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The Economics of War
by David R. Henderson

The following is a transcript of a speech given at The Future of Freedom Foundation's June 2008 conference, "Restoring the Republic: Foreign Policy & Civil Liberties" held in Reston, Virginia.

Jacob Hornberger: Our next speaker, David R. Henderson, is associate professor of economics at the Naval Postgraduate School in Monterey, California, and a research fellow with the Hoover Institution at Stanford. From 1982 to 1984 David served as an economist for Ronald Reagan's Council of Economic Advisers. His articles have appeared in such publications as the *Wall Street Journal*, the *New York Times*, *Barron's*, *Fortune*, the *Los Angeles Times*, *Chicago Tribune*, and many, many others. He has testified before Congress and has appeared on CNN, C-SPAN, *Jim Lehrer News Hour*, *O'Reilly Factor*, and many others. He received his Ph.D. in economics from UCLA. David Henderson's talk is on "The Economics of War." David Henderson.

David Henderson: I want to start by recognizing a bunch of heroes in this audience, namely the audience. I mean, I think about it and I saw what the price is, and I know Bumper said it goes for food. That's awfully expensive food. But anyway, whatever it goes for-- I'm sure most of it does go for food-- I'm just impressed that so many of you took a weekend, and bore your own transportation cost and came here, and bore a hotel expense and so on. So I want you to stand and applaud yourselves.

And now within the audience I want to single out a few people for a special commendation. I have had a couple of wonderful talks with Larry Ludlow and Mimi Kotner of San Diego, and they are just sweethearts. And Mimi's Jewish, and she is working in San Diego to defend the rights of Palestinians, and I just think that's wonderful. And I met a man this morning from Lodi, California, John Talbot, who has

been kind of following the issue of the feds' trying to set up some apparently innocent Pakistanis in Lodi. And I want to applaud you for just paying attention to that and following that story, and not being prejudiced against them.

And finally I want to recognize one of my mentors, who in the mid-'70s, when I was in my mid-20s, encouraged me to start freelance writing. As you know, I got my Ph.D. in economics, and one of the things you learn in economics, or one thing you learn in academia, is that publishing in things like the *Wall Street Journal* is supposed to be the kiss of death. And Alan Reynolds had a very different view of that. Please stand, Alan; he's one of the people who encouraged me. Alan lives near here, and he's actually now a Senior Fellow at the Cato Institute. And one of the things I'm going to be talking-- I'm talking about the economics of war today-- and one of the things I've been really discouraged about is how few economists have written about war, and Alan is one of them. And he's been very hardcore against the wars we've been involved in.

I've run into a number of people who find out I teach at the Naval Postgraduate School, and they wonder how that works. You know, I teach military officers, not just U.S., but from other countries. And how do I get away with saying some of the things I do in print? And I want to just tell you one story about that. A couple of years ago in a classroom, I was using a textbook by Harvey Rosen, a public finance text-- it's one of my favorite public finance texts. And one thing I particularly like about it is he talks at the start about views of society. And one of the views he talks about is the so-called organic view; and he points out that that view is held by Mao, Hitler, Stalin. And he says the dominant view in the United States is what he calls the mechanistic view, which we might call the individualistic view.

And I pointed that out, and I said, "But, you know, if you look at our language, we're very sloppy in our language. And I do mean we." And in fact, people use "we" all the time where they shouldn't, and they mean particular people, and they often mean the government. Now remember, I'm talking to military officers, some of whom have been in Iraq. And I said, "So take the statement, 'We invaded Iraq.' I didn't. Some of you may have, but I didn't." And we got into a pretty heated discussion.

A few days later I showed up at school and there's a military person in our department, he's the highest-ranking military person. And he was standing outside my door, and he's kind of the official liaison between the students and the faculty when any particular thing comes up that needs some kind of official treatment. And I think he was doing this on purpose. He had a smile on his face, and it was his way of saying up front, "Look, I'm just communicating a message. I'm not trying to signal anything." And he came into my office and told me a student in that class had come to him and said-- oh, oh, oh, and I told them in the-- I went to the board and said, "If you want to read more about this, go to antiwar.com and

read my article, 'Who is We?'" And so a number of the students did that. And one of these students showed up and said, "Where does Henderson get off, taking a check from DOD and writing something on antiwar.com?" He hastened to add that he didn't necessarily object to anything I'd written, which I found interesting, but that he just hated that term. And, of course, it wasn't professional for the person to tell me who the student was, and so I didn't ask. I had a sense who it was. And I said to this commander in the Navy, "That's a good question. What did you answer?" And he said, "I answered, I think it's something called the first amendment." That's not bad. So I feel like I've had running room my whole time there.

I want to start with three of my favorite quotes about war. From the documentary movie at Pearl Harbor War Memorial: "How should we remember them, those people who died? Mourn the dead. Remember the Battle. Understand the tragedy. Honor the memory." From Charles Adams, *For Good and Evil: The Impact of Taxes on the Course of Civilization*: "It takes great leadership and ability to settle differences through peaceful means. Any idiot can start a war." And from Randolph Bourne: "War is the health of the state."

