairman, so they just said here are our troop levels, here's how long we want you to budget these troop levels for, here's the expenditure equipment, here's the munitions we are going to use, you guys just tell us what the cost is?

Mr. ROTH. Again, for a set period of time, yes, sir.

Mr. VAN HOLLEN. For a set period of time, and that was the period of time in your testimony just for the supplemental?

Mr. ROTH. Yes, sir.

Mr. VAN HOLLEN. OK. Well, Mr. Chairman, I know——

Mr. SHAYS. We are going to do a second round. There are not many of us, so we will come back.

Mr. VAN HOLLEN. I appreciate that. Thank you, Mr. Chairman.

Mr. SHAYS. I would like to take my time and say to you I don't want to end this hearing until we have a better handle on this. I know we haven't asked State and USAID questions yet, and we may get to you in the second round, but I at least want to feel like we have a better sense of what the heck is going on here, and I am going to ask the GAO and the CBO and Congressional Research to listen to the answers and then help me out in trying to understand what I should rightfully expect.

Mr. Roth, what I need to do in terms of how you respond to questions, I assumed you were a policy person, not a scribe under or-

ders, and so that you recommend the best procedures that DOD should move forward with. Is that an accurate assumption? These aren't trick questions. These are just trying to understand.

Mr. ROTH. Yes, sir. I mean, I try to provide the best advice I can.

Mr. SHAYS. Well, have you been requested not to make estimates of future costs of the war by either the Secretary or anyone under the Secretary or anyone from OMB, anyone from the White House, anyone? Have you been requested not to make estimates of future costs?

Mr. ROTH. No one has directed me not to make estimates. No, sir. I mean, I am not——

Mr. SHAYS. Or your office or anything.

Mr. ROTH. No.

Mr. SHAYS. OK. I don't want to have to feel like I have to be——

Mr. ROTH. I am not trying to be. No, sir.

Mr. SHAYS. I don't know how we can project future manpower needs if we are not thinking about different scenarios. I, there is a scenario—I just came back from Iraq—that says we need 50,000 more people to really gain control of Baghdad, the 1-to–20 ratio which we talked about in the last hearing. I went in thinking, OK, we will need some more folks. Then I am leaving believing that has to be Iraqis with an Iraqi face, but I still had to wrestle with it.

Are we going to be asking for more people? It just seems to me that if I were a Secretary I would have directed you to say, OK, if we need to send in more troops this is what it is going to cost. I want to know. If we are going to bring down 10,000 troops every other month, this is what it is going to cost. I would want to know those numbers. And no one has asked you to even project that kind of scenario?

Mr. ROTH. We have certainly done analysis when requested to say what does it cost to field 10,000, what is the cost to field 20,000 people, and these kinds of things, but we have been given—what I am hearing here is have we been given a scenario over a multi-year period of time to price out to say what would it cost with X thousand of people over a 2 to 5-year period. We have not done that, No, sir.

Mr. SHAYS. OK.

Mr. ROTH. But we have, we are asked for information about what does it cost to field certain number of soldiers, these kinds of things, we have responded to those kinds of specific requests. Absolutely.

Mr. SHAYS. Let me ask just CBO and just GAO this question. Is it unreasonable? Am I thinking not logically that we would want to expect that DOD would make those kinds of analyses? And let me ask you, are they not doing that in the Budget Committee? Has no one in the Budget Committee, Dr. Marron, asked for these kinds of estimates?

Dr. MARRON. Sir, certainly in our line of business we get requests from various people, including the budget committees, as you emphasize, who bring to us, in essence, their scenarios, what might possibly happen, say, over the next 10 years in terms of personnel in Iraq, and then they come to us and they ask us to try to estimate what the potential cost implications of that would be.

Obviously, CBO was typically not in a position to make our own projections about what force levels would need to be. That is not our sort of core competence, but conditional on the scenario we can cost it out.

Mr. SHAYS. Is it considered bad business practices to want those projections or good business practices to want those projections?

Dr. MARRON. I would say we consider that to be a perfectly reasonable request from our clients at the budget committees.

Mr. SHAYS. Is it reasonable to expect the administration would do that?

Dr. MARRON. I guess I would be hesitant to say what is reasonable or not reasonable for the administration. Again, I think it is perfectly reasonable for our congressional clients.

Mr. SHAYS. What would——

Mr. WALKER. Mr. Chairman, it is my understanding the administration has taken the tack it is one supplemental at a time approach. In other words, they will come up with estimates for troop levels and other types of expenditures and they will provide that each time they submit a supplemental, but they generally have not gone beyond that. They have said consistently that they can't because of the uncertainty of what the conditions will be on the ground.

It is my understanding they haven't done it. We believe that they should be doing it for a reasonable period of time. We believe that it is prudent to do it. We believe that historically, if you look back at prior conflicts, after a period of time it has been done. You know, obviously there is a great degree of uncertainty, but we believe it is possible and prudent to have some estimate beyond the current approach.

Mr. SHAYS. And I will tell you why I would say it is prudent. I mean, if I look back on anything I regret over the past 4 years, I don't regret going into Iraq based on what I believe, but I do regret not nailing down what projected costs would be. And I actually was somebody who believed it would be paid first out of oil money and the administration said we are not going to do it. Then I believed it would be paid by us and whatever we could get from contributions from others. Because we were so off, I feel that we have even a greater obligation to try to nail down costs because we were so off. I, frankly, would have expected that DOD would have done that.

Mr. Roth, this is above your pay grade, but I will tell you what I suspect. What I suspect is that nobody is doing it because you don't want to know, because if you know then you have to share it with Congress, and that somehow we are not going to like what those numbers are.

Strongly believing that what we are doing in Iraq is a noble effort, bringing democracy to this part of the world, having been there where Iraqis say to me, when I ask their biggest fear, it is not the bombing. Their biggest fear is that we will leave them, giving them the taste of democracy. I don't wrestle with whether this is a noble effort worth the dollars or even the lives, and I don't wrestle with the issue with the issue of whether or not this is a "war of choice" or whether we waited until we get the heck bombed

out of us, because, frankly, I don't wrestle with the failure that we had in World War II.

Had we listened to FDR, had we acted sooner, maybe Russia wouldn't have lost 25 million people and maybe we wouldn't have had the killing fields that existed there and maybe we wouldn't have had the extermination had we stepped forward. And then would people have said, if we had done something before we were attacked in Pearl Harbor it was a war of choice? I don't think so. It would have been a more logical thing to have done. Japan went into China in 1928 and we seemed deaf to it. So I don't wrestle with that, but I do wrestle with my failure to come to grips with costs.

Mr. Higgins, when I get to your round I am going to be asking you about understanding why it is difficult to divide the war costs for State Department. It may be that you don't have that much incremental cost, but maybe you could explain it to me. I guess if you have a secretary or Ambassador they are going to be there, but clearly have more State Department folks in Iraq than elsewhere.

I would suspect that one of the answers that you are going to tell me is that a lot at State Department aren't State Department folks. There might be more CIA agents, intelligence agents. It might be more FBI. But I would love you to be able to kind of sort that out and think about it before I ask, because your cost—the thing that is challenging, it seems to me, for State Department is that half of the State Department is filled by people that aren't State Department. I would like that to be dealt with.

With the remainder of the time, I would like to start where I can't yet get to. I want to know the cost elements of determining the global war on terror. In other words, what are the elements that we then say are attributed to the war on terror? I would like to get from the panel definitions of what those elements are. I would like the kinds of things that we would call incremental, and I would like to know what we have left out of the equation.

I mean, you have all given us numbers, but one of them is a term, I think it is called reset, and reset is a term about what we then have to do to get our equipment back into shape, so I am going to want to know those answers. I will want to know before we leave what is a logical process for determining the war cost, how close are we to actually doing that? That is what I would like to do.

With this, I am going to go to you, Mr. Kucinich, for the second round.

Mr. KUCINICH. Thank you very much, Mr. Chairman.

I share your concern about a lack of information, reliable information that this Congress needs in order to have accountability to the American people. I also would suggest that the scope of this hearing is so important that it may be possible that we are not going to get all the answers today and we may have to invite some of these individuals back in the not too distant future as a follow-up.

I want to go back to Mr. Roth. You answered the Chair that no one has directed you not to provide information on the cost of the war. Did you ever have in-house talk about what the war costs?

Mr. ROTH. Clearly we talk about it every day, sir, but mostly in terms of this since we are, in fact, a budget shop. I mean, we deal in terms of today's cost, what is it costing me today. Is it funding that has been made available to us through the supplemental sufficient to cover today's costs, and these types of things. I will have to say, quite honestly, the vast majority of our conversations inside our office have to do with today's cost.

Mr. KUCINICH. All right. Now, have you ever had a discussion with the Secretary relative to the costs of the war?

Mr. ROTH. I personally have not, other than to brief him, obviously, on what the costs are in the supplemental, itself, and these kinds of things.

Mr. KUCINICH. So you have spoken to the Secretary?

Mr. ROTH. We have briefed him on the costs.

Mr. KUCINICH. You?

Mr. ROTH. My staff.

Mr. KUCINICH. Have you ever met Mr. Rumsfeld?

Mr. ROTH. Yes, I have.

Mr. KUCINICH. OK. Thank you. Have you talked to Mr. Rumsfeld about the budget?

Mr. ROTH. I have, yes, sir. I have briefed him on what the costs are in the budget, yes, sir, as I have said before.

Mr. KUCINICH. OK. You are the Deputy Comptroller from the Office of the Undersecretary of Defense, Comptroller, Department of Defense, and you deal with the program and the budget and you have talked to Mr. Rumsfeld. Has Mr. Rumsfeld ever asked you, gee, John, how much is this war going to cost?

Mr. ROTH. We haven't had that kind of a conversation. No, sir.

Mr. KUCINICH. Wow. Have you had that kind of a conversation with anybody in the rank between your office and Mr. Rumsfeld?

Mr. ROTH. Are you alluding to, again, trying to forecast the cost of war?

Mr. KUCINICH. Just how much is the war going to cost.

Mr. ROTH. Again, we talk every day about the costs that are being incurred, taking a look and seeing how that will affect——

Mr. KUCINICH. How much will it cost? How much will this war cost? Has anybody ever asked you?

Mr. ROTH. No one has provided me an estimate on when this war will be over, so, again, due to the uncertainty and due to the unpredictability of it, I don't have any basis to cost it out.

Mr. KUCINICH. If the war ended today, how much will it cost? Do you know?

Mr. ROTH. If the war ended today, I would have a cost estimate. I could come up with a number in terms of the cost. There would be, obviously, a tail in terms of bringing people home. There would be the reset bill, as the chairman has alluded to.

Mr. KUCINICH. And if the war ends in 5 years could you estimate the cost?

Mr. ROTH. I would have to do so. I haven't done so to date.

Mr. KUCINICH. If the war ends in 10 years, would you be able to estimate the cost?

Mr. ROTH. But, again, I would have to be given some parameters and some estimate of what kind of operating tempo we are talking

about, the kinds of troops we are talking about, those kinds of things.

Mr. KUCINICH. Now, are the elements in your cost estimates, you use how much money has been spent to a given date, right? Would that be——

Mr. ROTH. Yes, sir.

Mr. KUCINICH. In your cost estimates, would you use future spending and operations?

Mr. ROTH. Yes, sir. I mean——

Mr. KUCINICH. Would you include in your cost estimates the cost for the VA?

Mr. ROTH. No, sir.

Mr. KUCINICH. Would you include in your cost estimate the cost of brain injuries?

Mr. ROTH. I don't have a way of costing out future costs being incurred outside of the Defense Department for things like medical conditions and the like. Again——

Mr. KUCINICH. What about veterans' disability payments?

Mr. ROTH. Again, sir, that is not under my purview. That is under the Veterans Administration.

Mr. KUCINICH. Demobilization costs?

Mr. ROTH. Well, demobilization in terms of the military force coming home and bringing folks home and the logistic support and that kind of stuff which, in fact——

Mr. KUCINICH. Would you include that?

Mr. ROTH. Yes, sir.

Mr. KUCINICH. Would you include increased Defense spending, forecast for increased Defense spending, how much it is going to cost for certain operations?

Mr. ROTH. Again, if there are incremental costs associated with a military operation, I would, in fact, attempt to cost that out. Yes, sir.

Mr. KUCINICH. Would you cost out the interest on the debt for the cost of the war?

Mr. ROTH. Again, sir, that is not under my purview.

Mr. KUCINICH. Well, what we have established here briefly, Mr. Chairman, is that there are certain elements of budgetary cost which are not being built into the assumptions that come from the Department of Defense. They are not taking into account the cost of the VA, the cost for brain injuries, veterans' disability payments, and the interest on the debt. Is that correct, Mr. Roth?

Mr. ROTH. Yes, sir.

Mr. KUCINICH. We are speaking about the cost of the war here, yet we are only speaking about a fraction of the cost because there are other elements of cost which Mr. Roth cannot address because they are not under his purview but they are certainly related to the cost of the war.

I mentioned earlier the study on the economic cost of the Iraq war by Linda Vilmus and Joseph Stieglitz. Their report is as follows: December 30, 2005, total spending for combat and support operations in Iraq, $251 billion, and the CGO's estimates put the projected total cost at around $500 billion. They go on to say that these figures greatly underestimate the war's true cost. "We estimate a range of present and future costs by including expenditures

not in the $500 billion CBO projection, such as—" talking the cost of the war—"lifetime health care and disability payments to returning veterans, replenishment of military hardware, increased recruitment costs."

