The State and War:

An Austrian Political Economy Model

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May 9, 2003

International relations theories such as classical and structural realism treat the state as a unitary actor in a self-interested pursuit of power, with human nature as inherently conflictual, and the international system as anarchic. It has long been known, however, that the state is not a unitary actor. It is also debatable whether and to what extent human nature is conflictual. Certainly, there is a plethora of evidence that human beings are at least *also* cooperative. And while the anarchic international system can be useful for explaining state bahavior, it is often necessary to give recourse to the state and individual levels of analysis to fully explain the why's and wherefore's of a particular event. Political economists have much to offer in explaining the causes of international conflict in general, and war in particular. In this paper, I will draw upon the insights of the Austrian School of economics to develop a political economy model of the structural and institutional features of the modern state that can contribute causally to war, make it easier to enter into wars, and make it easier to conduct a war.

At the heart or foundation of this model is the Austrian conception of the state as a territorial monopolist of compulsion. Austrian economists do not view the state as the primary actor, however. The Austrian School is characterized by methodological individualism, a subjective theory of value, is theory-driven rather than data-driven, emphasizes the use of deductive logic, and follows the classical liberal tradition.[1] Thus, in this paper, the concept of the state will be used as shorthand for its myriad structural and institutional features, which influence and are shaped by individual human action, as well as the multitude of individual decision makers who influence state policy.

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[1] For a brief introduction to the history of the Austrian School as well its distinguishing characteristics, see http://www.mises.org/austrian.asp.

From the basis of the state as a territorial monopolist, the model will proceed with an analysis of the tendency of government growth. I will then discuss the difference between private and public ownership of government as well as the difference between profit and bureaucratic management. The following section will analyze the causal connection between interventionism, nationalism, protectionism, and war. I will then discuss the various methods of financing a war and present a cost-concealment hypothesis emphasizing the role of monetary inflation; the cost-concealment hypothesis provides an explanation for public support of a war despite its costs. And finally, I will conclude with an illustration of the model by briefly sketching the events of World War I and II with a focus on the United States.

The State as Territorial Monopolist

Reisman (1996) points out the fact that "[e]verything a government does rests on the use of force. No law actually is a law unless it is backed by the threat of force. (p. 21)" Hoppe (2001) argues that every government "is by its nature a territorial monopolist (p. 15)." Monopolist is used here in the sense that governments have a monopoly on the legal use of force and expropriation within a given territory, thus, competition is excluded; there can be no "free entry" into the "business" of government. "Under the assumption of self-interest, every government will use this monopoly of expropriation to its own advantage—in order to maximize its wealth and income. Hence every government should be expected to have an inherent tendency toward growth. (p. 15)"

Government growth can occur in both scale and scope.[2] When the scale of government grows, the resources allocated to existing governmental functions are increased. Governments grow in scope when they take on new functions. The tendency of government growth does not proceed at a uniform rate. Indeed, in the twentieth century, Western states have experienced an accelerated ratcheting up of the scale *and* scope of government in response to crises, such as the World Wars and the Great Depression (Higgs 1987, 2001).

Although the legitimacy of all governments ultimately rests upon public opinion (Hume 1971), political leaders possess a great deal of discretion. Sobel (2001) points out that public opinion does not control government policy, but merely constrains the policy choices of political leaders. Political leaders often pursue their own interests and frequently act in ways contrary to the dominant preference of their constituents. Political leaders also disseminate propaganda through government offices and the media in an effort to steer public opinion.

Privately-Owned vs. Publicly-Owned Government

Hoppe (2001) makes a distinction between private ownership of government and public ownership of government. The characteristic historical example of the former is monarchy, of the latter, democracy. A privately-owned government is one in which the government is considered to be the personal property of an individual(s). In contrast,

> [d]emocratic rule—in which the government apparatus is considered "public" property administered by regularly elected officials who do *not* personally own and are not viewed as owning the government but as its temporary *caretakers* or

[2] For a survey of the problems involved in analyzing government growth, see Robert Higgs, "Eighteen Problematic Propositions in the Analysis of the Growth of Government," *The Review of Austrian Economics*, Vol. 5, No. 1 (1991): 3-40.

