

**The Costs of America's War on Peace**  
**An economic analysis of US foreign policy**

**By**

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## I. Introduction

As the United States entered the 21st century, the annual military budget was \$387 billion dollars and political pundits were contemplating the best way to spend the \$200 billion federal surplus<sup>1</sup>. Almost a decade later, the United States allocated \$680 billion for military spending in 2009 - a 75% increase - and legitimate concerns are being raised about ever-increasing federal deficits. Since 2000, the US military budget has increased by a total of \$1.7 trillion dollars. Over half of this amount - \$921 billion - was spent in Iraq, Afghanistan, and "Global War on Terror" (GWOT) operations. By contrast, the event that sparked this massive increase in military spending - the September 11 2001 terrorist attacks - cost the Al-Qaeda terrorist network between 400 and 500 *thousand* dollars. The asymmetry of these costs is staggering, and many military experts are questioning the usefulness of building up traditional military forces when facing rogue terrorist elements<sup>2</sup>. Other experts claim that this build-up of military forces - and their subsequent intervention abroad - leads to terrorist attacks. If these experts are correct, then money being spent fighting the "War on Terror" is not only being wasted, it is fueling another terrorist attack that will cost even more money and human life in the future.

This paper will assess the cost of the current foreign policy of the United States, focusing particularly the Global War On Terror, and try to determine if recent trends in foreign military spending are beneficial for the United States. It is expected that military spending will prove to be wasteful relative to domestic spending, and that deficit reduction would provide an economic benefit in the long run. It is further expected that there is a "peace dividend" - a positive economic return created by reduced military spending - that the United States would do well to take advantage of.

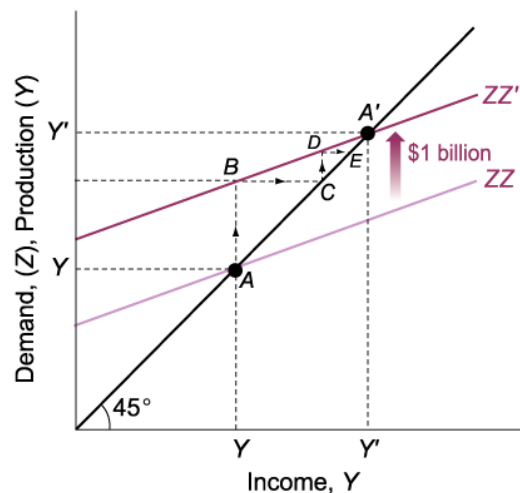
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<sup>1</sup> Global Issues.org – World Military Spending (2009 Dollars)

<sup>2</sup> Fourth Generation War – Austro-Hungarian Marine Corps.

## II. Analytical Approach

During the last decade, government military expenditures have risen dramatically and brought with them large fiscal deficits. The Keynesian approach suggests that when there is insufficient demand in an economy, government spending – usually financed by deficits – can increase demand and, eventually, output. When autonomous spending – “the demand for goods that does not depend on output”<sup>3</sup> – increases, the Keynesian model suggests that output increases to a greater degree than the amount of spending. In other words, a \$1 billion dollar increase in spending will increase output by more than \$1 billion:



**Figure 1 - Effects of an Increase in Autonomous Spending on Output<sup>4</sup>**

This “multiplier” effect is created when initial spending goes to buy goods and services (first round effects) and then the producers of those goods and services in turn use their increased profits to buy more goods and services (second round effects) and so on. This multiplier effect is very strong for certain types of spending and weaker for others. Domestic spending on infrastructure, education, or tax cuts provide strong first round effects and relatively strong next-round effects, leading to a high multiplier. By

<sup>3</sup> Blanchard, O. Macroeconomics, 4<sup>th</sup> ed (pg 52)

<sup>4</sup> Blanchard, O. Macroeconomics, 4<sup>th</sup> Ed. (pg 54)

contrast, spending abroad provides little first round effect. "Consider, for instance, \$1,000 spent to hire Nepalese workers to perform services in Iraq. The spending does not directly increase the income of Americans, so we say there is no "first-round" effect on domestic GDP."<sup>5</sup>