They make adjustments to reflect the social cost of resources deployed, that is, reserve pay is less than the opportunity wage and disability pay is less than foregone wages. And then they estimate the effects of the war on the overall performance of the economy, something that we never get into discussing in Washington. And they took a conservative approach and assumed that all U.S. troops returned by 2010, and by taking that conservative approach, building on all the other cost estimates, they are saying that the true cost would exceed a trillion dollars.

Using CBO's projection of maintaining troops in Iraq through 2015—2015 is why I asked 5 years, 10 years—they are saying the true cost of the war could exceed $2 trillion, reflecting back on the administration's cost, which was estimated at $50 billion to $60 billion. Then they go on with some other costs.

I point this out because Mr. Roth, with all of his experience in the Department of Defense, and while I might challenge the fidelity of the figures that you provide, we are not—Mr. Chairman, the true picture here is not going to be presented by the Department of Defense, alone. There are so many other things related to the war that are off the books. And so the American people really don't have an idea of the true cost, and I think that is unfortunate.

It is more than unfortunate. It is a tragedy, because what is happening is that these costs are off the books, or off your books, Mr. Roth. They are still going to have to be paid for. We established earlier with Mr. Walker they are being paid for by borrowing, and when you borrow money you pay for a war you are going to pay back that money at an interest rate. The interest rate in this Stieglitz report, just so you know—it is very interesting to look at the interesting rate—in billions of dollars the conservative estimate for the interest on the debt is $98 billion. The moderate estimate is $386 billion.

We are borrowing money to pay for a war, and when you borrow that money there is also another social cost that is factored in that we can't quantify, and that is a commensurate reduction in funds for education, for health care, for elderly programs veterans, which really has more to do with the reason why I came to this Congress, frankly.

So Mr. Chairman, I think it would be helpful at some point if we could invite in the authors, Linda Vilmus and Joseph Stieglitz, to talk about the true economic cost of the war and get all the elements in there, because we are only getting part of the picture here. As well intended as the gentleman from the Department of Defense is and as honorable as his service is to our country, he cannot give us the total picture.

I thank the gentleman.

Mr. SHAYS. I thank the gentleman, as well.

Mr. Van Hollen, you have the floor.

Mr. VAN HOLLEN. I thank you, Mr. Chairman.

Just to underscore Mr. Kucinich's request, I think it would be useful to have that, because, as many people do in budgeting, they

put together different scenarios and have different cost figures with respect to different scenarios, best case, worst case, medium case, and it seems to me that if we want to get a handle on this going forward we are going to have to do that as a Federal Government, so I think that would be very useful.

I think you all understand the concern here from the perspective of trying to hold people accountable in the past so that we make sure that going forward we have the best information, and we had a situation where claims were made about the existence of weapons of mass destruction. They weren't there. Claims were made about collaboration between Al Qaeda and Saddam Hussein. Turned out not to be true.

And then we had claims about cost estimates that were clearly low-balled, either low-balled on the one hand or people had a really rosy assessment of how things were going to go, and yet people today won't come forward and tell us what their assessment was and what went wrong, what part about what they predicted failed to come true.

Obviously, when you have an estimate of about $50 billion for the total cost of the war, you are expecting a pretty short time in Iraq. Yet, no one will say, well, yes, that is what we expected and we were wrong and here's where we messed up or here is why it was inevitable that what has happened happened.

People are unwilling to come up with figures now, but they were pretty confident then. Let me just quote from Secretary of Defense Rumsfeld, who quickly latched on to that OMB estimate. He was asked what the total cost would be back in January 2003, just 2 months before we went to war. Well, this is his response: "Well, the Office of Management and Budget has come up with a number that is something under $15 [sic] billion for the cost."

Now, I guess, Mr. Roth, my question to you is: when you heard this number out there, you had to have heard the $50 billion number floating around, right? I mean, it was in all the newspapers. And you heard Mitch Daniels over at OMB saying, you know, when Lawrence Lindsay said $100 billion to $200 billion, that is very, very high. You had to have heard it.

My question is: did you get on the phone and go to OMB and say hey guys, where did you come up with this estimate? I mean, you must have been a little bit curious. After all, the primary costs were coming out of DOD. Did you ever pick up the phone or talk to them or communicate with them in any way and say where are you guys coming up with these numbers?

Mr. ROTH. Again, as I said before, I will be real honest with you, I don't actually recall that number. I may have been involved or seen it. I understand your point it was perhaps in all the papers. So the short answer is I don't recall any conversations concerning that specific number. No, sir.

Mr. VAN HOLLEN. Because it clearly was so far off, and yet clearly a signal was intended to be sent.

Let me, if I could, ask you, Mr. Kunder, because there were also estimates about the reconstruction component of it, and I remember actually watching either Nightline or it was a sort of redo of Nightline, rerun of this component of Nightline. Ted Koppel was asking Andrew Natsios, who was a former AID, and I must say

overall did a terrific job as head of AID and I respect his public service, as well.

But here's what he was asked. Ted Koppel, "All right, this is the first. I mean, when you talk about 1.7, you are not suggesting that the rebuilding of Iraq is going to be done for 1.7 billion?" Natsios: "Well, in terms of the American taxpayers' contribution I do. This is it for the United States. The rest of the rebuilding of Iraq will be done by other countries who have already made pledges," and then he lists some of those other countries. Are you familiar with this quote? It has also been widely distributed?

Mr. KUNDER. Of course I am very familiar with it.

Mr. VAN HOLLEN. Now, what was Mr. Natsios basing this on? Let's first put on the record what was—I believe it is about $30 billion appropriated for reconstruction; is that right?

Mr. KUNDER. That is what was testified. The USAID portion of it is about $5.1 billion, but I believe that was the number we testified to earlier, yes, sir.

Mr. VAN HOLLEN. But the total number is around $30 billion. So can you tell me—maybe you are not aware. I don't know if you are in a position to know at the time where Mr. Natsios got this number which he said to the American public that the total cost of the American taxpayer reconstruction is $1.7 billion, and even when Ted Koppel said, are you sure, he said yeah, by God, I am sure.

Mr. KUNDER. Well, as Mr. Natsios said at that point, I think he was basing that on the assumption that other donors, multilateral and bilateral, would be coming in soon afterwards. Most of the initial USAID estimates were based on emergency humanitarian needs. If nobody else says it, I will be the first one to say I made some mistakes in estimates.

I mean, we made some estimates based on movements of population. It is very difficult to predict how populations are going to move in a conflict, but we made our best estimates based on previous crises on what sorts of internal displacement would take place, and we made some estimates based on food shortages, for example, and the need to bring emergency food aid to displaced populations. I know those were major components of Mr. Natsios' thinking at that time.

But, as he stated—so I think the $1.7 billion was built on a number of emergency needs estimates. As he stated, he expected other bilateral and multilateral donors to be coming in soon after that. As it turned out, as we all know now, there were relatively few major population movements at the time of U.S. forces going into Iraq and there were not massive food shortages or outbreaks of epidemic disease, which we also had planned for.

Some of the elements were quite accurate. We had planned on doing immediate measles immunization and other immunizations so that there would not be massive outbreaks of epidemic diseases, and those turned out to be precisely the correct interventions because we have not had any such outbreaks in Iraq.

But yes, we made some estimates based on humanitarian needs that turned out to be wrong.

Mr. VAN HOLLEN. I guess my question is the predictions you made that were wrong would have actually added to the cost,

right? In other words, if all those population migrations happened, it would have been a bigger number, right?

Mr. KUNDER. Yes, sir.

Mr. VAN HOLLEN. I mean, this is not just off. This is way off for the American taxpayer contribution, and it is just unbelievable in terms of forward-looking budgeting, that we would have—was there an assumption as to how long the United States would be involved in reconstruction in Iraq in that figure?

Mr. KUNDER. As you have stated, sir, he really did anticipate that there would be multilateral and bilateral donors lined up to contribute after that point. That is why the estimate was as limited as it was.

Certainly, if you had asked him what is the total cost going to be, at that point, as I think the subcommittee members well know, the World Bank was estimating the total reconstruction cost in Iraq would be $56 billion. That is probably still, given the fact that it was an early estimate, not a bad estimate if you are looking at reconstruction costs, non-military reconstruction costs. So Mr. Natsios would have been perfectly aware of that element, but he was asked a question what the U.S. contribution was going to be and that is what he answered.

Mr. VAN HOLLEN. Can you for the record provide us the number? What is the total amount actually spent by foreign partners in Iraq?

Mr. KUNDER. Yes, sir, we have that number. For example, the British government has contributed mightily to the reconstruction. We could get those numbers.

Mr. VAN HOLLEN. I sure would appreciate it.

Mr. KUNDER. We will do that.

Mr. VAN HOLLEN. And, you know, just going back, Mr. Chairman, the first Gulf war under the first President Bush, I believe the total cost has been estimated about $58 billion, and a large share of that, over $40 billion, I think $48 billion was, in fact, picked up by allies. It sounds to me like whoever was making assumptions about this time in Iraq picked up the same numbers, $58 billion. They were estimating between $50 billion and $60 billion.

It is obviously a very different enterprise. I mean, first President Bush made a very calculated decision not to go into Baghdad and occupy Iraq, and how the people planning for this venture in Iraq figured that the cost of occupying Iraq would be similar to the cost of simply forcing Iraqi troops out of Kuwait is beyond me. I think it is something the American people have just got to be scratching their heads about, and the failure of accountability, no one has been held accountable for these huge, constantly wrong projections in very many different areas.

Thank you.

Mr. SHAYS. I thank the gentleman.

This is a bit heart-wrenching for me because I couldn't believe more strongly that what we are doing in Iraq is a noble effort and that we have the extraordinary need to confront terrorism at home and abroad, and whether or not people think terrorists were in Iraq before, this is where they are now. We have no choice. We cannot allow the terrorists to win in Iraq.

So I am at the opposite end of my colleagues who have spoken. They think we shouldn't have been there, they don't think this is an effort we should have done, they think we have basically lost the lives of men and women for nothing, that we have spent, in their view, billions of dollars for nothing. I take the exact opposite view. But where we agree is that we should be trying to get a handle on the cost and that we should be trying to project what the cost will be in the future.

If I have two regrets out of the hundreds that I could regret, because I don't have lots of regrets, one, I believed he had weapons of mass destruction, he did not. Second, I wish early on I had asked about the cost of this war, so I wouldn't have said to my own constituents it will cost less than what it absolutely costs.

Now, I know why it has cost a lot more. We made some fateful decisions. We decided to not guard the depots so that we let the insurgents get literally hundreds of thousands of explosions. We proceeded to allow the looting, which was a huge message to the Iraqis that security was not our concern and, frankly, we didn't care about them. We didn't care about the fact that their country was being ravished.

But the biggest mistake is we disbanded their army, their police, and their border patrol. Every time I say it I am astounded by its impact. We basically said to 26 million people no army, no police, no border patrol. No police. Imagine all of New England and all of New York without any police. Imagine all of California with no police. Admittedly, California's 38 million people, we are talking 26, but Iraq is about the size of California. No police in all of California. Big surprise that we would have problems. That was a fateful and horrific mistake to which we are digging ourselves out.

So I don't fault Mr. Roth or anyone else for not anticipating what people ultimately did that caused that. What I want to do is get a handle on the cost. If we can't get the exact numbers, I would at least like to leave with basic principles. Can we agree on basic principles? Can you all agree or disagree on them?

I will start out with you, Mr. Walker. Is it better to have no estimates than to have estimates that may be wrong that at least are estimates?

Mr. WALKER. We should have estimates and recognize that there may be a variance from those estimates.

Mr. SHAYS. Mr. Higgins.

Mr. HIGGINS. I think yes, we do need estimates, but I also think we have to develop scenarios. This is all based on a transition to a self-reliant Iraq, so the speed in which we are able to get the job done correctly and get the foundation set up will have a direct impact. It will save billions, but it will also save many lives, so I think that the real focus should be on results. What are we trying to get to now?

Mr. SHAYS. OK. I am asking you, Mr. Roth, not whether you have them, but doesn't it make sense to attempt to have estimates, even if they are wrong?

Mr. ROTH. I think it is important to have some basic assumptions in place before you do the estimates, because otherwise you get into the same sort of dialog here about where the numbers came from years down the road.

Mr. SHAYS. I would agree with that. But let's just say you have to make assumptions to make estimates, but does it make sense to make assumptions and to make estimates?

Mr. ROTH. It makes sense to make estimates where you have some degree of confidence that you can come up with a good estimate.

Mr. SHAYS. Fair enough. Mr. Kunder.

Mr. KUNDER. Mr. Chairman, I want to be intellectually honest with you. As I try to grapple with the very profound question you are raising, I think about in our own circumstances. It seems to me that it is defining the realm that you are trying to ask for the estimate about that is hanging up the question, at least in my mind, because if you asked me what does it take to make Bangladesh a decent place to live, you know, I don't have an estimate for that.

Now, I have thought through very carefully what the components are of making Bangladesh, for example, a better place to live, and that has to do with some——

Mr. SHAYS. Let me interrupt you. I will make it very simple. Is it better to have no estimates or to have estimates that may be wrong?

Mr. KUNDER. I have estimates. It is better to have estimates, and I have estimates of all the components——

Mr. SHAYS. And I am going to ask you to explain why, because I think I know the answer, but I want it on the record. Dr. Marron.

Dr. MARRON. Short answer, yes.

Mr. SHAYS. Ms. Belasco.

Ms. BELASCO. I would agree that it is useful to have estimates, but I would also like to point out that the services, in fact, do make estimates a couple of years out. The Army makes estimates based on some sort of rotation plan for their troops. They have to make it beyond fiscal year 2007 and fiscal year 2008 for planning purposes, and they have to do that for other elements of war cost. It is just inevitable. It is inevitable.