> *trustees*—typically only follows personal rule and private government ownership (p. 17, emphasis in original).

These two forms of government have systematically different effects on social time preference.

The Austrian theory of time preference holds that, ceteris paribus, people tend to prefer satisfaction of wants sooner rather than later. An individual with a higher degree of time preference will be more present-oriented, while a person with a low degree of time preference will be more future-oriented or far-sighted. Under a privately-owned government, the ruler and the people will tend to have relatively lower degrees of time preference than they would under publicly-owned or democratic government.

Hoppe offers two interrelated structural/institutional factors that drive the tendency towards higher time preference in democracies: "public" ownership of the government and free entry into it.

> A democratic ruler can use the government apparatus to his personal advantage, but he does not own it. He cannot sell government resources and privately pocket the receipts from such sales, nor can he pass government possessions on to his personal heir. He owns the *current use* of government resources, but not their capital value. In distinct contrast to a king, a president will want to maximize not total government wealth (capital values and current income) but current income (regardless and at the expense of capital values). Indeed, even if he wished to act differently, he *could not*, for as public property, government resources are unsaleable, and without market prices economic calculation is *impossible*. Accordingly, it must be regarded as unavoidable that public-government ownership results in continual capital consumption. Instead of maintaining or even enhancing the value of the government estate, as a king would do, a president (as distinct from a king) has no interest in not ruining his country. For why would he *not* want to increase his confiscations if the advantage of a policy of moderation—the resulting higher capital value of the government estate—*cannot* be reaped privately, while the advantage of the opposite policy of higher taxes—*can* be so reaped? For a president, unlike for a king, moderation offers only disadvantages. (p. 24, emphasis in original)

This, of course, applies not only to presidents or prime ministers in a democracy but also to members of congress or parliament as well as to bureaucrats. Obviously not all politicians act in the manner described above, or at least do not intentionally pursue policies with such effects, but public-government ownership has the effect of encouraging such tendencies.

Moreover, in a modern democracy, entry into government is in principle open to everyone. In contrast, entry into government in a monarchy is restricted to the ruler and his family and friends. This has the effect of stimulating "the development of a clear "class consciousness" on the part of the governed public and promotes opposition and resistance to any expansion of the government's power to tax (p. 21)." Also, "government attempts at territorial expansion tend to be viewed by the public as the ruler's private business, to be financed and carried out with his own personal funds. The added territory is the king's, and so he, not the public, should pay for it. Consequently, of the two possible methods of enlarging his realm, war and military conquest or contractual acquisition [e.g., marriage], a private ruler tends to prefer the latter (p. 23)."

Free entry into government blurs the distinction between the rulers and the ruled. Anyone, in theory, can become part of the ruling class. The "class-consciousness" of the ruled is blurred. Pressure groups will inevitably attempt to influence politicians and get representatives elected in order to use the coercive power of the government apparatus to satisfy their short-run interests at the expense of others. Consequently, "public resistance against government power is systematically weakened (p. 25-26)."

The combined effect of these two factors—"public" ownership of government and free entry into it—is conducive to a state of affairs, commonly used to refer to environmental issues, that can best be characterized as a "tragedy of the commons."[3,4] Of course, the tendency of a higher social time preference under publicly-owned governments relative to privately-owned governments should be understood in conjunction with the tendency of government growth. The Jacobin-style, statist democracies obviously won out over Jeffersonian-style democracy in the twentieth century (Gottfried 2001).

The transition from monarchy to democracy in the West has been characterized by rising public debt, high levels of taxation and inflation, and the advent of total war. While there seems to be empirical support for the proposition that democracies do not fight one another, the fact that most stable democracies are economically advanced and have high levels of international trade suggests that the real causal factor behind "democratic peace" is capitalism and free trade. Democratic Peace Theory also posits that democracies will fight non-democracies. Historically, there is considerable empirical support for this, but the fact that non-democracies tend to be poorly developed economically undermines the theory. A "positive" correlation between democracy and increased militarization and war can be seen in Howard (1976) and Fuller (1969, 1992). This correlation is linked to the natural tendencies of government growth and centralization, and expansionism.