Government spending is by no means a panacea, however. Government spending – particularly deficit spending - has the tendency to "crowd out" other types of spending. If the government runs a balanced budget, government spending in one area (eg: military expenditure) will crowd out investment and expenditure in other areas such as education or infrastructure. When the government runs a deficit, private investment is crowded out as "the private sector competes for funds with the government".<sup>6</sup> To fund the deficit, governments must eventually divert resources from other fiscal expenditures, raise taxes, or print money. None of these choices is good for long-term economic growth, however, so deficit spending should be used only when necessary and only on projects that will provide long term growth opportunities.

This macroeconomic framework suggests that government spending, when properly directed, can provide benefits to the economy, as measured by GDP. As foreign military spending seems to provide little multiplier effect and no long-term growth prospects, it is likely that it will not provide the same level of economic return that domestic investment can provide. Furthermore, decreasing fiscal deficits are likely to be beneficial in the long run<sup>7</sup>, and reducing deficits via decreased military expenditure is unlikely to affect short-run production the same way that cutting domestic production might. The costs of foreign military spending will be analyzed using this framework, to attempt to understand the macroeconomic effects of such policies.

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<sup>5</sup> Stiglitz, J & Blimes, L. The Three Trillion Dollar War (pg 120)

<sup>6</sup> Stiglitz, J & Blimes, L. The Three Trillion Dollar War (pg 122)

<sup>7</sup> Blanchard, O. Macroeconomics, 4<sup>th</sup> Ed (pg 364)

### III. Data

At the turn of the 21<sup>st</sup> century, the US military Budget was \$387 billion dollars. In contrast, the US government appropriated \$680 billion dollars<sup>8</sup> for military spending in the 2009 fiscal year. Since 2000, the US military budget has increased by a total of \$1.7 trillion dollars. Over half of this increase - \$921 billion - was spent in Iraq, Afghanistan, and "Global War on Terror" (GWOT) operations. Supplemental war spending comprises much of this growth and is largely due to the Iraq and Afghanistan conflicts.

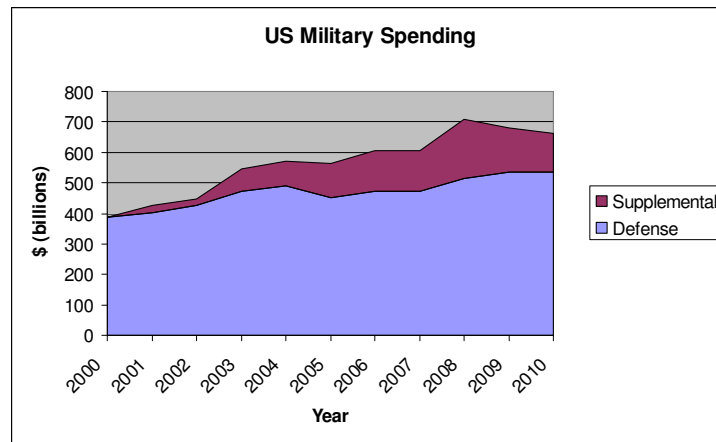


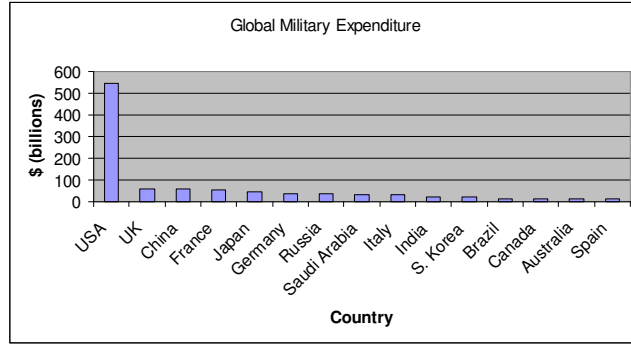
Figure 2 – US Military Spending in the 21<sup>st</sup> Century