Mr. SHAYS. And that is why it is somewhat stunning that in some cases we are avoiding making estimates.

Isn't it true, Mr. Walker, that by making estimates, if they are wrong we can go back and analyze what was wrong with our assumptions?

Mr. WALKER. That is correct, which means it would provide more accountability.

Mr. SHAYS. OK. Which is, I think, a very important element to this. In other words, what are estimates? Were they accurate? Why were they or why weren't they? And then who made the estimates and why did they make them? It may be they made wrong estimates but they are very talented people, but then in the future they will have learned from their faulty estimates and make better estimates.

Isn't it logical, Mr. Higgins, that if we make estimates and they are wrong and we learn why they are wrong we can make better estimates in the future?

Mr. HIGGINS. Just following up on what Mr. Roth was talking about was to set up correct assumptions, recognizing that we are in a war zone, but the practical matter, everything we have been doing for the last few years at the State Department is lessons

learned. How do we get better? Certainly estimates going forward is something we have to work from. But I also think we have to be dealing in the now and project what do we think, particularly what do we think the Iraqis are going to be able to do and what do we think the international players will do.

It seems logical, what I am hearing you say, and you are speaking basically from the State Department's side of this equation. Every time I go there I try to leave saying well, are they ready yet. I have a sense, you know, they are getting darned close, so maybe we only have 30 to 40 percent of Iraq that is controlled by the Iraqis, but it means we don't need our military there, which has meant that we can then bring our military to places we need them more. I can't imagine. I am trying to anticipate as I go there what does this mean for the future, and I try to come back with some findings of fact and then recommendations. I have to do that. I don't know why DOD wouldn't do that, and it would seem to me it would be logical.

Mr. Kunder, wouldn't you be making—let me just make you respond whether you agree or not with Mr. Walker. I want to know if I can have consensus here or not. Do you agree with Mr. Walker's comment about learning from mistakes, wrong estimates, and also accountability.

Mr. KUNDER. We have components of the reconstruction plan fully costed out. As I said in my testimony, anticipating the elections we costed out every item, ballots, town hall meetings, and so we can give detailed—I guess I don't want to leave you with the impression we are not doing any costing out, because, in fact, for components we have a major component of the reconstruction that has to do with building capacity in the ministries so that we have oil production and electric production up. The elements are things like building an Inspector General function, building a budgeting function, computerization, training of the civil servants. Each one of these items are detailed, costed out. We can provide you those cost estimates.

Mr. SHAYS. But you have to make assumptions in every case. In every case you have to make assumptions, correct?

Mr. KUNDER. Yes, sir.

Mr. SHAYS. I mean, to say that you can't do it because you can't make assumptions because you don't know how it is going to turn out to me is a faulty way to think. You have to make assumptions.

So let's just take one element that I think is under your territory, reconstruction of Iraq. Now, what is the biggest assumption we made that was wrong, in your judgment? I will give you a clue. It has something to do with security.

Mr. KUNDER. We did not anticipate the level of violence. That is correct.

Mr. SHAYS. Right. And so how much of what we intended to go for reconstruction went for security?

Mr. KUNDER. The easiest way to say that is that approximately—we have testified several times that approximately 22 percent of our total reconstruction costs—this is within USAID—has gone into providing security so the construction effort can go forward, so my best estimate would be that we have probably accomplished 80 per-

cent of the bricks and mortar or schools or teacher training that we intended to do, because our estimate is 22 percent.

Mr. SHAYS. Now, some people look at that as a horrible thing that we had to set aside so much for security, but it explains to me why we aren't as far ahead in reconstruction, because there is a reason. We made an estimate that was wrong. I learned from that as a Member of Congress. I would think you would learn from that.

That is why I would think we would project and then we would determine whether or not our projections were accurate or not. Our projections were wrong based on a good chunk of the dollars having to go to security, which then gets us back to asking, well, what mistakes did we make with security. It gets us to focus, in my judgment, on what is the biggest cost.

Dr. Marron, would you weigh in on this?

Dr. MARRON. Absolutely. Since, as you know, sort of CBO's No. 1 business line is providing estimates of all sorts of policy proposals that the Congress is considering, and I would say going through the estimation process has at least three benefits. The first is the estimates, themselves, are valuable for decisionmaking. The second is, as you have emphasized, is that over time you can learn from your estimates and make them better so you can make better decisions in the future. And then the third that I want to emphasize is that going through the estimation process, itself, is a way to learn about the policy choices that you face.

I can't tell you how many times there are that we will evaluate an estimate of a bill that has been proposed by some Member of Congress, we will come back to them with our score, and they will say oh, no, that is not what we intended. They learn by the process it is not what they intended. So in sort of in the development of policy at the time it lets you iterate and figure out what it is that you want to do.

Mr. SHAYS. Mr. Roth, I am not throwing stones at you on this. I think you are basically caught in the middle of decisions made by higher authorities, but it strikes me that by not having estimates, by not trying to anticipate, by not trying to forecast, it almost has a sense of fly by night. We are just going to do whatever we do.

I just think what I have learned mostly from this is if we are not making these kinds of estimates we are depriving ourselves of extraordinary information, we are depriving ourselves of some real accountability because, frankly, it will enable us to know who is really sharp in anticipating and was closer to the estimate. To me it is like an economist where you look at their track record and you say maybe the next time around, if I am a policymaker, I want to listen to that person as opposed to that one. It doesn't mean the other one is a bad person; it just means, you know, they didn't get it right. I have to live with that as a Member of Congress.

Ms. Belasco, did you want to weigh in on this?

Ms. BELASCO. You know, I just wanted to mention, even though Defense typically, from John's description, you know, each of the estimates for war are as they come up, I mean, if there is any agency in Government that does long-term budget planning it is

the Pentagon, because they are the ones who have had a future years defense plan and they routinely estimate at least 5 years out.

So in one sense the Defense Department should have the greatest skill at doing this kind of thing. And the other thing is that there is a very real stake in making sure that estimates are accurate, because if you don't learn from your mistakes you will include costs that are the wrong costs, and in order to do that you have to go through this kind of evaluation and then another estimate in the exercise.

Mr. SHAYS. Are you saying——

Ms. BELASCO. And there is nothing wrong with a range. I think that is the other thing.

Mr. SHAYS. And that is the reason, Mr. Roth, why I am so surprised, because I really believe DOD has been one of the most effective at trying to anticipate costs in the future. And I realize your comment would be you have dealt with greater certainties when it is not the war in Iraq, and you are on record with that.

Mr. Higgins, we do need to assist, pay a little attention in the State Department, give Mr. Roth a little bit of a rest here.

I need to understand the answers to the questions I asked before, which is basically your comment that you don't separate cost, you don't look at the incremental cost, so explain to me why the war in Iraq? Is it because the increment is so tiny, or is it because—why not?

Mr. HIGGINS. Well, as a practical matter, sir, we look at the global war on terror as our top priority. It is embedded in everything we do, from our consular affairs to our weapons of mass destruction efforts, but the way we have looked at Iraq and Afghanistan, it has been very much done by supplementals. We are a little different because our appropriations are done by program, so we are able to track it pretty effectively. So I think that a practical matter is we are not really looking at this incremental; we are looking at what is the specific cost in Iraq to run our operations and to run our foreign assistance programs.

Mr. SHAYS. So you are in Afghanistan, you are in Iraq, in particular, so those costs you just basically attribute to the war?

Mr. HIGGINS. That is right.

Mr. SHAYS. OK. And you attribute all the agency costs? I mean, let me just say we would have Treasury there, we would have Commerce there. Do you attribute that as part of the cost of the war, or does Commerce do it and does the agency do it and does Justice do it?

Mr. HIGGINS. At this point, as you know, the way we do our normal billings at the various missions is done by we bill all the agencies who happen to be there. In Iraq and Afghanistan at this point we pay for the life support and we put it into our budget.

Mr. SHAYS. So you only incorporate their life support? You don't incorporate their other costs?

Mr. HIGGINS. That is right, their particular salaries, things like that. No, that is picked up by the respective agency.

Mr. SHAYS. Yes. Mr. Walker, just walk me through what Mr. Higgins said. Translate what he said to me in a way that I maybe can understand a little better. I am pretty close. Not your fault, sir.

Mr. WALKER. Well, you are right, Mr. Chairman, in saying that the amounts of money involved here are a lot less significant than for the Department of Defense, and it is a little bit more difficult to differentiate between what is incremental and what is not, but let me give you an example of something that is incremental.

In order to get an adequate number of people to go to Iraq, the State Department is having to pay significant financial incentives to get people to go to Iraq. They may be having to do the same thing in Afghanistan. I am not sure. I would argue that is an incremental cost. That is a cost that otherwise they may not have incurred.

Mr. HIGGINS. I should also add that when we talked about incremental, I think what I am really looking at is the specific cost of operating in Iraq, and I think the clear cost driver is security. That is by far and away our largest particular cost of securing the embassy at the various regional sites. That is an incremental cost and General Walker is correct that there are other additional costs in terms of the people going over there, what we need to pay them in terms of hazard pay. For the record, they work 7 days a week, so we pay them for that.

Mr. SHAYS. For the record, you don't go out and play tennis.

Mr. HIGGINS. That is for sure.

Mr. SHAYS. You don't play golf, you don't go have a stroll through the city, you don't go to movie theaters, you don't go to night clubs, you don't go anywhere except to eat, to work out, and to work.

Mr. HIGGINS. That is right.

Mr. SHAYS. That is your three options. It is remarkable.

Let me ask you, then I am going to have the professional staff ask a few questions in a second, but when Mr. Bremmer was there for the first year was he under DOD, State, or both?

Mr. HIGGINS. Ambassador Bremmer?

Mr. SHAYS. Yes.

Mr. HIGGINS. CPA was a DOD operation.

Mr. SHAYS. OK. There has been speculation that Mr. Bremmer was paid a very sizable salary. What was Mr. Bremmer paid?

Mr. HIGGINS. I have absolutely no idea, sir.

Mr. SHAYS. Mr. Roth, what was he paid?

Mr. ROTH. I will have to take that for the record.

Mr. SHAYS. Was he paid as an employee or was he paid as a consultant?

Mr. ROTH. Again, I don't have that fact at my fingertips here.

Mr. SHAYS. OK. This is a very serious question to which I would like an answer by tomorrow. I would like to know what Mr. Bremmer was paid. I would like to know who controlled his operation. Did it go under your budget in DOD, Mr. Roth?

Mr. ROTH. Yes. I mean, he reported to the Secretary of Defense.

Mr. SHAYS. So when we sent over literally billions of dollars in crates, whose control was it? Who was supposed to control those dollars?

Mr. ROTH. When we sent the money—are you talking about the cash that came from——

Mr. SHAYS. Yes.

Mr. ROTH [continuing]. The seized assets and the like?

Mr. SHAYS. Well, were those the only cash that went?

Mr. ROTH. The answer to your question was it was a Defense Department operation.

Mr. SHAYS. OK.

Mr. ROTH. It was done under the auspices of financial officers of the Defense Department.

Mr. SHAYS. OK. Did you have control over that or was that a separate organization?

Mr. ROTH. I personally didn't have control over it, but the comptroller organization worked with—essentially it was the Department of the Army. Department of the Army and their financial officers did the hand-off from hand to hand until it was in the theater.

Mr. SHAYS. During my 13 trips, on occasion there were allegations that dollars were left in drawers, in closets, and so on. When I was there I literally saw stacks of dollars literally in crates, not locked up, not under any supervision. Is that a fact or not?

Mr. ROTH. I will have to take that for the record, sir. I don't recall all the circumstances.

Mr. SHAYS. Can GAO speak to that issue?

Mr. WALKER. There were inadequate controls over cash resources, no doubt, and I can provide more for the record if you would like.

Mr. SHAYS. OK.

Just in terms of the $9 billion, not to leave it hanging here, and it was not confronted, I want to make sure we are clear as to the $9 billion. The $9 billion number I believe includes a lot of different parts. This was not $9 billion lost, correct, Mr. Walker?

Mr. WALKER. That is correct, and most if not all that money, it is my understanding but I want to check for the record, was Iraqi money.

Mr. SHAYS. Right. But it was money that was given to pay salaries for Iraqis. For instance—and this is where the dicey part comes—Mr. Roth, if you were one of the generals in their military you were given a—I won't use you, Mr. Roth. That is not fair. I am sorry. Ms. Belasco, if you were a general in the army you were given and you said you had 1,500 troops, we allocated the salary for 1,500 troops, but it is my understanding that you may have only had 1,200 troops, and part of the problem of recordkeeping was the fact they had no checking system; is that correct, Mr. Walker?

Mr. WALKER. Correct. There is still a problem today with regard to not knowing how many employees they have, even with regard to their civilian ministries.

Mr. SHAYS. So they are paid in cash?

Mr. WALKER. At the time that you are speaking of they were paid in cash, correct.

Mr. SHAYS. Well, how would they be paid now?

Mr. WALKER. I can't state for the record how they are paid now. I will find out and provide it for the record.

Mr. SHAYS. Right.

But they don't have a checking system?

Mr. WALKER. In all likelihood they are paid in cash now. That is my understanding, but I am under oath. I want to make sure.

Mr. SHAYS. Fair enough. So can any of you just speak to that issue? We are going to end pretty soon here. The issue is of the $9

billion. We can let it hang out there. Mr. Roth, do you want to let the $9 billion hang or do you want to put a little clarity? I am not saying that it is a pretty story, but it is not $9 billion that just walked out. It went to pay soldiers, it went for other costs. The problem is we didn't have the accounting processes to document and certify that every penny was spent the way it was to be spent. That is my understanding. Is that correct or not, Mr. Roth?