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[3] See, for example, *Managing the Commons*, Garret Hardin and John Baden, eds., San Francisco: W.H. Freeman, 1977.

[4] It should be noted that neither Hoppe nor the present author advocate a return to monarchy or deny that monarchy suffers from serious flaws as well.

Profit Management vs. Bureaucratic Management

In addition to the importance of government growth and the distinction between private and public ownership of government to an understanding of the state is the distinction between profit management and bureaucratic management. The eminent Austrian economist, Ludwig von Mises, in his book *Bureaucracy* (1963a) and in other works, argues that bureaucratic management is the characteristic method of government and that it is appropriate only to government (not business, for example). Likewise, profit management is characteristic of the market and is not appropriate necessary government functions (such as police or military).

In a capitalist system of production, the capitalists, entrepreneurs, and farmers are beholden to the consumers. They must produce what the consumers want. "[I]f they fail to produce at the lowest possible cost what the consumers are asking for, they lose their office (p. 25)." "Profit and loss are the instruments by means of which the consumers keep a tight reign on all business activities. (p. 25)" Profit and loss accounting is made possible by the system of market prices, which necessarily depends upon private ownership of the means of production; the market price is also necessary to guide economic planning. Without a common denominator to weigh the costs of pursuing one plan out of countless others, of utilizing one factor of production among countless others, economic calculation would be impossible.

By its nature, bureaucratic management is incapable of economic calculation. It "is the method applied in the conduct of administrative affairs the result of which has no cash value on the market (p. 51)." There is no connection between revenue and expenditure in public administration; there is no market price for its achievements. The public services are concerned with spending money only. In the absence of the profit motive, it is necessary to impose thrift on the bureaucrat by regimentation. Consequently,

> bureaucratic management is management bound to comply with detailed rules and regulations fixed by the authority of a superior body. The task of the bureaucrat is to perform what these rules and regulations order him to do. His discretion to act according to his own best conviction is seriously restricted by them. (p. 50)

With profit management, on the other hand, "[t]here is no need to limit the discretion of subordinates by any rules or regulations other than that underlying all business activities, namely, to render their operations profitable (p. 50)."

For obvious reasons, then, a public enterprise in a market system, if it is to be operated without regard to profits, is also faced with the economic calculation problem. Since the behavior of the public is no longer a criterion of its usefulness, since every service can be improved by increasing expenditures, regimentation must be imposed upon the manager of a public enterprise. Extensive rules and regulations are required to guide the production of what, when, how much, and where. And unlike private enterprises, it is not a mark of failure to operate at a loss.

If the lack of any means of economic calculation is damaging to public enterprises in a market system, so too is it to socialism.

> Socialism, that is, full government control of all economic activities, is impracticable because a socialist community would lack the indispensable intellectual instrument of economic planning and designing: economic calculation. The very idea of central planning is self-contradictory. A socialist central board of production will be helpless in the face of the problems to be solved. It will never know whether the projects considered are advantageous or whether their performance would not bring about a waste of the means available. Socialism must result in complete chaos. (p. 62)

It is only because public enterprises exist within a country, and socialist states exist within an international system, the greater part of which operates as a market economy, that they are able to perform any kind of economic calculation at all. Under these conditions they are able to use the prices established in the rest of the national or international economy for their own economic calculation. If every state were to adopt socialism, however, “there would be no more prices for factors of production and economic calculation would be impossible (p. 64).”[5]

Government interference and impairment of the profit motive lead to the bureaucratization of private enterprise. There are a number of ways in which the government can interfere with business and impair the profit motive. The government may tax away all or most profits, fix prices, or limit profits in some other way. Such policies inhibit innovation as they limit the benefits to the entrepreneur while leaving him all the risks. The imposition of rules and regulations on private enterprise impose operating costs as efforts are made either to comply with them or evade them. To the extent that private enterprise is driven to bureaucratization, it will become more dependent upon government bureaus; it will have to spend more time engaged in political competition, utilizing diplomacy or bribery, in order to gain an advantage over its rivals, while its economic competitiveness is eroded and its incentive to compete economically is decreased.