US military expenditures – higher than any other country even in 2000 - increased far above that of other countries in recent years and “is **more than the combined spending of the next 45 countries.**”<sup>9</sup> In absolute terms, the United States accounts for almost half the world’s military expenditures, and US military expenditure is at its highest level since World War II.<sup>10</sup>

<sup>8</sup> Whitehouse.gov - 2009 Budget

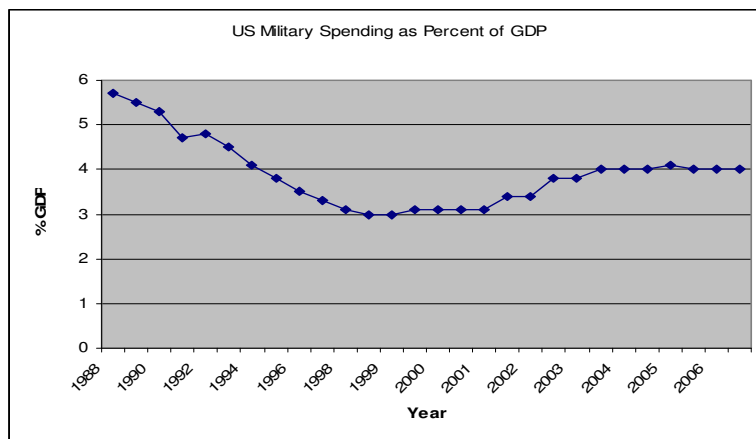
<sup>9</sup> Global Issues.org – World Military Spending

<sup>10</sup> SIPRI 2008 Yearbook



**Figure 3 - Military Expenditure by Country**

In relative terms, US military spending is increasing as a portion of GDP as well. In the 1990s, military spending dropped below 3% of GDP due to decreasing military spending combined with a burgeoning economy. Current US military spending on all GWOT related items is estimated at 4.2% of GDP<sup>11</sup>, but this figure is expected to rise as GDP growth slows and military spending remains unchanged. Despite massive spending, the US military expenditure as a portion of GDP is neither the world’s highest, nor the highest historically. As a portion of GDP, military expenditure is only now reaching Reagan-era cold-war levels.



**Figure 4 - US Military spending as portion of GDP**

<sup>11</sup> Congressional Research Service - Cost of Major US wars

During World War II, defense spending reached levels as high as 37.5% of GDP. During the Korean and Vietnam wars, military spending peaked at 13.2% and 9.5% of GDP, respectively. Persian Gulf War spending was similar to current levels, reaching 4.6% of GDP in 1991. While military spending as a portion of GDP has certainly been higher historically, this does mean such spending is necessarily beneficial. To the contrary, every conflict of the 20<sup>th</sup> century was followed by a recession. Most economists have long since abandoned the idea that “war is good for the economy”, and there is good reason for that. Military expenditures – particularly those for foreign conflicts – represent no investment or growth opportunities the way domestic infrastructure spending might. Instead, money spent on foreign conflicts is largely wasted.<sup>12</sup>

Government spending “can be financed in four ways: through higher taxes, reductions in other government spending, borrowing from the public, or money creation.”<sup>13</sup> When the government borrows money to pay for wars, the future interest that must be paid on that borrowed money is not taken into account by policy makers, who use cash accounting rather than accrual accounting methods. Thus, the cost of war is only analyzed in terms of *current* budget outflows, rather than the future costs of the war. This method of accounting is inadequate for any type of military expenditure as war carries with it numerous future obligations, including repaying interest on borrowed money, providing medical care and pensions for veterans, and transporting troops and equipment back to the United States. As the current conflicts in Iraq, Afghanistan, and the GWOT have been largely financed by borrowed money, cash accounting methods neglect the accruing interest as well future war obligations.