As I said, my talk today is on the economics of war. I chose that topic because there's a lot of misunderstanding about it. And the most mistaken view people have about it is that war is good for the economy. I want to show you why it's not, in two ways: the narrow view, the narrow way: we're worse off with war, and the broad way: war tends to lead to the permanent expansion of government and the concomitant permanent reduction of our freedom.

The mistaken narrow claim that war is good for the economy goes somewhat as follows: Look at all the output war creates, and the jobs it creates. One economist even formulated in a textbook recently what he called the iron law of war, which says war is good for the economy. Even Paul Krugman, the Princeton economist who writes for the *New York Times* and was a former colleague of mine with President Reagan's Council of Economic Advisers-- we were at both, when we were in the early '80s-- fell into that trap after 9/11 when he wrote about that the terrorist attack: "could even do some economic good by leading to increased spending to replace buildings." And of course for most Americans, exhibit A for the claim that war is good for the economy is World War II.

But that way of looking at things is mistaken. It commits what the 19th century French economist journalist Frederic Bastiat called the broken window fallacy. I use Bastiat's famous article, "What's Seen and What's Not Seen," in the first week of every class I teach, and we refer to it all through the quarter, because it's amazing how often people look at jobs as some kind of measure of something good, even if they aren't producing anything. And I know it has an effect on my students, because after I finish teaching them and the quarter's over and I can no longer affect their grade, I might be walking across the

quadrangle and I'll see a bunch of students huddled. And they'll see me and I'll hear one of them whisper, "There goes that Bastiat." Did you hear that? Or it sounds something like that.

"In the economic sphere-- and here's from Bastiat-- "In the economic sphere, an act, a habit, an institution of law produces not only one effect but a series of effects. Of these effects, the first alone is immediate. It appears simultaneously with its cause; it is seen. The other effects emerge only subsequently; they are not seen. We are fortunate if we foresee them. There is only one difference between a good economist and a bad economist: the bad economist confines himself to the visible effect; the good economist takes into account both the effect that can be seen and those effects that must be foreseen."

One of the stories Bastiat tells is of the broken window. A kid breaks a window, people gather around and say, "Well, you know, there's some good in this. There'll be work for the glazier to replace the window." That's what's seen. What's not seen is the money the storeowner spends to replace the window that could have been used to buy his son a pair of shoes. So after the window is replaced, the economy has the same number of windows, but one less pair of shoes. Bastiat summed it up: destruction is not profitable.

The same principle applies to war. People point to all the capital labor used to produce the materials of war and to fight the war: trucks, tanks, aircraft, bullets, and military manpower. "Isn't it great," they say, "that these workers have jobs, these plants are running." That's what's seen. What's not seen is that the capital people are using for these uses could have employed in other uses.

Take World War II, which some proponents of the iron law of war consider their best evidence. In a nutshell their evidence is this: In 1941, when America was not at war except for the last three weeks of the year, the unemployment rate was 9.9 percent. By 1944, the peak of wartime spending, the U.S. spending in the war was a whopping 38 percent of GNP, and the employment rate was down to 1.2 percent. Also in 1944, real GDP was 40 percent higher than in 1941. That's what's seen. But where do those resources come from to make those hundreds of thousands of trucks, tens of thousands of aircraft and tanks, and thousands of ships? Much of the capital labor would have been using to produce cars and trucks for the domestic economy. In fact, the assembly lines in Detroit shut down. If you go on Wikipedia, you can't find production from 1943 through '44. It was so small it wasn't worth reporting. And if you doubt that, can someone please tell me the name of a 1944 model?

Consider fuel, because the government wanted to buy fuel at an artificially low price. It imposed price controls on gasoline, which of course causes a shortage, and put itself first in line. (By the way, I should have known I wanted to be an economist: other kids hated broccoli; I hated price controls.) Then it

issued ration cards to Americans, dramatically reducing the amount that normal Americans could buy at controlled prices. In his autobiography, the late newsman, David Brinkley-- who by the way was somewhat of a newsman compared to some of what we're hearing about today-- he was a cut above-- tells how he was unable to continue a serious romance during World War II because his lady friend lived in another city. He couldn't get gas; it was rationed. Spaces on the railroad were rationed to military personnel. And he had to drop the relationship. By contrast, members of Congress got X stickers, export exempt. They could get all the gas they wanted. Lyndon Johnson was a Congressman in those days; he drove home to Texas almost every weekend.

Now imagine that somehow the United States had avoided entering World War II-- I don't want to talk about the consequences for the world. That's controversial, and more important, it's completely separable from the point I'm making. Millions of cars would have been produced. Millions of people would have been able to travel. People wouldn't have had meat, tires, nylons, sugar, eggs rationed. In short, by the standard measures of prosperity, Americans would have been much more prosperous, and David Brinkley would have been able to pursue his true love.

I mention that last consequence not to emphasize the trivia, but in fact do the opposite: to emphasize one of the millions of stories of the large human cost that befell even Americans whom the U.S. government did [not] put at the risk of dying. But I certainly shouldn't leave out the human cost without mentioning the ultimate cost: 407,000 Americans who lost their lives directly because of the war. As one of my students, a U.S. military officer in my class when we discussed this, pointed out, the war was not good for their economy. And I want to just look behind the unemployment measures, because we look at the fact that unemployment declined from 9.9 to 1.2 percent. But Bob Higgs has pointed out why: something called the draft. Ten million people were drafted, and most of the other 6 million were what labor-- a military manpower economist called draft induced. So when you start with about 8 million unemployed, it's not hard to get the unemployment rate down to about a million if you draft 10 million.