Interventionism, Nationalism, Protectionism, and War

According to Mises (1963b), statism—whether in the form of interventionism or socialism—is linked to aggressive nationalism and “must lead to conflict, war, and the totalitarian oppression of large populations (p. 96).” He also shows that protectionism “is

[5] For a detailed treatment of the socialist-calculation problem, see Ludwig von Mises, *Socialism*, London: Jonathan Cape, 1969. Reprint. Indianapolis: Liberty Classics, The Liberty Fund, 1982.

a necessary corollary of the domestic policy of government interference with business (p. 69).” Protectionism also results from the state’s natural desire for economic self-sufficiency (autarky). Protectionist policies foment conflict between states.

Interventionism is the popular modern doctrine that there is a third system as an alternative to capitalism and socialism. It conceived as a mixture of the two, “as an order based on private ownership of the means of production in which, however, the government intervenes, by order and prohibition, in the exercise of ownership rights (p. 62).” However,

> …each constellation of the market has a corresponding price structure. Prices, wages, and interest rates are the result of the interplay demand and supply. There are forces operating in the market which tend to restore this—natural—state if it is disturbed. Government decrees, instead of achieving the particular ends they seek, tend only to derange the working of the market and imperil the satisfaction of the needs of the consumers. (p. 61)

Mises illustrates this fact by examining the two most important types of intervention: interference by restriction and interference by price control.

“Interference by restriction aims directly at a diversion of production from the channels prescribed by the market and the consumers (p. 63).” The government prevents men from utilizing some of the means available for the satisfaction of their needs by forbidding “the manufacture of certain goods or the application of certain methods of production, or makes such methods more difficult by the imposition of taxes or penalties (p. 63).” Such measures obviously consume wealth and disrupt the tendency of natural market forces to utilize every means of production in such a manner as to provide for the highest satisfaction of human wants.

“The aim of price control is to decree prices, wages, and interest rates different from those fixed by the market (p. 64).” Price control has the effect of disrupting the tendency towards an equilibrium of demand and supply in the market. At an equilibrium, everyone ready to buy or sell at the market price can buy or sell as much as he wants. However, a price ceiling fixes the price of a good below the market level; without an increase in supply, the buyers who had been willing to pay the market price now have to compete with those able to pay the new price and a shortage ensues. Unless the government is willing to allow distribution on a first-come-first-serve or a favoritism basis, it will have to introduce some form of rationing. But price ceilings also serve to reduce the supply, because “[t]he marginal producers [of a given good], those with the highest costs, will, in order to avoid losses, go out of the business of producing and selling [that good] (p. 65).” They will employ their resources and skills for more profitable purposes. For example, if milk is the price-controlled good in question, the marginal producers will shift production to cheese, butter, meat, or some other good they can produce with their cows. Thus the supply will be reduced and the government will have to either repeal the control or it will have to add another price control to the factors of production involved in the production of the first good. But the effect of this second price control will be the same, thus price ceiling must beget price ceiling until all the prices in the entire economy are fixed.

The effect of fixing minimum prices above the market rate—e.g., with minimum wage laws and pro-labor legislation—is the same.

> The artificially elevated wage rates cause permanent unemployment of a considerable part of the potential labor force. At these higher rates the marginal employments for labor are no longer profitable. The entrepreneurs are forced to restrict output, and the demand on the labor market drops. (p. 67)

The government can attempt to supplement its use of price controls or correct the problems created by its price floors and ceilings with increased spending. However, it must finance this increased spending with increased taxes or borrowing from the public (which must eventually be financed by higher taxes).

Interventionism thus begets the bureaucratization of private enterprise, increases costs of production, and curtails private investment and spending.