This fiscal approach is not unprecedented in the United States. In Fiscal Year 2009, the cost of current wars accounted for about 31% of the total federal budget<sup>14</sup>. This does not paint the whole picture, however, as another 13.5% of the federal discretionary

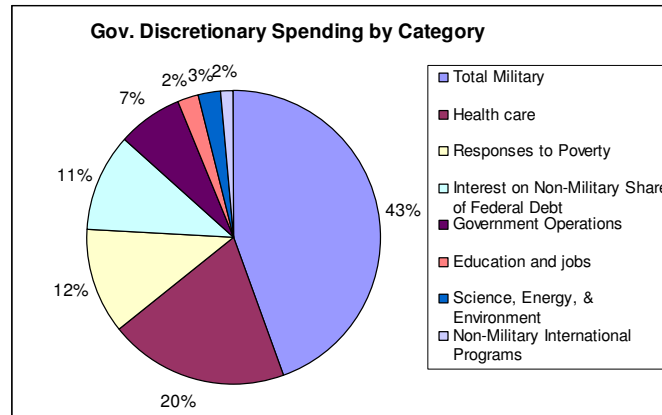
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<sup>12</sup> Stiglitz, J. & Blimes, L. [The Three Trillion Dollar War](#)

<sup>13</sup> CRS - Financing Issues and Economic Effects of American Wars

<sup>14</sup> Friend’s Committee on National Legislation - FY 2009 Budget Proposal

budget goes to pay for caring for military veterans as well as paying the military portion of the debt. In 2009 alone, the government allocated \$226 billion to pay for debt from *past wars*. This figure is not calculated in the government’s tabulation of military expenditures, suggesting that the total military spending is much higher than it appears at first glance.



**Figure 5 - Discretionary Spending by Category - Total War cost**

Since beginning the Global War on Terror, the government has funded most operations with borrowed money, leading to large federal deficits over the past 8 years. Servicing the war debt will require that the economy grow enough to account for the amount borrowed plus any accrued interest. As the wars in Iraq and Afghanistan are providing no measurable financial benefit to the United States Economy, it seems unlikely that this will occur.

Stiglitz and Blimes<sup>15</sup> estimated the total cost of the Iraq and Afghanistan conflicts for two scenarios, a “best case” and a “realistic-moderate case”:

In our “best case” scenario, we have estimated that the number of US troops in Iraq and Afghanistan will decline to 180,000 (the pre-“surge” level) in 2008, then fall to 75,000 by 2010. By 2012 this will drop to a non-combat force of 55,000

<sup>15</sup> Stiglitz, J & Blimes, L. The Three Trillion Dollar War

servicemen and women. This is truly a “best case” assumption, in view of the fact that the United States still keeps 80,000 troops in the Korean theater, and still had over 20,000 U.S. troops in Kuwait ten years after the end of the first Gulf War.

[The “realistic-moderate” scenario] assumes that troop levels will decline more slowly as we approach 75,000 in 2012. This scenario is based on the recent deployment estimates by the Congressional Budget Office...We also assume that these troops will continue to serve a primarily military function, including offensive operations against al Qaeda, working alongside Iraqi and Afghan forces, and maintaining security in violent neighborhoods<sup>16</sup>.

In 2007, Stiglitz and Blimes estimated the total budgetary cost of the Global War on Terror in the best case and realistic-moderate case, including past and future costs, through 2017. Military pensions, medical care, and equipment refreshment are included in these estimates. They estimated the best case total cost at \$1.7 trillion and the realistic-moderate case at \$2.68 trillion. After adding interest payments on borrowed funds, these estimates increase to \$2.33 trillion and \$3.49 trillion<sup>17</sup>, respectively.

Research by the Congressional Budget Office also estimated the costs of two potential scenarios through 2017<sup>18</sup>. The first CBO case - scenario 1 - reduces the number of active GWOT troops to 30,000 by 2010. Scenario 2 reduces the total troop deployment to 75,000 by 2013. The CBO’s scenario 1 is much more optimistic than Stiglitz and Blimes’ best case scenario, with a reduction to 30,000 troops by 2010 compared to a reduction to 55,000 troops by 2012. Both the CBO and Stiglitz and Blimes worst-case estimates are similar, with the CBO’s reduction to 75,000 troops taking one year longer – 2013 instead of 2012 – to accomplish. The direct budgetary costs of the Global War

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<sup>16</sup> Stiglitz, J & Blimes, L. The Three Trillion Dollar War (pg 36-37)

<sup>17</sup> Stiglitz, J & Blimes, L. The Three Trillion Dollar War (pg 59)

<sup>18</sup> CBO - Estimated Costs of U.S. Operations in Iraq and Afghanistan (pg7)

on Terror, as calculated by the CBO, are \$1.33 trillion in the first scenario and \$1.82 trillion in the second scenario<sup>19</sup>, before interest is added. Once interest payments are added to the calculations, the CBO estimates the total budgetary costs to be \$1.5 trillion in the best case and \$2.11 trillion in the less optimistic case<sup>20</sup>.