And you can't say, based on that, that those people were better off. The only way economists or anyone else has of figuring out whether people are better off in a job is whether they chose the job. And they didn't get to choose. Didn't gross national product increase? Yes, but look behind it. GNP measures output; it doesn't measure value necessarily. Those things were produced and destroyed. If that percentage of GDP had been back in, even with a lower rate of decline of the unemployment rate, virtually every American would have been better off.

Now war isn't good for the economy in the narrow sense, but also it isn't good for the economy in the wider sense. It provides the opportunity and the excuse to expand government and reduce freedom. Then once the war is over government loses some power, but never goes back to its earlier size.

Take World War I, please. During the war Woodrow Wilson nationalized railroads. After the war ended, railroads were returned to the original owners but with a heavy degree of regulation on top. This regulation didn't end until Congress and President Carter ended it in 1980. In 1916, the year before America's entry into the war, the top marginal tax rate on Americans was 15 percent, and only a few high-income Americans paid it. In 1917, the year the United States entered the war, the top-rate jobs were 67 percent. By 1918 it had hit 77 percent. And the heroic secretary of the treasury, Andrew Mellon, through the 1920s under Republican administrations, cut the rates drastically, but never again did the top rate go under 25 percent. And Higgs points out that although we think of prohibition as beginning with the Volstead Act, it actually started with the Lever Act of 1917. How could the government justify imposing price controls on wheat, without then dictating how wheat was to be used? So they dictated that none of these foodstuffs were to be used in producing alcohol. It gave people a little taste before the fact of Prohibition. Prohibition also brought rent controls, which took years to disappear until after the war ended.

And also, of course, it brought the most extreme price control of all, along with forced sales: that is, the military draft. Conscription gave the government the power to pay less than a market wage by giving it the power to put young men in prison for not signing up. The good news is that conscription ended after the war ended. The bad news is that it softened up the country for its reintroduction in 1940.

Civil liberties also took a hit during World War I, especially free speech. One of the most famous cases was that of one of Woodrow Wilson's political competitors, Eugene V. Debs. Wilson had run against him for president in 1912. Debs gave a speech in June 1918 in which he denounced World War I and the draft. Interestingly, he did not go to prison until after the war ended. And Wilson refused to commute a sentence. On Christmas Day 1921, in his first year of office, Warren Harding, that guy we're supposed to think of as one of the worst presidents, commuted the Debs sentence and set him free.

I had an argument with Lew Rockwell yesterday about whether Harding was the best president or only the fourth best. To put the Wilson administration's action in perspective, it would be like George Bush putting Pat Buchanan in prison. Or if Al Gore had become president in 2001, Al Gore putting Ralph Nader in prison. Again, the damage was long-term because the Supreme Court, in *Schenck v. United States*, which upheld the World War I violations of free speech, corrupted basic legal thinking. The court voted nine to zero to uphold the Espionage Act's restrictions on free speech. Indeed, it was in the *Schenck*

decision that Supreme Court Justice Oliver Wendell Holmes made his famous statement that "The most stringent protection of free speech would not protect a man in falsely shouting fire in a theater."

Great line, but Holmes never connected it with the case at hand. *Schenck* was arguing against the military draft on the grounds that it violated the 13th Amendment's restriction on involuntary servitude. He never said how that was like crying fire. Sounds to me like it was a fire. Indeed, the biggest violation of civil liberties was the military draft, which is upheld by the Supreme Court in *Arver v. United States*. It's not a long decision. I recommend you get online and read it because you will see nine dishonest old men torturing the English language the way they do to uphold the draft.

I'll just mention three highlights. The first is their economic reasoning. Mr. Chief Justice White stated, "As the mind cannot conceive an army without the men to compose it, on the face of the Constitution the objection that it does not give power to provide for such men would seem to be too frivolous for further notice." But no one was objecting to the U.S. government's hiring people for the military. The objection was to coercing them. Article I, Section A of the Constitution, the section that gives the Congress the power to raise and support armies, also gives Congress the power to coin money. But that doesn't give Congress the power to force producers of zinc, copper, nickel, and silver to cough it up.

The second striking thing about their justification is their listing of all the countries in the world that had conscription, as if this was enough to justify the United States having conscription. Among the countries listed ironically were Germany and Austro-Hungaria. This leads to two questions. First, what I call the best question your mother ever asked question: "If other kids want to jump off the cliff does that mean you should?" And second, does the Supreme Court understand how special the United States is? Did they understand that one of the whole points was to restrict what the government could do to people and not to track the Old World?

And the third striking thing was that the Supreme Court's opinion did not address the key issue, and in fact did not get into involuntary servitude until the exact last sentence, and here's what they said (I won't quote it all): "We are constrained to the conclusion that the contention to that effect is refuted by its mere statement." Pretty clever, huh? You guys are making the argument, refute it yourselves. No need to do it on our part. For that sleight of hand they should have won the Hubert Humphrey Constitutional Scholar Award.