Free trade and interventionism are incompatible. The aims of interventionism would be frustrated if foreign products were allowed to compete freely on the domestic market. Interventionism therefore leads to economic nationalism. Protectionist policies in the form of tariffs, quotas, subsidies, etc., must be instituted in order to protect the aims of interventionism and the competitiveness of hampered domestic businesses. The imposition of import duties, or protective tariffs, facilitates the formation of monopolies or cartels when domestic production is greater than is needed for domestic consumption. Domestic producers "can form a cartel and charge domestic consumers monopoly prices which can go up to a level only slightly lower than the world market price plus the import duty. With their domestic monopoly profits they can afford to sell at lower prices. (p. 73)" Alternatively, the government could give a producer(s) a monopoly franchise. In any event, the domestic consumers are clearly worse off and international competitors will complain of unfair competition.

It will be fruitful to quote at length from Mises' treatment of the connection between protectionism, economic nationalism, and war.

> The international division of labor is a more efficient system of production than is the economic autarky of every nation. The same amount of labor and of material factors of production yields a higher output. This surplus production benefits

> everyone concerned. Protectionism and autarky always result in shifting production from the centers where conditions are more favorable—i.e., from where the output for the same amount of physical input is higher—to centers where they are less favorable. The more productive resources remain unused while the less productive are utilized. The effect is a general drop in the productivity of human effort, and thereby a lowering of the standard of living all over the world.
>
> The economic consequences of protectionist policies and of the trend towards autarky are the same for all countries. But there are qualitative and quantitative differences. The social and political results are different for comparatively overpopulated industrial countries and for comparatively underpopulated agricultural countries. In the predominantly industrial countries the prices of the most urgently needed foodstuffs are going up. This interferes more and sooner with the well-being of the masses than the corresponding rise in the prices of manufactured goods in the predominantly agricultural countries. Besides, the workers in the industrial countries are in a better position to make their complaints heard than the farmers and farm hands in the agricultural countries. The statesmen and economists of the predominantly industrial countries become frightened. They realize that natural conditions are putting a check on their country's endeavors to replace imports of food and raw materials by domestic production. They clearly understand that the industrial countries of Europe can neither feed nor clothe their population out of domestic products alone. They foresee that the trend toward more protection, more insulation of every country, and finally self-sufficiency will bring about a tremendous fall in the standard of living, if not actual starvation. Thus they look around for remedies. (p. 77)

States with the power to do so will, in such cases, be more likely to go to war in order to achieve autarky. Historical examples are imperialism and colonialism. In the post-World War II era, the U.S. has repeatedly used force to set up or prop up regimes favorable to it.

Interventionism foments conflict in the international system in other ways as well. The statist mentality that leads to interventionism at home will inevitably lead to interventionism abroad. What form this takes will depend upon the interests, relative power, and other characteristics unique to each country. At its most extreme it can manifest in attempts at world domination. But, more relevant for the current international environment, it can manifest as a need to be the world's policeman (e.g., both the UN and the US). The advanced, Western countries desire to make the world safe for democracy and seek to export it and Western values, often by force. Such activities, unsurprisingly, often stir up anger and resentment. Aggressive nationalism need not be based on ideology. Nationalism originated along linguistic lines. And it has been based on ethnicity or religion as well.

It should by now be obvious that the traditional realist assertion that foreign and domestic policy are separate and unrelated spheres of activity is wrong. As Ludwig von Mises argues, “A nation’s policy forms an integral whole. Foreign policy and domestic policy are closely linked together, they condition each other. Economic nationalism is the corollary of the present-day domestic policies of government interference with business and of national planning as free trade was the complement of domestic economic freedom. (Mises 1943, p. 158)"

It is important to point out—in connection with government growth and the effect of publicly-owned government to increase present-orientedness—that the advent of modern, statist democracy has seen a dramatic rise in the tendency of the public (or parts of it) to demand that government “do something now” in response to crises. This has manifested not only in demands for social-welfare policies but also interventionist and protectionist policies.

Financing and Concealing the Costs of War

The conduct of war necessarily entails a “vertical” as well as “horizontal” reallocation of factors of production from capital and consumer goods to military goods. As Mises points out, “War can be waged only with present goods (1983, p. 168).” Not only is the production of present goods shifted from consumer to military use. But conducting a war “also entails a “vertical” shift of resources from the “higher” stages of production to the “lower” stages of production, that is, from the production and maintenance of capital goods temporally remote from the service of the ultimate consumers to the production of war goods for present use (Salerno 2001, p. 435).” Shifting to a war economy shortens its time structure of production and thus “consumes” its capital. As the war drags on and capital goods are worn out and not replaced, “real income inevitably declines—possibly precipitously—below its previous peacetime level (p. 435).”