The disparity between the two estimates stems from several factors: disagreement over veteran medical costs and enlistment bonuses, different troop recall timelines, the cost of refreshing equipment, the cost of contractors, and the cost of increasing the size of the military in the future. The CBO research was done one year before Stiglitz and Blimes' research and recent spending trends indicate that Stiglitz and Blimes' estimates may be much more realistic. As \$921 billion has already been spent and the CBO estimated the interest accrued – as of 2007 – to be \$415 billion in payments until 2017<sup>21</sup>, the \$1.33 trillion CBO "best case" estimate has already been met. Once the costs of future obligations to veterans, the costs of returning the troops back to the US, and the costs servicing the additional interest accrued since 2007 are added, it seems that Stiglitz and Blimes did indeed provide realistic estimates, at least for the best case scenario. For the less optimistic scenario, the difference in the two estimates is \$570 billion dollars.

In addition to budgetary costs, the war brings with it numerous social and economic costs. The social costs come from lost productivity due to soldiers killed or wounded while serving abroad, unavailability of National Guard and reserve troops within the US, lost wages for reservists, and decreased quality of life for veterans. Stiglitz and Blimes estimate these social costs to be \$295 billion in their best case scenario and \$415 billion in their realistic-moderate scenario.<sup>22</sup> Economic costs from unstable oil prices and foregone domestic spending are estimated by the Senate Joint Economic Committee to be \$1.1 trillion dollars in a "middle ground" scenario where 75,000 troops remain in Iraq

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<sup>19</sup> Includes the \$162 billion appropriated to increase the size of the Army and Marines

<sup>20</sup> CBO - Estimated Costs of U.S. Operations in Iraq and Afghanistan (pg9)

<sup>21</sup> CBO - Estimated Costs of U.S. Operations in Iraq and Afghanistan (pg7)

<sup>22</sup> Stiglitz, J. and Blimes, L. "The Three Trillion Dollar War" (pg 112)

and Afghanistan as of 2013<sup>23</sup>. Similarly, Stiglitz and Blimes estimated the macroeconomic costs to be \$263 billion in the best case and \$1,900 billion in the realistic-moderate case bringing the estimated total of the two scenarios to \$2.28 trillion and \$4.9 trillion, respectively. Even the Joint Economic Committee's more conservative estimates suggest that the total cost of the war – budgetary, social, and economic costs – will surpass \$3.5 trillion dollars.

As the cost of the Global War on Terror is fast approaching the combined cost of the conflicts in Korea and Vietnam<sup>24</sup>, each of which was followed by a recession. The post-Vietnam recession was particularly challenging, as the economy had to deal with the fall out from the Johnson administration's "guns *and* butter" approach. As the nation coped with the costs of the "Great Society" program as well as rising war costs, it became abundantly clear that a nation cannot choose guns and butter, and that there is no such thing as a free lunch. The current fiscal conundrum is eerily similar and it is alarming that federal deficits are *growing* during a recession. It is difficult to say when it will be possible to begin repaying the debt as the *principle* is increasing as the number of obligations (eg: veteran health cares) is still increasing, bringing with it even more interest.