Mr. ROTH. Sir, I don't know the fact about the $9 billion. I am not trying to dodge the question; I honestly do not have any first-hand knowledge of it.

Mr. HIGGINS. Mr. Chairman, I spent 13 months over in Iraq in two tours, so I had the opportunity to be there at that time. I think Thegar, who reported that, has done a great job in terms of helping us give advice about how to fix some of the issues we have. I have always disagreed with that. The issue—and you hit on it—was one of there is not an adequate audit trail based on U.S. standards, again reflecting on the fact that we were paying the salaries. The money went to the Central Bank of Iraq that was turned over to the Ministry of Finance who then, in turn——

Mr. SHAYS. So we can document that it was turned over?

Mr. HIGGINS. Yes. It was turned over to ministries. The question of how far—at least on the bulk, you know, there were a number of issues, but the bulk of the money—I think General Walker hit on it—was the Iraqi salaries. There was 1.1 million Iraqis being paid monthly, so that the ministries——

Mr. SHAYS. That was 1.1 million?

Mr. HIGGINS. Yes, 1.1 million Iraqis were getting paid, and so effectively what happened was that the money was turned over to the ministries and they would pay their salaries, as I am sure they continue to do today.

Mr. SHAYS. Mr. Walker, any comment?

Mr. WALKER. My staff tells me they are still on a cash basis with regard to payment.

Mr. SHAYS. Before professional staff, Dr. Marron or Ms. Belasco, do you care to add anything to this?

Dr. MARRON. I have nothing to add.

Mr. SHAYS. OK.

Mr. CHASE. Mr. Higgins, what are the prospects for re-engaging the international community to assist us in providing additional resources for the reconstruction of Iraq?

Mr. HIGGINS. I think last week when Ambassador Jeffries and Ambassador Khalilzad spoke they pointed out the discussions that Prime Minister Malaki and the U.N. are moving forward with the compact. The international community is a key player in the financial plan or the future of Iraq, Iraq's ability to help pay for its own reconstruction. But, again, the $13.5 billion that has been pledged, we are now getting to that stage where we anticipate seeing more of that as the U.N. has set up and the World Bank has set up operations in Iraq.

Mr. WALKER. At some point, Mr. Chairman, I would like to answer your earlier question which I thought was an excellent one, and that is what represented incremental cost and what, if any, recommendations do we have.

Mr. SHAYS. That is how we are going to end up. And the elements. I would like if maybe you would start that, Mr. Walker.

Mr. WALKER. Thank you, Mr. Chairman. I think those are both excellent questions. Keep in mind we are talking about incremental costs here; therefore, they represent costs that would not be incurred but for the global war on terrorism, and one has to have a solid definition of what that is.

To me that would be such things as military and civilian personnel and support cost, additional capacity building, reconstruction cost, support of Iraqi security forces, reset cost. Reset cost would include repositioning as well as reconstitution of equipment. Also, other long-term costs that on a cash basis you don't see right away but undoubtedly will be there. That includes long-term disability and health care costs. So those would be direct, incremental cost.

I would also respectfully suggest that since the country is running huge deficits, that we will have to debt finance this, so an additional direct cost would be the interest cost associated with these expenditures, although those don't just relate to the global war on terrorism, they relate to deficits that don't have anything to do with the global war on terrorism, and most of our deficit does not have anything to do with the global war on terrorism.

Last, I think one could speculate as to how much of an impact this is likely to have on our long-term ability to recruit and retain individuals and the related costs that we might incur. There are likely to be some costs there, but I think it would be difficult to estimate that with any degree of reliability.

As far as recommendations, Mr. Chairman, I will give you three for now. No. 1, that the respective departments and agencies be required to build into their normal budget request and appropriation request a reasonable estimate of the cost for the global war on terrorism; that they also be required to segment out by the major elements, meaning Iraqi Freedom, Enduring Freedom, and Noble Eagle, which are that three major components; and that we recognize that these will be good faith estimates based upon certain assumptions, and that if there are significant variances they may have to come forth with a supplemental, but that would be for the variances, not for the baseline request, which would be based on their good faith estimates.

In addition I would suggest the that Congress needs to act quicker on appropriations bills, because there are costs, there is disruption, and there are increases that are incurred when the appropriations bills aren't enacted in a timely manner. CR should be a rare exception rather than the rule.

Mr. SHAYS. Thank you.

Dr. Marron, would you add, and Ms. Belasco? I would also like all of you to speak to this issue of the elements. You can just say you agree with Mr. Walker and would add to it or subtract from it, whatever you would like.

Dr. MARRON. I think Mr. Walker set out quite well the list of incremental costs to consider. The one element I would highlight, which raises some issue, is the interest burden that comes with financing these expenditures. Really, the issue there is what purpose are we going to put the cost estimate to.

As you know, many of the cost estimates that are used in the usual course of the congressional budget process that CBO provides do not include interest in them. So if you want to do an apples to apples of a scenario for the Iraq war versus some other type of spending or tax program, apples to apples there would typically be no interest in either. If you wish to use interest in the Iraq war or the global war on terror estimates, it would be important that, whenever comparing that to some other source of financing or spending, that interest be added in in parallel there.

Mr. SHAYS. I thank you for making that point. You recently announced that the deficit is anticipated to be how much lower? From what to what in this fiscal year?

Dr. MARRON. Several months ago, looking at the strong revenues, we suggested that the deficit this year might be somewhere in the neighborhood of $300 billion. The administration came out with $296 billion last week.

Mr. SHAYS. As opposed to what is actually projected when we started out in the budget?

Dr. MARRON. When we started out including the administration's policy proposals, we were in the $370 billion range. I should emphasize we will come out with our formal estimate in August.

Mr. SHAYS. When we adopted the budget we were at 370?

Dr. MARRON. Excuse me?

Mr. SHAYS. Weren't we in the 400's?

Dr. MARRON. The administration, in their budget proposal with their estimates, had a number north of $400 billion.

Mr. SHAYS. But when we adopted the budget we were at what number?

Dr. MARRON. I am sorry? Which number? I am sorry, the confusion is so the administration said 400, I believe it was 412, in that neighborhood.

Mr. SHAYS. And what did you all say?

Dr. MARRON. And then we re-estimated that exact set of policies and had an estimate of 371.

Mr. SHAYS. So basically we are seeing, from CBO's projection, we are seeing a $71 billion reduction?

Dr. MARRON. As of where we were, that was the number we put out 2 months ago now. I would suggest that it may differ again when we come out with——

Mr. SHAYS. OK. Fair enough.

Dr. MARRON [continuing]. Our formal estimate in August.

Mr. SHAYS. Fair enough.

Ms. Belasco.

Ms. BELASCO. I would like to make——

Mr. SHAYS. This is about elements.

Ms. BELASCO. I think the elements are good elements. I think it is very important to make sure that we don't build into future estimates higher costs that are due to contracting problems, and nobody has brought that one up, so I just want to mention that.

Mr. SHAYS. OK.

Ms. BELASCO. Because the models tend to be updated with the latest actual costs, but if the actual costs build in inflated costs that is not a good idea.

I think in terms of recommendations, even though this sounds like a sort of a budgeteer's recommendation, I think it would be worth looking seriously at setting up separate accounts for war appropriations, which now run more than a fifth of DOD's total appropriations. That would give you more visibility.

Mr. SHAYS. When you say war, are you saying specifically the war in Iraq or the global war on terror?

Ms. BELASCO. In fiscal year 2006 the total amount for the global war on terror was about, I think, $117.6 billion.

Mr. SHAYS. I am just asking you——

Ms. BELASCO. DOD's peacetime budget is about $444 billion.

Mr. SHAYS. OK. Fair enough. Thank you.

Mr. Kunder, Mr. Roth, and Mr. Higgins, I would like a response on this.

Mr. KUNDER. Sir, with profound respect for the Congress, I just would like to say that, as an operator, as somebody who has to make these programs happen on the ground, the comment about the delay in appropriations every year is really very significant.

Mr. SHAYS. I will let you say that, but tell me elements first, about the elements. I am going to let you come back to that point. What about the elements? Mr. Walker was talking about the elements that you need to determine the true cost of the war. What are the elements? Do you disagree with anything Mr. Walker said? Do you care to add anything to it?

Mr. KUNDER. Yes, sir. I am sorry. I just wanted to emphasize that one first. We are trying to learn from our mistakes, what we did right and wrong with the earlier estimates, but I find those to be useful recommendations going forward.

Mr. SHAYS. I will let you come back and make your point in full.

Mr. Roth.

Mr. ROTH. Dealing with what I heard, I don't have anything really to contend with. Again, in our terminology the cost of the military operations, themselves, and all the costs that go along with that in terms of the additional logistics support, additional personnel costs, special pays, the mobilization of the Guard and Reserve, those kinds of things, we have pretty clearly a lot of experience in demarking the fact, the line between what our incremental costs and what our so-called peacetime or baseline costs.

I would agree that the reset and reconstitution of equipment is a cost, an incremental cost of war. We also have costs in terms of additional force protection requirements and some additional initiatives in terms of dealing with the improvised explosive device threat and those kinds of things that we would also argue are incremental costs of the war, as well. So, in general, from what I heard from Mr. Walker, I don't have any problem as far as the DOD cost.

Mr. SHAYS. Thank you.

Mr. Higgins.

Mr. HIGGINS. I would concur with General Walker, but I would probably be a little more expansive. I would probably add in the cost of when we start realizing that the global war on terror is just not a military or security cost, it is a development and diplomatic cost, building partnerships, helping develop some level of prosperity elsewhere to take away the reasons for terror, so I think when

we look at the global war I think we really do need to look at all three of those and balance the funding in looking at it from that basis, that a diplomatic and a developmental solution is far less expensive if we get involved early on.

Mr. SHAYS. That is an interesting point. You are speaking to a former Peace Corps volunteer. What I hear you saying is when we add up all these costs and we can say we can go this route or we can go this route or we can do a combination, maybe our long-term costs will be a lot less if we go in a different direction than just where some might think we need to go.

Mr. HIGGINS. Absolutely. I think the lesson that we are taking from Iraq is that the need to be involved early on with a strong diplomatic and development focus will save a lot of money and save a lot of lives other on. There are a lot of other areas around the world that have problems right now, and I think we need to be very focused on that. It is not just a security approach, chasing down terrorists, but what are you doing to change that. I hate the term hearts and minds.

Mr. SHAYS. OK. I am going to make some assumptions and just put them on the record and then I am going to ask each of you to just make whatever closing point you wanted so you, Mr. Kunder, can make the point you wanted to make.

We have over 130,000 of troops, but we also have a lot of contractors who do the work that troops used to do. Frankly, I am happy those contractors are doing exactly what they are doing. It allows our military to be at the tip of the spear.

If we don't allow or encourage the new Prime Minister to reach out and to provide amnesty, to have reconciliation, we will, in my judgment, see this war continue ad infinitum, and some of the greatest opponents of the war are opposed to reconciliation, opposed to amnesty, which is curious to me. That absolutely has to happen. If the Prime Minister chooses not to crack down on the gangs that are roaming Baghdad, allows for basically these militias to continue, he is basically, in my judgment, going to go the route of a civil war.

And then I would say to you, Mr. Roth and DOD, that this very strong support of the war is going to say we need to get out, because what then is happening is that we would be having a government that says Shiites and Kurds want to dominate the Sunnis and we just want to battle it out with them. Well, if they are going to battle it out, then my recommendation is to go. But if this Prime Minister does what he says he wants to and empowers his own troops to crack down on the militia, and they would be some of his own people, or at least people who helped get him in his office, then I think that you will see a noticeable and meaningful reduction in our troops.

But now, having said that, having been to Serbia and Bosnia and other places where they are 10 years later, if we do our job we are not getting all our troops home. They don't have the logistics, they don't have the medics, they don't have particularly the aircraft to do what they need to do. They have been trained to be insurgents and not to be an army that can defend its border with Iran, Turkey, or Syria, so we will have to have some presence there.

Those are assumptions that I think are pretty logical, and they would steer me to make some assumptions. I don't think it is wrong for DOD to make some assumptions. They will know in a few weeks or months this new Prime Minister and the route he is going to go, and then I think they can make some very real assumptions.

I guess, Mr. Roth, I would say to you I hope and pray that the mindset of DOD is to start to make estimates of the future, to be proud of those estimates, to share them with Congress, to go on record, and the worst thing that could happen is you are wrong, but at least we have estimates as opposed to no estimates. That would be the message I would like you to take back, and I appreciate it, and I realize that you are taking the position that DOD has sent you here and you are doing your job. All of you are patriots. All of you are good people. All of you I know want to see success in Iraq. I pray that we see it. But I think that we have our work cut out for us.

It is a plea, as someone who is supportive of our being in Iraq, that we be more forthcoming about the cost of this war and that we make a greater effort to nail those numbers down.

With that I would just invite each of you to make whatever closing comment. We will start with you, Ms. Belasco. Anything you want on the record, anything you want on the record, now is your shot.

Ms. BELASCO. Well, I think you are right in saying essentially that the stakes are very high in this, and I just like to say that I think it is an important option to look at budgeting for war earlier with the caveat that yes, indeed, you may be less accurate, but maybe it is still worth it. And I think it is also important, if Defense budgets for war at the same time as they budget for their regular operations, then there is a better chance that they can look at how the pieces connect, and that really hasn't happened much in the past.

I think particularly with the reset issue, which is many billions of dollars, that is very important, because there may, in fact, be some offsets in the peacetime budget because of the earlier spending to meet war needs. Only if you look at things together as a whole is that likely to come out.