I want to read to you from my book, *The Joy of Freedom: An Economist's Odyssey*. I had the chance to argue with Hubert Humphrey when I was 18 and he came to the University of Winnipeg where

I was an undergrad and gave a speech. This was the year after he lost the presidential election to Nixon. And a friend of mine, my mentor Clancy Smith, asked him a question about the draft that he kind of dodged. So I went up at the end of the talk to try to hammer him. So here's what happened. Henderson: "Do you believe in the U.S. Constitution?" Humphrey: "Yes." Henderson: "Do you believe in the 13th Amendment to the Constitution which forbids involuntary servitude?" Humphrey: "Yes." Henderson: "Then how do you reconcile your belief in the 13th Amendment with your belief in the draft?" Humphrey: "They are reconciled." Henderson: "How?" Humphrey: "We have the 13th Amendment, and we have the draft."

And just as World War I led to an expansion of government, so did World War II. I'm not going to get through all the examples I have here: I just want to mention a couple. One of them is, the government wanted to tax way more people, so they turned the class tax into the mass tax. One little problem: people used to pay their taxes-- say, their 1940 taxes in March 15th, 1941-- so they had to save all through the year. Well, Gallup Poll data showed there were millions of people not prepared for this, and the Secretary of the Treasury Henry Morgenthau fretted, "Suppose we have to go out and arrest 5 million people?"

Enter Beardsley Rummel, chairman of the Federal Reserve Bank of New York and advisor of the president. While treasurer at Macy's, Rummel had noticed that customers didn't like big bills, but liked paying in installments; so he proposed that the government withhold some people's checks. And of course, as many of you know-- this is inside baseball to some extent-- but the young Treasury economist who helped design this system was one of my mentors and heroes, Milton Friedman. Milton Friedman now agrees that withholding set the stage for today's big government. In *Two Lucky People*, his memoir, he candidly states that he was "helping to develop machinery that would make possible a government that I come to criticize as too large, too intrusive, too destructive of freedom." And Rose [Friedman] said she never forgave him for that.

Incidentally, one person on the Left who recognized that war leads to more government control and applauds that fact is editor of *The Nation* Katrina vanden Heuvel. In the November 25th, 2001 issue of *The Nation*, vanden Heuvel and co-author Joel Rogers wrote, "If anything, the war on terrorism creates an opening for progressives, not closure. Indeed, it presents the opportunity of a lifetime. It is a truism of modern politics that war generally mobilizes and helps the Democratic Left. It does so despite the repression of dissent that wartime also often brings, because war raises the stakes in politics and invites consideration of wider goals including justice. War's mobilization of the populace against a shared threat also heightens social solidarity while underscoring the need for government and other social institutions

that transcend or replace the market." In other words, government grows in wartime, displacing market institutions.

I want to turn somewhat to the cost of the Iraq War, which has been very costly. Who has borne that cost? Obviously those who've borne the biggest cost are those who've died, over 4,000 Americans in uniform and, depending on the source, somewhere between 100,000 and 1 million Iraqis. And I have no expertise that tells me where in that range the real number is.

How about the cost to Americans other than those in the military? Well, let's look at the CBO's estimates of the annual budget cost of the war. And by the way, I'm artificially starting the war in March 2003. In a very real sense the war started in 1991. The U.S., British, and French established the no-fly zone and made almost daily sorties bombing parts of Iraq for about 12 years, but started [the war] in March 2003. According to CBO data, we're now about at \$500 billion in spending, and that's just directly for the war. To put that into perspective, one of my other colleagues at the Council of Economic Advisors in the early '80s was Larry Lindsey, who was a member of the Bush administration and estimated that the cost would be \$100 billion to \$200 billion, and he got canned for that. Everyone thought that was too high.

Harvard economist Linda Bilmes and Columbia University economist Joe Stiglitz have pointed out in their book, *The Three Trillion Dollar War*, [that] that's a substantial underestimate for two reasons: it leaves out the incredible degradation of military equipment that will be replaced, and it also leaves out the huge cost to roughly 30,000 people so far who are coming back with major wounds, major injuries, and will have a lot of money spent on them the whole rest of their lives, and their lives will be long.

Now \$500 billion is an abstraction, so let's put it in individual family terms. There are approximately 300 million individuals in the United States, about 120 million families. So if we take the cost per average person, it will be \$1,700 so far, and the average per family about \$4,000. But averages are always misleading. To take one example, in 1996 the average income of Stanford economics majors who dropped out that year after their sophomore year was extremely high. And the main reason for that high average was one person, a man named Tiger Woods.

So let's go beyond averages here: Who actually pays for federal government spending? And this might surprise you, but it really shouldn't if you've looked at some of the data on this. The federal tax system is what's called progressive. And now, boy did they ever win a big battle with that word-- Tom Sassen, you know, has always emphasized the importance of language-- progressive. And it doesn't mean progressive in any real sense; it means graduated. It means the higher your income, the higher the tax rate you pay. And not just the income tax, but other aspects of it, too.