There are four methods that governments have at their disposal for financing a war: taxation, borrowing from the public, monetary inflation, and coercive requisitioning of material and human resources. Large-scale wars have historically seen the use of a combination of these methods. While governments can technically finance a war exclusively with increased taxation and non-inflationary borrowing on capital markets, war is an extremely costly enterprise. “When the public is accurately apprised of its full costs, war becomes increasingly unpopular, civilian enthusiasm and labor efforts lag, and unrest and even active resistance may ensue on the homefront and spread to the frontlines (p. 439).” Monetary inflation and coercive requisition of material and human resources operate to partially conceal the costs of war from the public’s view.

The coercive requisition of material and human resources works best with non-reproducible resources, such as human labor. The primary example of this is conscription. “By legally compelling its citizen-subjects to serve a specified term in military service at wage rates far below market levels, the government significantly reduces the budgetary costs of war and thus the amount by which it must ratchet up taxes

(p. 439).” However, uncompensated confiscation of reproducible resources confronts an insuperable difficulty: while it does yield access to existing stocks of resources, it destroys the incentive on the part of private individuals and firms to reproduce these resources (p. 440).”

Monetary inflation is an increase in the money supply. This necessarily results in a decrease of the purchasing power of money. “[T]o the extent that it is not adapted to in accounting procedures, [it] will inescapably falsify business calculations (p. 448).” The problem is compounded by the fact that the newly created money does not circulate through the entire economy instantaneously but seeps in as it is used by the government to buy the goods and services necessary to conduct the war.

> A boom is consequently precipitated, featuring rising prices, profits, and stock values [in the industries of the war suppliers]. The boom is particularly intense and dazzling in these industries because, during an inflation, prices rise in temporal sequence. Thus, prices and nominal incomes initially increase only for those sellers who receive the new money in the first round of spending and, therefore, before the prices of the productive inputs and consumer goods they themselves regularly purchase have had a chance to rise. (p. 449)

Market interest rates do not initially rise and the…

> …higher prices for consumer and war goods eventually spread up the ladder of the structure of production and result in higher prices for the capital-goods inputs produced by the higher stage firms. With their higher prospective earnings discounted by an unchanged interest rate, equity values increase for these firms also. War appears to breed universal prosperity. (p. 449)

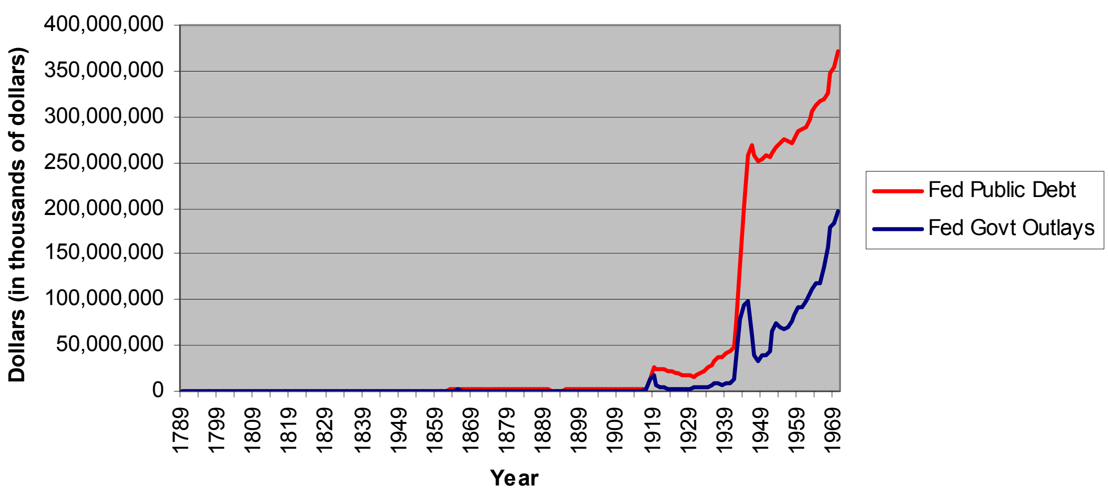
But capital consumption proceeds unabated. Aggregate real losses are suffered especially hard by higher-order firms because standard prewar accounting practices assume roughly stable prices. Years down the road, the loss will be realized when existing capital goods need to be replaced.