Thank you very much.

Mr. SHAYS. Thank you very much.

Dr. MARRON. I guess in concluding I would just echo some things from my original testimony about in order for CBO to serve the Congress and provide the best cost estimates for scenarios possible, it helps to have as good information as possible about where we have been historically, both in terms of spending obligations, et al., and to the drivers of that. To the extent it is possible to have more information that links what is happening on the spending side to what is happening on the ground, that strengthens our ability to cost out some areas that the Congress may want to consider.

Mr. SHAYS. Thank you.

Mr. Kunder, make your point now, sir.

Mr. KUNDER. I will save that one until later, sir.

Mr. SHAYS. No, don't save it. I want you to make it. I interrupted it. You can make two points.

Mr. KUNDER. In order to keep our folks focused on the need to do good planning and budgeting, the appropriations do have to come in a timely fashion. We just got the appropriations from 2006 based on by the time you go through the OMB apportionment and so forth. And so the folks out in the field who are trying to run real problems in the Bangladeshes and Afghanistans of the world who have gone through detailed budgeting processes then find that all of their planning has gone out the window. So I just want to link the important issue you are raising about planning with the appropriation cycle, sir.

Mr. SHAYS. Well, Mr. Kunder, I sleep with a woman who tells me the same thing. My wife happens to work in the Peace Corps and she says it does raise havoc, and she is not happy about it, and I take the heat for all of Congress.

Any other point you want to put on the record?

Mr. KUNDER. Mr. Waxman is not here to defend himself, but he said at the end of his statement we have to stop the waste, fraud, and abuse in Iraq. With all due respect, the folks who are out there now are risking their lives, and this is—I will quote SEGIR, the Inspector General for Iraq reconstruction has said repeatedly in his quarterly reports that for the last couple of years for the appropriated funds that are out there I know there are huge policy debates but there has not been massive waste, fraud, and abuse. Those folks who are out there are working under careful accountability rules. There is not massive waste, fraud, and abuse by the U.S. Government employees, Defense, State, and AID who are out there working in Iraq.

I am a Scythian creature, so I know there are big policy issues. That is different. But there is not massive waste, fraud, and abuse in Iraq.

Thank you, sir.

Mr. SHAYS. Fair enough. Thank you for making that point.

Mr. Roth.

Mr. ROTH. The only comment I would make in conclusion, a number of comments that address the accuracy and reliability of Defense data. I really would like to emphasize that the data we provide both in the budget justification material, itself, and in the accounting reports and financial management systems is, in fact, accurate and reliable.

And, going even further, we recognize room for improvement, as well, and we have very serious efforts that the senior leadership of the Department is very committed to, to improving the internal controls, improving reducing material weaknesses, and the like. So I just wanted to leave that as the Department's position.

Mr. SHAYS. Thank you, sir. Thank you very much.

Mr. Higgins.

Mr. HIGGINS. I think I would like to leave with one point, and that is that when we analyze costs and budgets I think we need to recognize the fundamental fact, and I think we have talked about it today that this is not a post-war reconstruction, this is a wartime reconstruction, that it is the front line of the war. The insurgents, a primary focus is to destabilize and keep essential services from being set up and keep the government from taking hold.

So when we talk about what we are doing on the developmental side, keep that in mind. It is a key part of the war on terror.

I think also when you realize we have lost over 500 contractors and 5,000 wounded and 2,000 attacks——

Mr. SHAYS. That is 500 contractors have been killed?

Mr. HIGGINS. Yes.

Mr. SHAYS. It is pretty amazing. Percentage-wise, that must be a huge number.

Mr. HIGGINS. Yes. And so I think Jim Kunder is absolutely right. We spend a lot of time criticizing, but nothing like this has ever happened in history. I was in Washington the weekend of the sniper and the place was empty. One sniper. This is a daily event for those people out there. So I think when we realize what they have been operating under, I think that, you know, rather than being too hard, we are very hard.

And I think the last point I want to make is that, having been out in Iraq for the time I have, I have had a chance to see you and we have made some presentations. I think you and a number of the Members, but particularly you, sir, you have your 13 trips. You have gone to places I don't think I would have the courage to go. We appreciate it.

I am speaking as someone who has spent a good deal of time out there and expect to be going back there again. We have developed a great deal of admiration, because the trick is you are asking the hard questions and you are demanding the accountability. One of the commitments I made when I took this job was to ask the hard questions and to demand accountability, so personally I want to thank you for the example you have set for all of us.

Mr. SHAYS. Mr. Higgins, you have made me a friend for life. Thank you. You are my friend for life. God bless you.

Mr. WALKER. Plus, he is a constituent and he can vote, too, Mr. Shays.

Three comments, one of which is based on——

Mr. SHAYS. See, I should be saying that about him.

Mr. Walker.

Mr. WALKER. One of which is based on your comment, Mr. Chairman. Again, I want to compliment you again for holding these oversight hearings. Iraqis need to do more to build bridges between Shiite, Sunni, and Kurds domestically. We, the United States, need to do more to build bridges and partner for progress internationally. And both the United States and the international community needs to do more to provide civilian technical assistance to help the Iraqis deliver results that the people will care about, whether they are Shiite, Sunni, or Kurd. All three of those I think are critically important and I stand by my prior recommendation.

Thank you, Mr. Chairman.

Mr. SHAYS. Thank you very much. It is a wonderful way to end this hearing with all of your comments. It is nice, Mr. Walker, to end with yours, in particular.

Thank you all very much. This hearing is now adjourned.

[Whereupon, at 5:30 p.m., the subcommittee was adjourned.]

[Additional information submitted for the hearing record follows:]

July 18th Hearing -- Response for the Record (pg. 89)

DOD provided GAO with a copy of its December 2005 Financial Improvement and Audit Readiness (FIAR) Plan and we reviewed that document. We also received and reviewed the limited FIAR Plan update that DOD prepared in June 2006. In addition, DOD has provided us with several briefings on its financial management improvement efforts. Based on the documents and briefings provided, DOD is systematically tracking its progress in addressing certain material weaknesses that were previously identified by auditors as being impediments to good financial management information and to auditability.

According to DOD, the FIAR Plan documents and briefings that we have received are high-level summaries of detailed individual military service and component plans that identify very specific tasks, systems and/or process solutions, and milestone dates for achieving those solutions. As such, we have not been provided with the level of detail necessary to evaluate the sufficiency of DOD's corrective action plans and the accuracy of its reported progress. Although we have requested access to the underlying service and component plans, DOD has not yet granted that access to us.

DOD is currently preparing another update of its FIAR Plan and we expect to receive that summary level document when it is final.

Insert for page 144:

CG statement: There were inadequate controls over cash resources, more information will be provided for the record.

Response:

Through its semi-annual audits of the DFI, the International Advisory and Monitoring Board has consistently reported inadequate controls over Iraqi cash resources. As recently as August 2006, IAMB reported that most ministries paid monthly salaries in cash and did not have proper controls to ensure that salaries were only paid to eligible employees. Specifically, IAMB found no controls to reconcile the number of employees listed on ministry financial records with the actual number of employees working. Furthermore, the auditors reported that Iraqi ministries did not prepare monthly reconciliation reports on the amounts paid by the Ministry of Finance and the amounts received by each ministry.

The IAMB further reported that the DFI's overall control systems were ineffective due to, among other reasons, the lack of written policy and procedures, trained staff, and an effective internal audit function. The audit report noted that the accounting, financial, information technology, internal controls, and management systems in use throughout the Iraqi government were out dated and not in-line with international best practice.

Insert for page 145

Question: CG agreed to clarify whether the $9 billion in unaccounted funds cited by Rep. Shays was Iraqi money.

Response: The $8.8 billion came from the Development Fund for Iraq – Iraqi resources derived from oil proceeds, UN oil for food program surplus funds, and seized assets returned to the Iraqi government. The Coalition Provisional Authority used DFI funds to pay Ministry salaries and operating costs, fund reconstruction projects, import fuel oil, and provide training and equipment for Iraqi security forces.

Insert for page 146

Question: Are Iraqi ministries still paid in cash?

Response: Yes.

James R. Kunder
July 18, 2006
Page 126
Line 2816

FOREIGN GOVERNMENT DONATIONS FOR IRAQ RECONSTRUCTION

At the October 2003 Madrid International Donors' Conference, donors other than the United States pledged over $13.5 billion in assistance for the reconstruction of Iraq. This amount included $8 billion in assistance from foreign governments and $5.5 billion in lending from the World Bank and International Monetary Fund (IMF) -- all to be disbursed between 2004 and 2007. Approximately $900 million in additional funds have been pledged by donors since the Madrid Conference.

As of June 2006, over $3.5 billion of the pledges of non-U.S. assistance had been disbursed; about $3 billion of this amount was from other donor governments, either in bilateral projects or through the World Bank and UN-administered International Reconstruction Fund Facility for Iraq (IRFFI).

OFFICE OF THE UNDER SECRETARY OF DEFENSE
(COMPTROLLER)

September 6, 2006

MEMORANDUM FOR MR. BRIGGS

Subject: HGR Hearing – July 18, 2006 – Accuracy of Cost estimates for War on Terror

Attached is the edited transcript (Mr. Roth's portion only) and inserts for the record for the above-mentioned hearing. This satisfies all for this hearing.

Thank You

Lucy Williams
(703) 571-9183

q:\ofcadmin\lucy\shrthgr doc

Hearing Date: Jul 18, 2006
Hearing: Accuracy of Cost Estimates for War on Terror
Member: Congressman Kucinich
Insert: (Page 67, Line 1339)

(The information follows):

Iraq Audits: $8.8 Billion

Issue: Perceived lack of accountability of $8.8 billion of Iraqi funds administered by Coalition Provisional Authority (CPA), in Iraq reconstruction efforts, based on a January 2005 audit.

Key Points:

- The Special Inspector General for Iraq Reconstruction (SIGIR) audit of $8.8 billion in Development Fund for Iraq (DFI) funds provided to Iraqi ministries concluded that the CPA "provided less than adequate controls" over those funds.

- These were not U.S. appropriated funds, but rather Iraqi money.

- CPA provided $8.8 billion to the Iraqi ministries, which used those funds to pay for Iraqi government salaries and pensions, for economic reconstruction and repair of infrastructure, and to meet the humanitarian needs of the Iraqi people.

- The SIGIR did not say that the $8.8 billion was missing or unaccounted for. The CPA properly accounted for the DFI funds disbursed to the Ministry of Finance and other Iraqi Ministries. After that, these funds were the responsibility of the Iraqi Ministries.

- Ambassador Bremer responded to the SIGIR audit by stating the "report suggests that the CPA should have delayed paying Iraqi public servants until it had fully modern pay records. This would have taken many months, if not years. More than a million Iraqi families depended on the Iraqi government for their salaries."

- He continues, "Not paying the civil servants would have been destabilizing and would have increased the security threat to Iraqis and to Americans. In brief, such a course would have cost lives."

- The CPA was acting under authority of the United Nations, which charged it with transferring to the Iraqis as much responsibility as possible, as quickly as possible.

- Before the handover, the CPA took a number of steps to improve the Iraqi Government's budgeting and financial management to include:

  - Establishing a functioning budget process;

  - Reestablishing Iraq's Board of Supreme Audit;

- Establishing Inspectors General in each ministry: and
- The USG is helping the Iraqis develop and implement a Financial Management Information System for the Ministry of Finance that, when complete, will provide the expenditure tracking called for by the audit.

Hearing Date: Jul 18, 2006
Hearing: Accuracy of Cost Estimates for War on Terror
Member: Congressman Platts
Insert: (Page 87, Line 1880)

(The information follows):

Office of Management and Budget Circular A-123, Management's Responsibility for Internal Controls, Appendix A: Internal Control over Financial Reporting Department of Defense FY 2006 Implementation Strategy

The Department of Defense (DoD) has been implementing A-123 for many years through an established infrastructure of assessable unit managers throughout the Department. Each of these assessable unit managers prepares an annual statement of assurance for the next higher level of management to support the annual Federal Manager's Financial Integrity Act Statement of Assurance for each DoD component and the Department as a whole.

This year, the Department added to its existing A-123 requirements, the requirements of Appendix A of the revised A-123 (December, 2004) using the existing infrastructure. The Department limited the scope of its implementation to 8 major focus areas which represented approximately 78 percent of DoD's assets and 48 percent of its liabilities. The focus areas were:

ASSETS	LIABILITIES
Funds Balance with Treasury	FECA Liabilities
Investments	Environmental Liabilities
Real Property	Medicare-Eligible Retiree Health Care
Military Equipment	

The eighth focus area, Appropriations Received, is not a balance sheet account. The Department plans to fully implement Appendix A by FY 2009 in consonance with the DoD Financial Improvement and Audit Readiness initiative.

The Department is committed to implementing Appendix A. It believes implementation can only lead to financial reporting improvements. In fact, the Department, as a result of its current implementation strategy, has already discovered and corrected weaknesses discovered during the testing process.