Furthermore, the share of military expenditures as a portion of federal discretionary spending is increasing at a troubling rate due to the Global War on Terror. Each year, a larger portion of tax dollars is being spent on something that provides no return on investment yet accrues interest and creates future financial liabilities. In fact, military spending as a portion of federal expenditure "has grown 27 times as rapidly as domestic discretionary programs"<sup>25</sup> since beginning the Global War on Terror. The failure of policy makers to consider the obligations of war and the future payments it requires could create a situation where future obligations create an excessive burden on

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<sup>23</sup> Senate Joint Economic Committee – War At Any Price (Oct 2007)

<sup>24</sup> CRS - Costs of Major U.S. Wars

<sup>25</sup> Center on Budget and Policy Priorities - Federal spending 2001-2008

the economy. The annual amount of war debt paid - \$226 billion in 2009 – is approaching the cost of the most recent peacetime military budget: \$387 billion in 2001. If the spending and borrowing continue at their current pace, interest payments on borrowed money will demand a greater portion of federal funds and may eventually cost more than the military spending itself.

#### **IV. Analysis & Conclusions**

It remains to be seen whether this type of military spending – particularly deficit spending - is sustainable. Even the most optimistic estimates suggest that at least 55,000 troops will remain in Iraq long after the conflict is over. This will result in higher peacetime costs for all future military budgets. The US has 84,488 active duty troops stationed in Europe, 7,850 stationed in North Africa and the near east, 33,122 in Japan, and another 11,258 stationed or afloat in the Asian pacific and surrounding countries. Another 26,339 troops are stationed in South Korea<sup>26</sup>. Maintaining this foreign military presence has meant that every post-war peacetime military budget has been higher than the peacetime budget preceding the war. Even the “best case” GWOT scenario means more wasted money, more financial obligations, and more troops put in harm’s way. As the costs of the Global War on Terror continue to increase, the question of what the country could have done with that money becomes relevant.

Recent research by Mark Zandi explores the estimated “multiplier effect” of various government expenditures. He estimated that tax rebates would have a multiplier of 1.02 to 1.26, while aid to state governments and infrastructure spending would have a multiplier of 1.36 to 1.59<sup>27</sup>. Research done by Robert Barro suggests that the government multiplier for military spending is 0.8<sup>28</sup>. Similarly, Stiglitz and Blimes argue that the *difference* between the foreign military spending multiplier and the domestic

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<sup>26</sup> Department of Defense - Active Duty Military Personnel Strengths

<sup>27</sup> Zandi, M. A Second Quick Boost From Government Could Spark Recovery

<sup>28</sup> Barro, R. “Government Spending is No Free Lunch”

investment multiplier is 0.4<sup>29</sup>, a number they claim is an extremely conservative estimate. If military spending does indeed have a multiplier of roughly 0.8 and domestic investment has a multiplier of approximately 1.3, then a 0.4 difference is probably a reasonable - albeit conservative - approximation. Overall, the research suggests that almost any domestic alternative would have provided a greater return than fighting the GWOT. Stiglitz and Blimes have estimated the "macroeconomic cost" of the Global War on Terror to be between \$1.1 and \$1.9 trillion dollars<sup>30</sup>, using the aforementioned multiplier estimates.

Further economic benefits may stem from a decrease in military expenditure as tensions between countries are reduced – the "peace dividend". An IMF study in the 1990's researched the effects of post-war military spending and looked for empirical evidence of a "peace dividend"<sup>31</sup>. After running several econometric analyses of global conflict and military spending, the researchers found that "military spending is a public bad; increasing military spending will not necessarily lead to more security for a country since its neighbors are likely to follow the same strategy. The evidence also shows that peace is a public good; mutual reductions in military spending across borders have multiplier effects that are beneficial to all parties concerned." Reductions in military spending may be met with further reductions in military spending from other countries, which will provide an increased economic benefit for all parties as fiscal policy is diverted away from military spending.