The inevitable rise in prices that results from monetary inflation tends to be followed by interventionism in the form of price controls, which has the predictable result described above. Thus interventionism not only contributes causally to war but also aids the state in financing and conducting a war. The interventions of the war economy are rarely, if ever, entirely dismantled after the war is over, thus contributing to the long-term growth of government (Higgs 1987, 2001; Salerno 2001).

Case Study: The United States, World War I & II

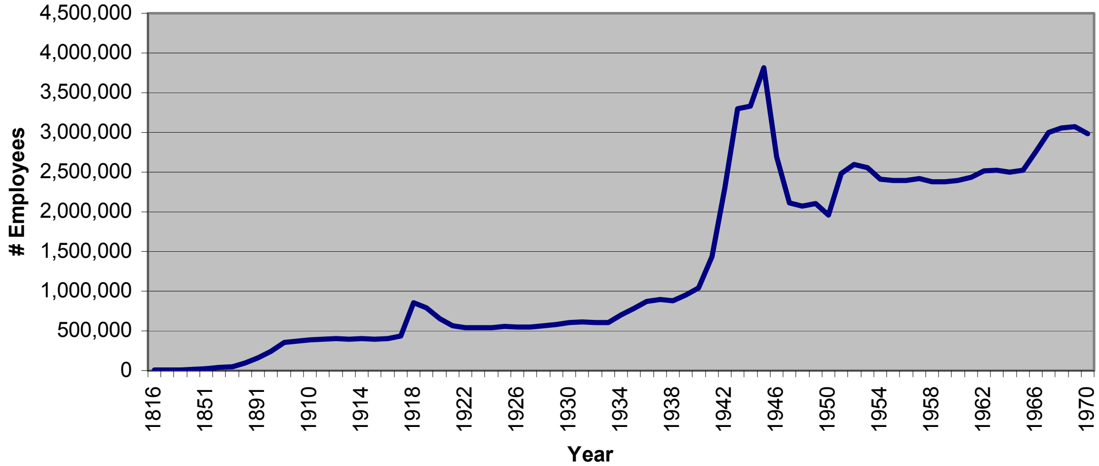
The United States government has grown dramatically since its founding, but most of that growth has occurred since World War I. As government growth is not the main focus of this paper, I offer only a handful of statistical measures in the graphs below to illustrate the model. The growth of the United States government is dealt with in great detail in Higgs (1987, 2001).