Hearing Date: Jul 18, 2006
Hearing: Accuracy of Cost Estimates for War on Terror
Member: Congressman Platts
Insert: (Page 91, Line 1959)

(The information follows):

SFIS provides an enterprise-wide standard for categorizing financial information along several dimensions to support financial management and reporting functions. These dimensions include: Appropriation Account, Budget Program, Organizational, Transaction, Trading Partner, and Cost Accounting information. SFIS is being implemented in phases.
Phase I is focused on 62 data elements necessary for financial reporting. Phase I requirements were defined in May 05 and implemented in the Business Enterprise Architecture (BEA) 3.0.
Phase II is focused on 3 additional data elements to support performance management. These elements have been deployed in the BEA 4.0.
Phase III is focused on cost accounting data elements and is being defined now. The definition process is being led by a governance team that is represented by every business area within DoD. Phase III is targeted to be complete by March 07 along with BEA 4.1.
Once SFIS elements are defined and incorporated in the BEA, systems must demonstrate compliancy. This is done through the Investment Review Board (IRB) process. As various legacy accounting, business feeder, and target accounting systems come through the IRB process they are required to be SFIS compliant. At minimum, systems must provide an implementation plan and complete a compliance checklist.

Hearing Date: Jul 18, 2006
Hearing: Accuracy of Cost Estimates for War on Terror
Member: Congressman Shays
Insert: (Page 141, Line 3194)

(The information follows):

L Paul Bremer was compensated approximately a total of $213,853 over FY03 and FY04. This is an approximation because the records only hold data for FY04. FY03 data is approximated based on his date of appointment of May 9, 2003, and his compensation per pay period reflected during FY04.

He was hired as a "3161" employee pursuant to 5 U.S.C. 3161, which authorizes the hiring of temporary employees for temporary organizations, like the Coalition Provisional Authority. His base salary at hire was set at $142,500 per FY, however as an employee in theater he was also eligible for additional pays such as Danger Pay and Holiday Pay.

Hearing Date: Jul 18, 2006
Hearing: Accuracy of Cost Estimates for War on Terror
Member: Congressman Shays
Insert: (Page 143, Line 3232)

(The information follows):

The United States Army provided US Dollar cash assets to the Coalition Provisional Authority and subsequently, the Iraqi Interim Government, comprised primarily of Development Funds for Iraq (DFI) and, to a much smaller extent, seized assets confiscated from the prior Iraqi regime.

DFI funds were provided in cash from special United Nations accounts at the New York Federal Reserve to the Army at Andrews Air Force Base. It was then transshipped by Air Force cargo jet with an Army courier to Iraq. Funds were then turned over to the CPA for further use in support of the Iraqi people. This involved billions of dollars in physical cash, which were all newly minted bills in sealed Treasury bricks on pallets. There was a complete chain of custody from the Federal Reserve through the Army to the CPA. No funds were ever lost or unaccounted for in this process. Funds within the control of the Army were secured and/or guarded throughout the process. These funds were never on the official accounting records of the US Treasury as the Army operated simply as a courier between the Federal Reserve and the CPA.

Seized assets were turned in to Army finance offices upon discovery and immediately recorded in the accountability of the disbursing officer. Using a Treasury designated deposit account, funds were held by the disbursing officer in Kuwait until disbursed to a representative of the CPA as duly authorized by an appointed certifying official. An audit of the seized assets by the Army Audit Agency found "that the Army did properly secure and account for seized cash and metal bars".

DRAFT

U.S. Army Audit Agency

Audit of Vested and Seized Assets, Operation Iraqi Freedom

XX October 2004
Audit Report: A-2005-XXXX-FFG

DRAFT

DEPARTMENT OF THE ARMY
U.S. ARMY AUDIT AGENCY
Office The Auditor General
3101 Park Center Drive
Alexandria, VA 22302-1596

XX October 2004

Under Secretary of Defense (Comptroller)
Inspector General, Coalition Provisional Authority
Commander, 336th Finance Command

This is our report on the audit of Vested and Seized Assets in support of Operation Iraqi Freedom. We performed the audit at the request of the Deputy Assistant Secretary of the Army (Financial Operations) to determine if there were adequate controls and procedures in place and operating to secure and account for vested and seized assets.

We address recommendations to the Under Secretary of Defense (Comptroller) and the 336th Finance Command. We have previously provided the Inspector General, Coalition Provisional Authority with some suggestions in a prior report so that it could take appropriate action. We also provided the Inspector General's Office some additional suggestions in this report.

During our review, we issued a time sensitive report to the Inspector General, Coalition Provisional Authority resulting from a situation needing immediate corrective action.

This report is subject to the command-reply process prescribed by Army Regulation 36-2. We will establish the Army's official position on the conclusions, recommendations and command comments addressed to Army activities in objective B. The official position on conclusions, recommendations and command comments in objective A will be done with the Department of Defense.

I appreciate the courtesies and cooperation extended to us during the audit.

JOYCE E. MORROW
The Auditor General

For more information about this audit, please call the Financial Operations Division at (703) 681-9766. For extra copies of this report, please call (703) 681-9863.

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Were adequate procedures and controls in place and operating to properly secure and account for vested and seized assets?

Not completely. While adequate procedures and controls were in place and operating for the seized cash, similar procedures and controls were not in place and operating to properly secure and account for non-cash seized assets such as jewelry, automobiles and other assets belonging to the former Iraqi regime. These assets were not properly inventoried, accounted for and secured.

B – Audit Trail 18

Did adequate audit trails exist to support the on hand balance of the vested and seized asset accounts?

No. Adequate audit trails did not exist to support the on hand balance of the vested and seized asset accounts. Our review found that the Comptroller's Office, Coalition Provisional

Authority didn't perform required reconciliations of the on hand balance in the vested and seized asset accounts. Also, the 336th Finance Command needed to reorganize its filing area to allow for reasonable access to official documents supporting the audit trail for the vested and seized accounts.

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INTRODUCTION

WHAT WE AUDITED

At the request of the Deputy Assistant Secretary of the Army (Financial Operations), we audited the controls and procedures for vested and seized assets in support of Operation Iraqi Freedom. We focused on evaluating whether established procedures, controls and audit trails were in place and operating to effectively secure and account for these assets.

OBSERVATION

There were some extenuating circumstances related to the operational environment that may have limited the ability of the Coalition Provisional Authority and the Army to effectively implement the DOD Guidance on vested and seized assets.

- Unknown quantities of assets were seized prior to the 31 July 2003 guidance; these items were not inventoried, accounted for, or secured. Consequently, significant quantities of these assets were possibly lost due to looting and/or destruction of the storage sites during 2003 and 2004.
- Combat officially ended in May 2003; however, significant hostilities have continued to date.
- Significant personnel turnover has been experienced in theatre due to troop rotations.

In making recommendations, we put our results in the context of this environment.

RESULTS IN BRIEF

We found that the Army did properly secure and account for seized cash and metal bars. However, the Coalition Provisional Authority and Coalition Forces didn't maintain adequate controls over the majority of non-cash seized assets belonging to the former Iraqi Regime.

During the audit, numerous non-cash assets were found unaccounted for and in some instances unprotected. Further, the Army didn't always maintain adequate controls upon receipt of non-cash seized assets that were turned over for safekeeping.

The Coalition Provisional Authority and Coalition Forces didn't maintain adequate controls to make sure that non-cash seized assets were properly accounted for and secured. As a result, there was generally no accountability over the non-cash-seized assets and the assets were at risk for looting, destruction, and theft.

Our review also examined whether the audit trail for vested and seized assets supported the on hand balance. Our review found that adequate audit trails didn't exist to support the on hand balance in the vested and seized asset accounts. The Coalition Provisional Authority's Comptroller's Office didn't perform required reconciliations on its account balances for vested and seized funds with the Defense Finance and Accounting Service and the Department of Treasury records. We also found that the Army didn't maintain a filing area suitable to reasonable access to official documents that support disbursements from the vested and seized asset accounts, and needed to develop standing operating procedures to better emphasize a proper audit trail.

As a result, more funds could be spent than allocated and insufficient support was maintained to show the accuracy, completeness, and timeliness of all transactions. Despite these problems, we were able to find evidence that these transactions were being used for the benefit of the Iraqi people. We also found that the Defense Finance and Accounting Service and the Army were making improvements in meeting the 24 hour time period to record transactions using vested and seized funds.

BACKGROUND

President Bush issued an Executive Order on 20 March 2003, stating that it was in the interest of the United States to confiscate certain property of the Government of Iraq and its agencies, instrumentalities, or controlled entities, and that all right, title, and interest in any property so confiscated should vest in the Department of the Treasury. He also stated that such vested property should be used to assist the Iraqi people and to assist in the reconstruction of Iraq.

The United Nations also issued orders for seizing and vesting of assets of the former Iraqi regime. Security Council Resolution number 1483 dated

22 May 2003 states that all Iraqi assets being held in member states of the Security Council will be frozen, without delay, and held for the use of the reconstruction of Iraq.

Coalition Provisional Authority Orders 2 and 4 and Memorandum 7 provide overall guidance on the intent of how to manage real property and seized assets. The overall intent for the orders and memorandum were to hold assets on behalf and benefit of the Iraqi people, and to use those assets for the recovery of Iraq.

- Coalition Provisional Authority Order 2 "Dissolution of Entities," dated August 23, 2003 dissolves Iraqi entities and directs all assets to be held by Coalition Provisional Authority on behalf and benefit of the Iraqi people and to be used to assist in the recovery of Iraq.
- Coalition Provisional Authority Order 4 "Management of Property and Assets of the Baath Party," dated May 25, 2003 directs that all assets of the Baath Party be subject to seizure on behalf and benefit of the Iraqi people.
- Coalition Provisional Authority Memorandum 7 "Delegation of Authority under De-Baathification," dated November 4, 2003 empowers the Iraqi governing council to coordinate with Coalition Provisional Authority to seize and manage property and possessions of the Baath party.

The Under Secretary of Defense (Comptroller) issued a 31 July 2003 memorandum on vested and seized Iraqi property that provides the procedures for administering, using and accounting for vested and seized Iraqi property. This memorandum directed the Coalition Provisional Authority and Coalition Forces to use the appendices provided in the memorandum in their management and accounting of vested and seized Iraqi property.

The Defense Finance and Accounting Service Regulation 37-1, dated 25 January 2000, provides procedural guidance for accounting, travel and vendor pay for all levels of resource management. It also includes, but is not limited to, guidance covering administrative control of funds, managerial accounting, and reporting requirements to meet fiduciary accounting requirements.

OTHER MATTERS

Time Sensitive Report

During our audit we determined that the potential for a serious problem existed with the accountability and security of non-cash seized assets. We issued a time sensitive memorandum report (A-2004-0305-FFG) to the Inspector General, Coalition Provisional Authority in order to elevate our results so that appropriate corrective action could be taken immediately. The Inspector General, Coalition Provisional Authority used this information in conjunction with its review of the controls over seized and vested assets. The Inspector General's Office found that the Facility Management Office personnel didn't adequately manage, secure and safeguard seized non-cash assets. The Inspector General's conclusions and recommendations to correct the problems are shown in its audit report, "Coalition Provisional Authority Control over Seized and Vested Assets", Report Number 04-008 dated July 28, 2004.

RESPONSIBILITIES

The Coalition Provisional Authority had overall responsibility for Humanitarian Assistance in Iraq. It directed the rebuilding of Iraq and had overall authority to expend the resources of the old Iraqi regime to include all vested and seized assets. They also had the responsibility of implementing the guidance issued by the Under Secretary of Defense (Comptroller) in Iraq.

The Under Secretary of Defense (Comptroller) at the direction of Congress was tasked with the overall responsibility for creating and issuing guidance on procedures and controls for seizing, securing and accounting for vested and seized assets in support of Operation Iraqi Freedom.

The Department of the Army is the fund holder and the executive agent for vested and seized assets. It is responsible for implementing guidance issued by the Under Secretary of Defense (Comptroller).

The Defense Finance and Accounting Service is responsible for inputting vested and seized transactions into the Standard Finance System, in support of Operation Iraqi Freedom. It is responsible for reconciling the balance of the vested and seized asset accounts in the system to the balance maintained by the Department of the Treasury.

The 336th Finance Command provides command and control of all finance elements supporting Operation Iraqi Freedom/Operation Enduring Freedom. It directs theater finance policy; provides central funding and payroll support; and executes procurement, accounting and internal control support for all theater finance units. It also serves as the single responsible finance and operations authority.

OBJECTIVES, CONCLUSIONS, RECOMMENDATIONS AND COMMENTS

A - PROCEDURES AND CONTROLS

OBJECTIVE

Were adequate procedures and controls in place and operating to properly secure and account for vested and seized assets?

CONCLUSION

Not completely. We found there were adequate procedures and controls in place to account for seized cash assets and in one situation a non-cash asset (metal bars). However, there weren't adequate procedures and controls in place and operating to properly secure and account for the majority of the non-cash seized assets.

This condition occurred because most assets were seized prior to the 31 July 2003 guidance on accountability of vested and seized assets. And because the Coalition Provisional Authority and Coalition Forces had not established controls to make sure policies and procedures developed for managing vested and seized assets were followed. Therefore,

- Seized non-cash assets within Iraq were not inventoried and accounted for.
- Chain of custody for many of the items was not properly performed and accountability was lost.

As a result, these assets were at high risk for looting, destruction or theft. Further, this condition could result in financial claims against the Coalition Provisional Authority and Coalition Forces, and adverse publicity that could hinder the accomplishment of long-term goals. Our detailed discussion on these conditions starts on page 12. Our recommendation starts on page 17

BACKGROUND

The Under Secretary of Defense (Comptroller) 31 July 2003 memorandum on procedures for vested and seized Iraqi property provides the procedures for administering, using, and accounting for vested and seized Iraqi property. Appendix B of this memorandum addresses the duties, responsibilities, and procedures to be followed by Coalition Forces, upon discovery, possession, seizure, or receipt of property in Iraq. This guidance augments existing Military Department regulations for receipt, control, inventory, and disposition of property.

DISCUSSION

In this section we discuss:

- Procedures and controls over seized cash and metal bars.
- Procedures and controls over non-cash seized assets.