So people who've looked at the whole tax system have concluded that it's progressive. The bottom quintile pays 4.8 percent of their income in federal taxes of all sorts. The top quintile-- where is that? The top quintile pays 25 percent. Moreover, the top quintile's share of all taxes paid is over 60 percent. So assuming that spending in the Iraq War was paid for with taxes, the bottom quintile paid 1 percent of that or \$5 billion, which works out to about \$200 a piece so far, per family. The top quintile by contrast per family has paid about \$13,000 in extra taxes. If we go further up the income range, the numbers get bigger of course. The top 5 percent pays about half of all federal taxes. You need \$250 billion, so their average payment so far is \$43,000. In short, high-income people are paying a very high share of the budget cost of the U.S. war in Iraq. By the way, one of my victories: I joined the Peace Coalition of Monterey County, our group Libertarians for Peace did, and we're the only non-Left, non-Liberal group there. And I gave a talk on this and managed to say that, and have people get it to some extent.

Now what about this idea that corporations gain from the war? Well, it's true that some corporations gain. Obviously defense contractors gain. Obviously companies like Haliburton gain. But it is not true that corporations in general gain. War is incredibly destructive. And a person who responded to my anti-war column on this said, "Well, you know, high-income people own a large part of the corporations." Well, let's go through an example of that. Let's assume the government tax is \$1 billion. High-income people are going to pay half of that, \$500 million.

Let's say the government spends a billion on the war effort on a firm that's a member of the military industrial complex. That billion is not a net gain to the firm. If you apply the typical upper end of the profits as a percentage of income for the firm, 10 percent, that means the firm's gain is \$100 million. So even if high-income people owned the whole firm, they would get \$100 million. And what did they pay in taxes for that? \$500 million. And I stated all those numbers to give an upper estimate of their gain. Benefiting high-income people by spending on war is like trying to feed sparrows by feeding horses. In my \$1 billion example, the dead-weight loss is \$900 million. And that's assuming the bombs do no harm.

Now it is true that the cost of oil falls disproportionately on low-income people. And because of the war there's less oil coming out of Iraq now than there was during the sanctions, about 400,000 barrels a day less, which doesn't sound like a lot. It's half a percent of world output. Because of the highly elastic demand for oil, that alone accounts for a 5 percent in price. So out of roughly \$130 per barrel, that's about \$6.50 a barrel.

And I don't want to go past Iraq and Afghanistan without talking about the enormous loss in civil liberties. And I could see it coming; I could see it coming on September 11th. I watched the news that night, and Tom Brokaw said, "Well, I guess we're going to have to start looking at losing some of our

liberties." And so what he had in mind, I think, is, well, you know, you might have to sacrifice certain liberties to get a certain amount of security. Of course you know the famous line that you'll deserve neither; but even worse, you'll get neither.

But beyond that, I gave a talk to David Thoreau's Institute on this shortly after, and I said, "Okay, let's talk. Tell us what civil liberties you want to abandon and tell us how that's going to lead to this increase in security. Let's have that discussion at least." Instead, what we got was people kind of acting like the Judean Liberation Army in the great film *The Life of Brian*. Do you remember when Christ is on the cross, or Brian is on the cross, and those people go to save him and they're willing to commit suicide, so what do they do? They go up and they commit suicide. He's still on the cross. Thanks. Well, it's like, "Oh, we got the first part right, let's drop the civil liberties. Oo, forgot to think about why we were doing it."

It's kind of like Eric Garris, the managing editor of *Antiwar.com*, says it as follows. It's a great British series, *Yes, Minister, Yes, Prime Minister*. There are two of them. They have a crisis. Someone says, "Something must be done. This is something, therefore it must be done."

Now I want to just talk about kind of using economics to look at other aspects of foreign policy. One of the most valuable things economists do is reveal the unintended consequences of government policies. Ludwig von Mises made a career out of this, or the last 20 years of his career. Rent control, for example, which governments often choose as a way of achieving cheap housing, achieves the opposite: reduces the housing start, reduces the quality, reduces maintenance. So government can go ahead and drop the rent control, or it can start subsidizing housing. Which do you think it typically does?

And we had this in the 1970s. The price controls on gasoline kept the price artificially low. We kept buying gas guzzlers. Jimmy Carter and his bureaucrats called us energy pigs. But Ford and his bureaucrats actually did the damage with the corporate average fuel economy laws on cars. And auto producers responded by producing lighter cars that killed more people.

Similar kinds of unintended consequences, it turns out, have led to further interventions in foreign policy. These have been pointed out, unfortunately rarely, by economists. Economists haven't studied this much. And it's not as if there are a lot of data out there. Two of the best sources are the late Jonathan Kwitney and Chalmers Johnson. Kwitney, for example, details a number of incidences of negative consequences, even from a narrow U.S. government point of view, of interventions in other countries' affairs. Summarizing some of these during the Cold War, he writes, "The excuse for intervention, of course, is the notion that if we don't fight, Moscow will win by default." Yet as one travels the globe from Indochina to Cuba to Angola, one finds that the third world countries or the Soviets are

alleged to have the strongest influence, are precisely those countries where we fought. Meanwhile in countries that weren't militarily threatened by the United States, where Soviet influences had a chance to flunk on their own merits, it has. In Egypt, Ghana, Algeria, Somalia, Nigeria, Indochina-- except in occupied countries along the Soviets' own borders, the Russians have been kicked out.