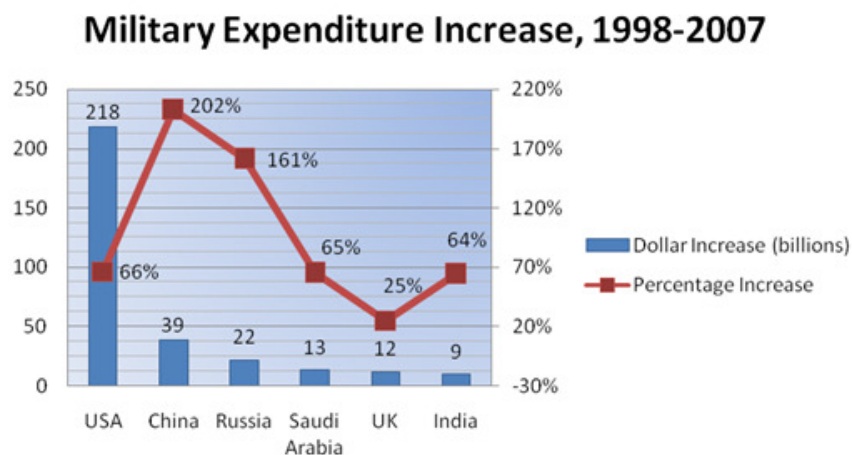
The IMF report suggests that global military spending is a positive feedback loop, where increased military spending is met with a further increase in military spending, similar to the arms race during the Cold War. Current global trends in military spending suggest that this is indeed the case. Over the past decade, global military expenditure has increased substantially:

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<sup>29</sup> Stiglitz, J. and Blimes, L. "The Three Trillion Dollar War" (pg 121)

<sup>30</sup> Stiglitz, J. and Blimes, L. "The Three Trillion Dollar War" (pg 130)

<sup>31</sup> Military Spending, the Peace Dividend - IMF Staff Papers (2001)



**Figure 6 - Military Expenditure Increase 1998-2007** <sup>32</sup>

Another argument against this type of buildup is the relative ineffectiveness of traditional fighting forces. Warfare is changing and traditional standing forces are highly ineffective against insurgency and terrorism – so-called “Fourth Generation War”. In an analysis done by the Imperial and Royal Austro-Hungarian Marine Corps, it was concluded that “Regardless of how... Forth Generation war changes in the future... it will still be very challenging for state armed forces to defeat Fourth Generation Enemies. It therefore logically follows that we should avoid Fourth Generation wars whenever possible”<sup>33</sup>.

While “military spending” is viewed as a public bad, “defense” spending is typically seen by economists as a “public good” as it presents a classic free-rider problem. The IMF report suggests the benefits of a *reduction* in military spending rather than abolition of defense spending. Some budget analysts posit that the “true” US defense budget should support the Department of Homeland Security – comprised of the US Coast Guard, Border Patrol, FEMA, and several other subsidiary and auxiliary departments.

<sup>32</sup> Global Issues.org – World Military Spending – Using data from SIPRI

<sup>33</sup>Fourth Generation War – Austro-Hungarian Marine Corp - FMFM1-A

The cost of this basic defensive budget is a mere \$43 billion<sup>34</sup>. Drastically reducing the military budget may cause short-term economic issues as the economy re-aligns, but proper planning can mitigate this adjustment process.<sup>35</sup>

The Senate Joint Economic Committee's estimated cost of the Global War on Terror - \$46,400 per family<sup>36</sup> - is becoming increasingly hard to justify. Military strategists suggest that such foreign military spending is ineffective against the threat it presumes to protect against. Research by several different groups suggests that the Global War on Terror will cost far more than anyone initially imagined and that the money would be better spent on domestic projects. Stiglitz and others argue that war spending is bad for the economy, citing 21<sup>st</sup> century conflicts that have been followed by recessions. Continuing the current foreign policy is unnecessarily expensive, and places US soldiers in harm's way. The United States has much to gain by adopting a more modest, defense based foreign policy. Americans will be safer, more prosperous, and better able to handle *real*/threats to national security. The foreign policy most conducive to American philosophy and economic well-being is indeed "Peace, commerce and honest friendship with all nations; *entangling alliances with none*."<sup>37</sup>

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<sup>34</sup> Department of Defense FY2009 Defense budget

<sup>35</sup> Dunne, J. Paul "The Economics of War and Peace: Opportunities in the Post-Cold War World"

<sup>36</sup> Senate Joint Economic Committee - "War at Any Cost?" - cited by Council on Foreign Relations

<sup>37</sup> Jefferson, T. - First Inaugural Address

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