Procedures and Controls over Seized Cash and Metal Bars

The Army followed procedures and controls and properly secured and accounted for cash and gold-like metal bars that were seized by the Coalition Forces.

We reviewed the procedures and controls in place to ensure these assets were properly secured and accounted for. We also inventoried the items, reviewed the chain of custody documents for these assets from time of seizure to receipt by the Army, and reviewed overall controls of the vault where the Army secured these assets.

Cash Assets

The Army properly secured and accounted for seized cash.

Coalition Forces seized about $926.8 million of cash belonging to the former Iraqi regime during FY 03 and FY 04. Coalition Forces delivered the seized cash to the nearest finance activity for safekeeping. The finance office would prepare a Cash Collection Voucher, which was

forwarded to the 336th Finance Command at Camp Arifjan, Kuwait so the accountability of the cash could be established in the Army's accounting system.

To determine if the Army had sufficient procedures and controls in place over cash assets, we reviewed the procedures and controls that the 336th Finance Command had in place to secure and account for its cash. We found that the Finance Command secured all cash assets in their main vault under armed guard at all times. Controls over the security of the vault were in accordance with the DOD Financial Management Regulation and we found no operating deficiencies.

On 10 April 2004, we performed an inventory of all cash that was secured in the vault and compared this inventory to command's accountability record for its on hand balance in that vault. Our inventory identified that the Finance Command physically had $101.5 million in cash in the vault. This balance was in agreement with command's accountability record.

We also verified that there was an independent cash verification team conducting cash counts, at least quarterly, in accordance with the DOD Financial Management Regulation. The last cash verification was conducted on 28 March 2004 and no deficiencies were noted.

Based on the results of our review, we concluded that at the time of our review the Army did have adequate controls to account for and secure seized cash.

Metal Bars

The Army properly secured and accounted for gold-like metal bars that were seized by the Coalition Forces and transferred to the Army because they were thought to have value.

The Army received about 3,350 gold-like metal bars between May and June 2003 The Commander of the 336th Finance Command had these bars inventoried and secured. Further, since these bars were believed to be of value the Commander also requested an analysis of the metal bars by the Under Secretary of Commerce and Industry, Department of Valuable Metals of Kuwait in June 2003 to determine their value. The test results showed that the bars were made from a wide variety of metals, the most common being copper, zinc, iron, and a small amount of gold.

Based on the analysis reports provided by the Under Secretary of Commerce and Industry in Kuwait, the Army determined that the gold

like metal bars had limited value. However, the Coalition Provisional Authority informed the Army that they were responsible for these bars until such time as they could be turned over to the new sovereign government of Iraq.

The metal bars were secured in the same vault as the cash and were stored in 39 separate wooden crates and 5 plastic boxes. Each listed the number of metal bars that were in them. We totaled all of the bars listed and it agreed with the number (3,350) that were seized and turned over to the Army by the chain of custody documents. Further, we conducted an inventory on a judgmental sample of 13 of the 44 boxes and/or crates to verify if the number of metal bars listed were the number of bars that the box or crate contained. We found only a couple of slight differences in the counts (plus or minus one or two), but nothing that would warrant special attention. We made sure that all parties involved in the inventory (two auditors and a representative from the 336th Finance Command) were in agreement on the number of metal bars and changed the count on each box or crate affected.

Based on the results of our review, we concluded that the Army did have adequate controls to account for and secure these bars until they can be turned over to the new sovereign government of Iraq.

Procedures and Controls over Non-Cash Seized Assets

The Coalition Provisional Authority and the Army didn't have adequate procedures and controls to account for the majority of non-cash seized assets.

During our review, we found supporting documentation showing that the 336th Finance Command had received seized jewelry that belonged to the former Iraqi regime. These assets were subsequently transferred to the Coalition Provisional Authority in Iraq for safekeeping. Personnel from the Coalition Provisional Authority Comptroller's Office also informed us that there may be other assets belonging to the former Iraqi Regime located in the Presidential Palace in Iraqi that may not be properly secured and accounted for.

To determine the quantity and status of the non-cash seized assets we requested assistance from the Coalition Provisional Authority Inspector General's Office to conduct inventories of all non-cash seized assets maintained in Iraq (the increased hostilities during April 2004 prevented us from traveling to Iraq).

Based on this review, we determined that serious problems potentially existed with the accountability over the majority of non-cash seized

assets belonging to or potentially belonging to the former Iraqi Regime. Specific problems were:

- Auditors found that the seized jewelry was secured by the Coalition Provisional Authority, but was not accounted for at the time of the audit. The 336th Finance Command reported doing an inventory and documenting 861 bags of jewelry after combat units seized the jewelry in May and June 2003. The command, however, didn't follow the DOD guidance and establish proper accountability over the jewelry. The guidance requires that the unit receiving the seized assets do an inventory, include the specific date of the inventory, and certify that the inventory represented the actual count and description of the assets seized by the combat units. The Finance Command started with an inventory and documentation of individual pieces of jewelry. However, when it physically transferred the jewelry back to the Coalition Provisional Authority in Iraq in October 2003, it transferred the jewelry collectively as five boxes of jewelry. Accountability for individual pieces was lost. The Coalition Provisional Authority Inspector General performed an inventory on 25 April 2004, but could not locate 86 numbered bags that were included in the description of individual items that the 336th Finance Command had documented in October 2003.

- The Coalition Provisional Authority Inspector General's Office found numerous items belonging to the former Iraqi regime throughout the compound and in other locations in Baghdad. These assets had not been inventoried since the Coalition Forces took control of the locations. Further, no controls existed to ensure that these assets were accounted for and were properly stored to prevent loss or damage. Although the work of the Inspector General's Office included only observations on assets within the Presidential Palace compound and one other location in Baghdad, responsible officials from both the Inspector General's Office and the Comptroller's Office told us that the lack of accountability over seized non-cash assets was pervasive throughout the country of Iraq.

The Coalition Provisional Authority Inspector General took the initiative to conduct inventories, so the Coalition Provisional Authority could establish accountability for some of these assets that it believed to be of value. For example, the auditors found a number of vehicles. The auditors inventoried the vehicles and had Coalition Provisional Authority officials establish accountability for:

VEHICLE INVENTORY	
Year	Make
1936	Daimler Benz
1931	Bentley
1956	Bentley
1932	Rolls Royce
1957	2 each, Cadillac Fleetwood
1958	Lincoln Continental Convertible
Unknown	2 each, Horse-Drawn Coaches
Unknown	Pontoon Bike
Unknown	Three Wheel Bicycle Taxi
Unknown	3 each, Kia Galloper II v6 4WD Wagon
Unknown	Rolls Royce
Unknown	Mercedes Benz
Unknown	Jaguar P2574
Unknown	2 each, Cadillac Fleetwood

These conditions first occurred because most assets were seized prior to the 31 July 2003 DOD guidance on accountability for vested and seized assets and during elevated levels of hostilities in Iraq. After the guidance was issued, the Coalition Provisional Authority and Coalition Forces had not established controls to make sure that the DOD guidance on taking custody of, accounting for, and securing non-cash seized assets was followed. Guidance wasn't followed because of the volume of assets, the inability to account for missing assets, and other priorities.

Without accurate accountability and proper security for these seized assets, they are at a high risk for looting, destruction, or theft. This could lead to not only financial claims against the Coalition Provisional Authority and Coalition Forces, but also lead to adverse publicity that could hinder accomplishment of long-term goals.

Because of the potential serious nature of this problem and the nearness of the hand over of control to the Iraqi government we issued a time sensitive report (A-2004-0305-FFG) dated 18 May 2004 to the Coalition Provisional Authority Inspector General. We suggested that the Coalition Provisional Authority implement the DOD guidance by developing a plan for establishing accountability for all non-cash seized assets being held by the Coalition Provisional Authority. By developing a plan, the Coalition Provisional Authority can work with Coalition Forces to identify, account for, and secure these assets that must be returned to the Iraqi people. The plan should include as a minimum:

- Establishment of a baseline inventory.
- Assignment of accountable officers for the inventory.
- Use of a property accountability record system that includes at least the description of the items, the quantity, and the location.

The Inspector General, Coalition Provisional Authority used our results and suggested actions in conjunction with its review of the controls over seized and vested assets. During its review, the Inspector General's Office found that Facility Management Office personnel at the Coalition Provisional Authority didn't adequately manage, secure and safeguard seized non-cash assets. The Inspector General's Office issued recommendations (similar to our suggestions) in its report ("Coalition Provisional Authority Control Over Seized and Vested Assets", Report Number 04-008 dated July 28, 2004) to correct the problems with accountability and security over non-cash seized assets.

In addition, since the lack of guidance on how to account for these assets at the time of the earlier seizures was a contributing factor in this problem, DOD needs to finalize its guidance on accountability of vested and seized assets and include it as part of a financial regulation. This will codify the procedures in Defense Financial Management Regulations should any similar situations arise in the future.

We address the need to include guidance in the Financial Management Regulations in Recommendation A-1.

RECOMMENDATION AND COMMENT

This section contains a specific recommendation.

Under Secretary of Defense (Comptroller)

A-1 **Recommendation:** Incorporate the 31 July 2003 memorandum on procedures for vested and seized assets as a permanent part of the DOD Financial Management Regulation to ensure guidance will be available for future contingency operations.

Command Comments: (To be added.)

B - AUDIT TRAIL

OBJECTIVE

Did adequate audit trails exist to support the on hand balance of the vested and seized asset accounts?

CONCLUSION

No. We found that adequate audit trails didn't exist to support the on hand balance in the vested and seized asset accounts. Specifically:

- The Coalition Provisional Authority didn't perform the required reconciliations with the Defense Finance and Accounting Service and the Department of the Treasury.
- The 336th Finance Command didn't maintain a filing area suitable for reasonable access to official documents and needs to better emphasize the necessity for a proper audit trail.

Therefore, the Army didn't maintain sufficient supporting documentation for disbursements made from the vested and seized accounts. As a result of these weaknesses, there was an increased risk of overspending by the Coalition Provisional Authority. Despite these problems, we were able to find evidence that these transactions were being used for the benefit of the Iraqi people. We also found that the Defense Finance and Accounting Service and the Army were making improvements in the 24 hour time period required to record transactions using vested and seized funds.

Our detailed discussion on these conditions starts on page 19. Our recommendations start on page 25.

BACKGROUND

Under Secretary of Defense (Comptroller) 31 July 2003 memorandum, Appendix E requires the 336th Finance Command to e-mail scanned

vouchers to the Defense Finance and Accounting Service–Rome on a daily basis. This appendix also requires the Coalition Provisional Authority and Defense Finance Accounting Service to conduct a joint reconciliation of commitments and obligations in accordance with the DOD Financial Management Regulation, Volume 3, and Defense Finance Accounting Service-Indianapolis Regulation 37-1.

DOD Financial Management Regulation requires that DOD Components (Defense Finance and Accounting Service Customers) ensure that audit trails are maintained in sufficient detail to permit tracing of transactions with a unique identity from their sources to their transmission to the Defense Finance and Accounting Service. This is necessary to demonstrate the accuracy, completeness, and timeliness of a transaction, as well as to provide documentary support, if required, for all data generated by the DOD Component and submitted to the Accounting Service for recording in the accounting systems and use in financial reports.

DOD Financial Management Regulation also requires Finance Offices to retain original records for a 6-year 3-month period as provided in the National Archives and Records Administration. This affects offices who receive payment or collection transactions, or who transmit financial reports, without regard to whether such records are paper or electronic copies. When such records are electronic, these requirements apply, regardless of whether the original supporting documents are maintained at the source (preparing) office or at the disbursing office.

DISCUSSION

In this section we discuss:

- Required reconciliations
- Access to documentation
- Timeliness of transactions

Required Reconciliations

The Coalition Provisional Authority didn't perform the required reconciliations of its vested and seized asset account balances with the Finance Service and the Department of Treasury records as required.

The Finance Service reconciles its commitments and obligations on a daily basis for vested and seized accounts with the Standard Army Finance System. However, at the time of our review the Coalition Provisional Authority Comptroller's Office wasn't performing reconciliations of its account balances to the financial system's records. Without this reconciliation, Coalition Provisional Authority didn't know the actual balance of available funds and risked over spending its allocated funds.

During our discussions with the Comptroller's Office on its processes, procedures and on hand balance we became aware that the Comptroller's Office was unsure of the exact balance in its vested and seized accounts. In fact, the Office requested that, as part of our audit, we perform a review of the Document Control Record. The Coalition Provisional Authority uses this record similar to a checkbook; it is used to record all allocations, obligations and disbursements of vested and seized funds. Since the Coalition Provisional Authority didn't perform the required reconciliations with the Finance Service and the Department of Treasury, the Document Control Record was the only source that showed the Coalition Provisional Authority Comptroller the amount of available funds in the vested and seized accounts.

Our review of this record did not identify any overspending, however, it did disclose 7 transactions that did not appear to have adequate support for the entry and also did not appear in the Army's financial system. These transactions appear in the chart below.

Unsupported Transactions as of 28 April 2004

	Allocation	Obligation	Disbursement
PRB 28	$ 400	$ 400	$ 400
PRB 29	$ 150,000	$ 150,000	$ 150,000
PRB 106	$ 603	$ -	$ -
PRB 132	$ 100	$ -	$ -
PRB 174	$ 22,500	$ -	$ -
PRB 406	$ 400,000	$ 400,000	$ 400,000
PRB 445	$ 1,300,000	$ -	$ -
TOTALS	**$ 1,873,603**	**$ 550,400**	**$ 550,400**

PRB = Program Review Board in Iraq

We discussed our results with the Coalition Provisional Authority Comptroller's Office and told responsible personnel that based on our work, these transactions weren't valid and should be added back to the available balance of vested and seized funds. The Comptroller's Office indicated that it believed our findings were correct and that it would perform the necessary research to validate.