And Kwitney draws 15 lessons from that, and I want to highlight three. One, forceful intervention by a big power in a third world country, no matter how well-intentioned, is almost always dramatically harmful to the people who live in the country being intervened in. Two, intervention by either major power regardless of what the other is doing usually tends to be counterproductive for the intervener. And three, force creates enmity. If it creates respect as well, that is less enduring. Chalmers Johnson even gives a name to this, that the CIA coined: he calls it blowback.

Now the term blowback is narrower than Johnson uses it. The CIA used it to refer to the unintended consequences of policies that were kept secret from the American people. But we have unintended consequences from things that aren't kept secret also. World War I was not exactly a secret, but it helped lead to Hitler. One of, by the way, Johnson's examples he gives of blowback is again not a secret policy, but instead a reaction to a widely known government policy. The 1988 bombing of Pan Am flight 103 over Lockerbie, Scotland is now widely recognized as a retaliation for a 1986 Reagan administration aerial raid in Libya that killed Moammar Kadafi's daughter. By the way, that day I became an American citizen. I started to wonder.

And of course there are the unintended consequences with the CIA as early as 1963 helping the Baath Party take over in Iraq, and you know who came out of that, and of course the Ayatollah Khomeini. And I would tell that whole story-- but it's been told a couple of times now and very well, especially by Stephen Kinzer-- but I just want to highlight one thing he didn't mention. He mentioned Kermit Roosevelt being involved in that. He didn't mention another name you might have heard of, Norman Schwarzkopf. Not Norman Schwarzkopf, Junior; Norman Schwarzkopf, Senior, the daddy. He helped overthrow the Iranian government. And of course when President Carter was asked about this after the '53 event, because of course the hostages were taken in 1979, he said it was ancient history. Has anyone in this room ever taken a course in ancient history? Raise your hand. Remember something being talked about from 26 years ago? Another use of economics in foreign policy, and I wrote an article on this in an academic journal, laying some of this stuff out. I've started this process.

By the way, I wrote a piece on antiwar.com entitled...I wouldn't be doing this if-- "How George Bush Changed My Life"-- not for him. And it's called "The Information Problem." In 1945 Hayek pointed out that one of the big problems with centralized economic planning was that virtually all the information

that's important to plan an economy is not centralized, but rather exists in a decentralized form in millions of individual minds and cannot be centralized. Economists now who write in that tradition call that local knowledge. Now there's nothing in Hayek's argument to suggest that applies only to central planning of a domestic economy. A government that wishes to intervene in another country's affairs faces the same problem, possibly even magnified by the fact that the small number of government policy makers at the center have even less information about the foreign country than they have about their own country. The problem then becomes one of knowing which countries they should intervene in. And beyond that, even if they seem to have solid grounds for intervening, how to intervene.

One economist who addressed this issue 35 years ago briefly but insightfully is David Friedman in his book, *The Machinery of Freedom*. He pointed out that when the government of a fairly liberal country wishes to intervene, it often faces a choice between two or more illiberal dictators. Friedman gives a pithy instance: "In practice, the interventionist's policy almost inevitably involves alliance with the Shah of Iran, or the present government of China, or Joseph Stalin, or Ferdinand Marcos, or in the case of the actual pulse of the U.S. over the last 45 years, all of the above." And he goes on, "In order for the policy to work it is necessary to correctly figure out which countries are going to be your enemies and which your allies ten years down the road. If you get it wrong you will find yourself unnecessarily blundering into other people's wars, spending your blood and treasure on their fights instead of theirs and yours. You may, to take an example not entirely at random, get into one war as a result of trying to defend China from Japan; spend the next 30 years trying to defend Japan and Korea and Vietnam from China; then finally discover that the Chinese are your natural allies against the Soviet Union."

Kwitney, talking about the information problem, recounts how U.S. government officials made major decisions about foreign policy with little knowledge of the countries for which they were making the decisions, with often disastrous consequences. In discussing the Congo, for example, Kwitney tells how U.S. government officials in 1960 failed to understand that the Congo was a few hundred million as people were trying to avoid daily starvation. Instead, these officials interpreted everything with reference to their own Cold War with the Soviet Union. It's all about us.

This lack of local knowledge extended even to cultural differences. President Eisenhower's Undersecretary of State C. Douglas Dillon judged the Congo's Patrice Lumumba to be "an irrational, almost psychotic personality." His evidence? Lumumba "would never look you in the eye." What he didn't know apparently was that many Africans are taught that avoiding eye contact is deferential. Because of these officials' negative assessment of Lumumba, President Eisenhower gave the order for him to be murdered. And by the way, here's where I part company: I think what Karen Kwiatkowski did in that movie, *Why We Fight*, was heroic, [but] I can't get on board with Eisenhower's being that great a hero.