Any remaining balance in the vested and seized accounts will have to be turned over to the new sovereign Iraqi government . We, therefore, suggested that the Comptroller's Office validate the balance of its Document Control Record by working with the Finance Service to perform the required reconciliation with the account balances for vested and seized assets maintained by the Finance Service and the Department of Treasury.

Access to Documentation

The 336th Finance Command didn't maintain a filing area, which provided adequate access to documentation supporting disbursements from the vested and seized accounts.

DOD Financial Management Regulation requires that, at a minimum, the following documents must be maintained:

- Disbursement and collection vouchers including supporting documents.
- Appointments and revocations of accountable individuals.

- Any other document, record, log or electronic file that supports disbursing transactions or affects the accountability of the disbursing officer.

To test whether the Army maintained adequate documentation to support the disbursements from the vested and seized accounts, we obtained a random sample of 120 disbursement transactions that were recorded in the financial system during the period November 2003 to February 2004. We attempted to obtain the disbursement voucher and all attached supporting documentation for each transaction from the 336th Finance Command's filing area.

We had a difficult time locating the majority of the disbursements vouchers in our sample because the Finance Command did not maintain a filing area that provided reasonable access to the stored documents. Specific problems we identified were:

- Numerous files had not been moved from boxes to available filing cabinets.

- Boxes containing files were not labeled.

- The contents of many boxes were misfiled.

After a considerable length of time (about two weeks) and with the help of several Finance Command personnel we were able to obtain disbursement vouchers for 108 transactions. Documentation for the remaining 12 transactions could not be located at the 336th Finance Command. We, however, were able to obtain the disbursement vouchers for the 12 missing transactions from the Defense Finance and Accounting Service–Rome to complete our sample of 120 transactions.

After we obtained the disbursement vouchers and all attached supporting documentation, we conducted a review to determine if the minimum documentation required by the DOD Financial Management Regulation was met for maintaining an adequate audit trial for these financial transactions. Our review found that:

- 59 of the 120 transactions (49%) had sufficient documentation attached to the disbursement voucher to support the payment.

- 33 of the 120 transactions (28%) had some support attached to the disbursement voucher but not sufficient to substantiate that the payment was made.

- 28 of the 120 transactions (23%) did not have any required supporting documentation attached to the disbursement voucher.

During the audit we discussed our results with responsible Finance Command personnel and told them that improvements were necessary to maintain sufficient documentation for disbursements made from the vested and seized accounts. We also provided some recommendations to help the command better emphasize this need:

- Develop a standard operating procedure for filing documents in theater that lists all required documents that must be retained to support disbursement transactions.

- Maintain a filing area suitable for retention and retrieval of all required supporting documentation.

Command agreed that improvements were necessary and indicated that they had begun to take corrective action during the audit. Specifically, the Finance Command began to purge files and reorganize its filing area and also drafted a Standard Operating Procedure that listed the required documentation that must be maintained.

We believe the Finance Command's actions will improve its ability to retrieve official documents and will provide for the maintenance of an adequate audit trail in the future.

We address the actions we recommended to the 336th Finance Command in Recommendations B-1 and B-2.

In addition to the above, we reviewed the description of the goods or services purchased listed on the disbursement vouchers to verify the purchases were for the benefit of the Iraqi people. If we didn't have adequate documentation on the disbursement voucher we reviewed the description of the transaction on the Coalition Provisional Authority's Document Control Record. Our results found that all 120 transactions in our sample were made for the benefit of the Iraqi people.

Timeliness of Transactions

The Defense Finance and Accounting Service and the Army were making improvements in meeting the 24 hour time period to record transactions using vested and seized funds.

We reviewed the timeliness of transactions for these assets to follow up on a condition identified by Defense Finance and Accounting Service Internal Review. In its report (Report Number IN03PAA054ROM Iraq Accounting at DFAS Rome DSSN 8551 August – October 2003) The Internal Review Office identified that the Finance Service was not

receiving the scanned transaction documents from the Army disbursing station in Kuwait on a daily basis. Consequently, this resulted in a condition where the Finance Service was not recording transactions using vested and seized funds in a timely manner. Further, the report identified that the Finance Service was not consistently following up with the Army when vouchers were not received. To correct this condition, the Finance Service developed an action plan to better communicate with the Army disbursing station in Kuwait when transaction vouchers were not received. This plan included:

- Requiring the Army to send the Finance Service scanned documentation of transaction involving vested and seized funds prior to the receipt of the hard copy.

- Requiring the Finance Service to record transactions using vested or seized funds within 24 hours of their receipt.

- Establishing more frequent communication between the Finance Service and the 336th Finance Command.

To determine whether the Finance Service's plan was implemented and was effective we randomly sampled 82 transactions processed during November 2003 to February 2004 (after the action plan was implemented). Our review identified that the Finance Service did implement its action plan and that the plan was effective. We found that the Finance Service was contacting the Army disbursing station when transaction vouchers were not received. This communication was effective as the Army disbursing station in Kuwait was generally scanning all vested and seized transaction vouchers and sending them to the Finance Service as required. We also found that 50 (about 61 percent) of these transactions were recorded within the established 24-hour period. Of the remaining balance, we found that another 18 percent were processed within 3 days; while not meeting the 24-hour goal, these transactions were recorded in significantly less time than the average of 11.7 days as the Finance Service's Internal Review reported. The remaining transactions that went beyond this time period were transactions by non-Army activities that were recorded by another finance activity and not within the control of Defense Finance and Accounting Service-Rome.

While working in Kuwait, we also tested the Army disbursing station's (Disbursing Station Symbol Number 8551) timeliness in recording transactions. Documentation wasn't available to determine the processing time for our original sample (November 2003 – February 2004). Therefore, we reviewed 89 judgmentally selected commercial vendor transactions that were processed during the period April through May 2004 (these transactions are processed in an identical manner as

transactions using vested and seized assets). It took Army finance personnel about 4 days from the time the vouchers arrived at the disbursing station to enter the transactions in the financial system. We found this to be a reasonable time and concluded overall that vested and seized transactions were being processed timely.

However, due to personnel rotations at the Finance Command, the practice of scanning vested and seized vouchers to the Finance Service was no longer being performed. We brought this requirement to the attention of the 336th Finance Command and informed them that this oversight could soon begin to delay the processing of transactions and may affect the accuracy of the account balances. Senior leadership at the Finance Command stated that they were unaware of the requirement, however, after being informed of the problem they took immediate action to re-implement this procedure. All vouchers were being scanned and sent to the Finance Service on a daily basis upon our departure from Kuwait.

We address the actions we recommended to the 336th Finance Command in Recommendation B-3.

RECOMMENDATIONS AND COMMENTS

This section contains specific recommendations and a summary of command comments for each recommendation. Verbatim command comments are in Annex C.

Commander, 336th Finance Command

B-1 **Recommendation:** Develop a standard operating procedure for filing documents in theater that lists all required documents that must be retained to support disbursement transactions.

Command Comments: Command agreed and stated that it has established standard operating procedures for the central funding activity, for the paying agent and the disbursing agent. These standing operating procedures all include the list of required documents to support disbursements/claims/payments. The standing operating procedures also describe the necessary steps to clear the vouchers and forward them to the Central Funding Disbursing Officer for proper filing. These SOPs were issued in June 2004.

Agency Evaluation of Command Comments:

B-2 **Recommendation:** Establish controls and procedures to maintain a suitable area for retaining all required supporting documentation for disbursement transactions.

Command Comments: Command agreed and stated that it has reorganized the entire filing room and system. Command added that during the reorganization it found and filed over 99 percent of the required documents, it has purchased filing cabinets and are currently storing and safeguarding all disbursing vouchers. Action on this recommendation was completed by 30 October 2004.

Agency Evaluation of Command Comments:

B-3 **Recommendation:** Make sure that all disbursement vouchers for transactions using vested and seized assets are scanned and sent to Defense Finance and Accounting Service-Rome on a daily basis.

Command Comments: Command agreed and stated that immediate action was taken during the audit and as of 30 April 2004 all disbursement vouchers using vested and seized funds are being sent to the Defense Finance and Accounting Service on a daily basis.

Agency Evaluation of Command Comments:

Official Army Position:

ANNEXES

AUDIT SCOPE AND METHODOLOGY

We performed the review:

- From February through May 2004.
- In accordance with generally accepted government auditing standards and reviewed the management controls that we considered necessary under the circumstances.
- At the locations listed in Annex B.

We reviewed:

- Vested and seized asset balance and examined the processes, procedures, and controls related to securing, accounting for and disbursing these assets.
- Source documentation to ensure vested and seized assets were used for the benefit of the Iraqi People.

We also:

- Conducted inventories of seized assets (cash and non-cash) in Kuwait. We requested assistance from the Coalition Provisional Authority Inspector General to conduct inventories of non-cash assets in Iraq when increased hostilities in April 2004 prevented our staff from traveling to Iraq.
- Interviewed key officials responsible for securing, accounting for, and disbursing vested and seized assets.
- Compared financial system data to source documents to determine the reliability of the automated data. We found the data was reliable for the purpose of answering our objectives for this audit.

ANNEX B

ACTIVITIES INCLUDED IN THE AUDIT

Coalition Provisional Authority, Comptroller's Office

Defense Finance and Accounting Service-Indianapolis

Defense Finance and Accounting Service-Rome

336th Finance Command

- Camp Doha, Kuwait
- Camp Arifjan, Kuwait

ANNEX D

OFFICIAL ARMY POSITION/VERBATIM COMMAND COMMENTS

Official Army position will be included when received.

DRAFT

ANNEX D

DEPARTMENT OF THE ARMY
HEADQUARTERS, 336TH FINANCE COMMAND
CAMP ARIFJAN, KUWAIT
APO AE 09366

REPLY TO
ATTENTION OF

336th FI

7 November 2004

MEMORANDUM FOR U.S. Army Audit Agency, Office of the Deputy Auditor General, Forces and Financial Management, 3101 Park Center Drive, Alexandria, VA 22302-1596

SUBJECT: USAAA Audit of Vested and Seized Assets, Operation Iraqi Freedom

1. The 336th Finance Command, Kuwait has reviewed subject reports, comments are enclosed.

2. The POC is LTC Lisa G. Craig, Finance and Accounting Officer, 336th FINCOM, DSN: 430-1341, e-mail: lisa.craig@arifjan.arcent.army.mil

MAURENIA D. WADE
COL, FC
Commanding

Encl

ANNEX D

USAAA DRAFT REPORT
AUDIT OF VESTED AND SEIZED ASSETS
OPERATION IRAQI FREEDOM

OBJECTIVE A – PROCEDURES AND CONTROLS

OBJECTIVE: Were adequate procedures and controls in place and operating to properly secure and account for vested and seized assets?

CONCLUSION: Not completely. We found there were adequate procedures and controls in place to account for seized cash assets and in one situation a non-cash asset (metal bars). However, there weren't adequate procedures and controls in place and operating to properly secure and account for the majority of the non-cash seized assets.

RECOMMENDATIONS: No recommendations were identified for the 336th FINCOM. Adequate controls were in place for all cash assets and metal bars.

OBJECTIVE B – AUDIT TRAIL

OBJECTIVE: Did adequate audit trails exist to support the on hand balance of the vested and seized asset accounts?

CONCLUSION: No. We found that adequate audit trails didn't exit to support the on hand balance in the vested and seized asset accounts. Specifically:

The 336th Finance Command didn't maintain a filing area suitable for reasonable access to official documents and needs to better emphasize the necessity for a proper audit trail.

RECOMMENDATION FOR 336th FINCOM:

B-1 Recommendation: Develop a standard operating procedure for filing documents in theater that lists all required documentation that must be retained to support disbursement transactions.

Command Comments: The 336th FINCOM created the Central Funding SOP, the Paying Agent SOP and the Disbursing Agent SOP that all stipulate the proper documentation to support disbursements/claims/payments. They also describe the necessary steps to clear the vouchers and forward them to the Central Funding Disbursing Officer for proper filing. These SOP's were completed in JUN 04.

B-2 Recommendation: Establish controls and procedures to maintain a suitable area for retaining all required supporting documentation for disbursement transactions.

Command Comments: The entire filing room and system was reorganized with 99.99% of the vouchers found and filed. The FINCOM purchased filing cabinets in which to store and safeguard all disbursing vouchers. This recommendation was completed 30 Oct 04.

B-3 Recommendation: Make sure that all disbursement vouchers for transactions using vested and seized assets are scanned and sent to Defense Finance and Accounting Service - Rome on a daily basis.

Command Comments: This recommendation was implemented during the initial audit and completed 30 Apr 04. We are sending copies of all documents to DFAS on a daily basis.

ANNEX D

OTHERS RECEIVING COPIES OF THIS REPORT

Assistant Secretary of the Army (Financial Management and Comptroller)
Directors
  Defense Finance and Accounting Service
  Defense Finance and Accounting Service-Indianapolis
  Defense Finance and Accounting Service-Rome
Inspector General, Department of Defense

ANNEX E

AUDIT TEAM
(Project Code A-2004-FFG-0316.000)

Operations Center
Anita F. Bales
Winifred C. Curran

Fort Belvoir Field Office
Don R. Knutson

Huntsville Field Office
Kenneth E. Sedlmayr

Fort Meade Field Office
Mischelle A. Johnson

St. Louis Field Office
Charles R. Brownfield
Thomas Wybierala