And another example of that is McNamara. If you've seen McNamara in *The Fog of War*, he talks about how he was talking to his counterpart years later, who said, "You know, you guys always thought it was about us allying with China. You didn't understand we're enemies with China for a thousand years." Well, you know what? There are books written about that. And I know high government officials don't have time to read. I know that. But you know what? They've got staff. They can have staffers read and summarize, and choose the good ones. And of course that local knowledge problem doesn't just apply to the United States. Castro made the same kind of mistake in his Congo policy, simply assuming, because he lacked local knowledge, that the conflict in Congo was part of the Cold War struggle.

A more recent instance is the U.S. government's overreliance, before it invaded Iraq in March 2003, on information from the Iraqi expatriate Ahmad Abdul-Hadi Chalabi about the state of Saddam Hussein's weapons of mass destruction. Chalabi claimed that he had them in large quantities. As is now known, much of Chalabi's information turned out to be false, and of course we know what happened as a result.

Another application of economic thinking to the economics of war is the economics of externalities. One of the most widely accepted ideas in economics is the concept of an externality, whether negative or positive, and I want to focus on the negative ones. A negative externality occurs when you take an action that has a consequence for someone who's not involved in the exchange, not involved in the transaction, who bears a cost. A standard example we give is pollution. But economists have been very narrow in giving their examples. A much bigger example, a much more common example of an externality, is almost anything a government official does. They're taking actions that have consequences, and they don't take account of the consequences.

An official of the Food and Drug Administration, for example, might decide not to approve a drug that would save people's lives because his own life and the life of his loved ones are not in danger. And within the area of government action, some of the biggest costs have to do with war. A government official, typically in the United States the president, who decides to make war in another country, can and will impose huge costs on people in that country and in his own country, and he bears only a pro rata share of the cost. On the benefit side to him, he may go down in history as a great president. And there's this huge correlation between killing people in war and being thought of as great. Also the externality problem is compounded by the fact that most of the victims of war [fought] by country A don't vote in the elections of country A. In an academic article, "The Economics of War and Foreign Policy: What's Missing?" I said that one conclusion you can derive when you think about that is that a government will do more destruction to people in a foreign country than to people in its own country.

And there are two reasons: Those other people don't vote, and the people in their own country who might care about it don't have information about it. The information is not local to them. It's kind of what Sean was talking about. If you show them suddenly people tend to be against it. But that's why you don't show them. We should expect therefore, on just purely theoretical grounds, that foreign policy will be more destructive than domestic policy. And sure enough it is. We don't see the U.S. government bombing certain high crime areas of Los Angeles, for example, even though the arguments the U.S. government makes for bombing neighborhoods in Iraq could literally be applied to Los Angeles. That's obvious when you think about it, but I've never seen it written anywhere until I did. If the U.S. government gets out of other countries' affairs, the positive U.S. effect on the world would become more, not less.

The United States still has the strongest, wealthiest economy in the world. And by the way, I'm way more optimistic about that in this room than many of the people here, and worldwide could be in that position for the next 20 years. That message is already getting out to the world, and many countries are trying to emulate the relatively pro-freedom economic policies that have caused this long-term economic boom. But the message has been somewhat garbled by the white noise of U.S. interventionist foreign policy, which has caused some hatred of the United States around the world, and has given the left-wing parties in many countries the excuse to hang on a little longer to destructive socialist policies. With the U.S. out, the excuse would be gone.

Similarly, the U.S. government's paramilitary war against drug producers in various Latin American countries has destabilized fledgling democracies in Peru, Colombia, and Mexico. Drug producers in Peru, for example, have hired the Shining Path, the group of terrorist leftists, to defend them and their property from the U.S.-financed Peruvian military. With the U.S. government no longer intervening, those countries become more stable and would have a much higher chance of creating a freer political and economic system. The government could add to that positive effect on the world by loosening immigration restrictions even further, allowing millions more people a year into the United States. The consequent brain drain would further pressure the countries losing highly skilled labor to reduce their taxes and regulations and drive people out.

What the U.S. government should also avoid, besides carrying out an interventionist foreign policy by military means, is carrying out an interventionist foreign policy using government subsidies. The worst kind of subsidy is from one government to another. The government making the subsidy doesn't bear the cost because the government official isn't spending his own money. The government official receiving the subsidy doesn't spend it well because he's spending someone else's money, which is why government recipients of foreign aid often build palaces, dams that are economically destructive such

as the Aswan Dam in Egypt built with Soviet foreign aid, and monuments to themselves. Guess what kind of subsidy is virtually the only kind the World Bank and the International Monetary Fund make? That's right, subsidies to other governments. The U.S. government should end its participation in the World Bank and the International Monetary Fund. Some of my allies in the antiwar movement, the left-wing allies, have these bumper stickers: "If you want peace, work for justice." I think that's a good one. I think I've got a better one, and I want to end with that: When you think about what's behind war, it's the loss of freedom. If you want peace, work for freedom. Hi.

David Preston: Yes, hello. In your small debate...

David Henderson: What's your name?

David Preston: David Preston, George Mason intern. Ah, let's see. In your small debate with Hubert Humphrey, you seemed to use the 13th Amendment as your foundation for defeating him. But couldn't it be said that the 13th Amendment can be actually used against you, and that the second clause says, "except as punishment for crime whereof the party shall have been duly convicted," this will make involuntary servitude allowed? And could this be used to say, hey, if we're going to have a draft, and maybe one day we'll just start using our own prisoners?

David Henderson: Well actually, yeah. So it's true if you just go with the 13th Amendment it would justify a draft of prisoners, but not a draft of, I'm guessing, you.

David Preston: If I was Hubert Humphrey, that's what I would have probably told you.

David Henderson: Yeah, but that means you read...

David Preston: No, I know. I'm not promoting a draft, I'm just saying that.

David Henderson: Yeah. Right. Right.

Gene Carboneau: Good morning. Gene Carboneau from Portland, Maine. As an addition to what you were saying when you began your speech about applauding ourselves for being here, I just want to add this. Hotel room: \$150. Registration: \$495. The advice, counsel, the wonderful people here, the great conversations I've had with some of the participants and speakers: priceless. But my question, it might be a little off topic: Another unintended consequence of this fiasco is the Department of Homeland Security. What are the economics concerning that?

David Henderson: This is another kind of application of Hayek. In this whole decentralized information thing, the best people to defend you are you, and the people you hire. And my first week in class, when I talk about Hayek's information, I point out that the two good things that happened on September 11th were both examples of decentralized information. And because of the time constraint I want to point to just one of them, and that's United flight 93. I mean, think about it. Those people responded real time because of information they got on cell phones. If they had waited for some government order they would have been-- well, they were dead, but other people would have been dead, too.

And so I was traveling on September 22nd, 2001, and the airplane was pretty empty, so the stewardess and I had a lot of time to talk. And I said, "You know, I almost cancelled because I got a little superstitious, you know, double 11 and all that, you know." And so she said, "Yeah, we're so safe because of all those people." And I said, "No, no, no, no. We're safe because you and I are never going to act the way we were told to act. We're never going to do that again. That's why we're safe." And the lesson that should have been learned from Richard Reid's shoes is not to check people's shoes, but that those people beat him: they beat him: they tied him up. We can do this. And, you know, Brazil passed a law late that week, and the president didn't dare veto it. I think it was like a 600 to 5 vote or something to allow any adult over 21 to have a gun on a plane. And I think it's a little extreme. I think it's up to the airlines, it's private property. But the point is, there's so many things we can do to protect ourselves.

Ned Elmer: Ned Elmer, from Texas. As an M.D.-type doctor, I've always been interested in trying to get some economic translation between the amount of capital that government destroys at all levels and translating it into life lost or years of life lost. Are you aware of any sort of economic translation between, you know, dollars destroyed by government and how much actual life or years of life have lost in human terms?

David Henderson: John Stossel actually-- and I taught about that years ago. There's an article, I think it's in *Regulation Magazine* from some years back, that basically says, "Poverty kills," and the evidence is quite clear. And so then what you do is say, "Okay, how much poverty does government create? How much wealth does it destroy?" And then you can do that translation. And I haven't done it. I'm positive it's in the, for the United States, you know, thousand per year, maybe hundreds of thousands. But I can even point more directly. The FDA probably kills at least 10,000 people a year, just that one-- yes.

Forrest Travis: My name is Forrest Travis. I'm from Ponte Vedra Beach, Florida. We've heard a lot of comments over the last several days in opposition to war, which I can understand in an

environment we're in where we've been involved in "pre-emptive war." But I'm curious if we take a less war-like posture in our country. I would just love your comments and thoughts about the ability to wage a defensive war if that was ever necessary.

David Henderson: We've got these two great things protecting us: they're called the Atlantic and the Pacific. I mean, those just are such incredible protection. And so I think we could-- we now spend about five percent of GDP on war or defense-- I think we could cut that to one percent and have a substantial military force able to defend us. We haven't had a defensive war since 1812, so we had a lot of time without a large military in there. A follow-up.

Forrest Travis: David, it's just a quick follow-up. I appreciate that, and we're very fortunate in that respect. Part of my question there: if there is high-tech capability, and an ocean also doesn't oppose much opposition getting here, or closer, and missiles reach long distances, how would we maintain a defensive posture, and some have been attempted, I realize. For a high-tech war, do you think the one percent number would hold that? Thank you.

David Henderson: Yeah, I do. And let me just say that we've got two kinds of war we're talking about here. One is where people invade us, and that's what I was talking about. You're talking about where people send a missile. I've done a lot of soul-searching in this, so I'm not kind of totally happy with the answer I'm going to give you. But we did figure out how to deter the Soviets for about 40 to 50 years. It was to threaten to kill them, which meant killing mainly innocent people, and that's why I'm not happy with it. But the point is you can do that with one percent of GDP. And the thing is a lot of these threats would go away, see, and I think that came out in Kinzer's talk. It's not like these people are waking up in the morning in these parts of the world and saying, "Oh, I hate, you know, Britney Spears; therefore I'm going to attack the United States." They're saying, "I do not want the United States interfering in my country." So here's what I would say. Let's get down to that one percent of GDP. Let's pull out of virtually everywhere, and let's see what happens. Are we going to have these big problems? And it looks like my time's up. Thank you.