U.S. Federal Government Outlays and Public Debt, 1789-1970



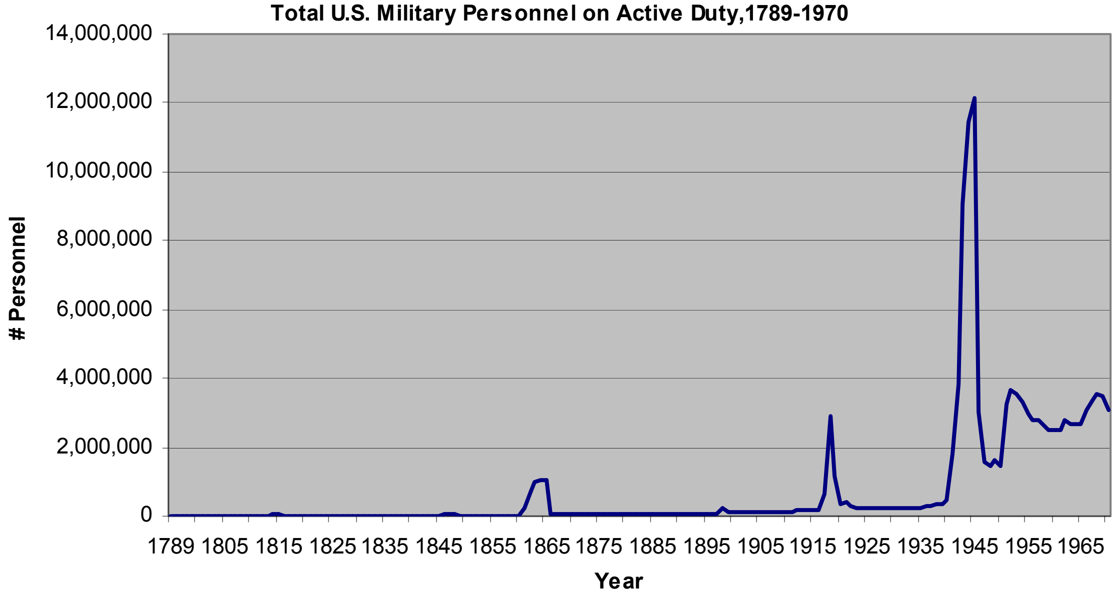
Source: U.S. Bureau of the Census: Historical Statistics of the U.S.: Colonial Times to 1970.

Paid Civilian Employment of the U.S. Federal Government: 1816-1970

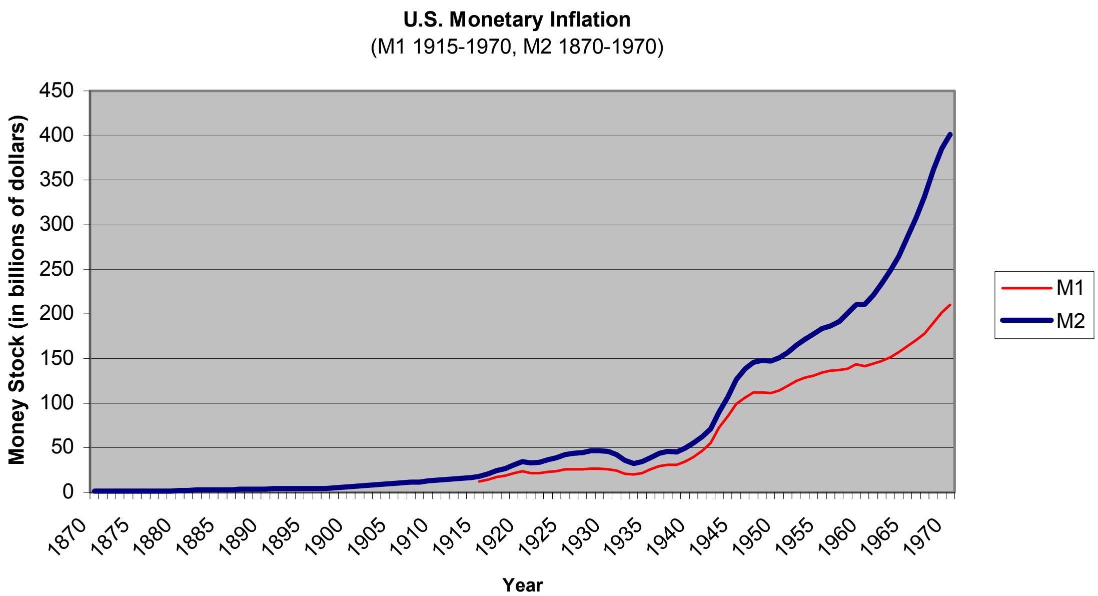


Source: U.S. Bureau of the Census: Historical Statistics of the U.S.: Colonial Times to 1970.

Total U.S. Military Personnel on Active Duty,1789-1970



Source: U.S. Bureau of the Census: Historical Statistics of the U.S.: Colonial Times to 1970.



Source: U.S. Bureau of the Census: Historical Statistics of the U.S.: Colonial Times to 1970.

While the United States did not start World War I or II, the stage for its entry into World War I was set with the Spanish-American War. The war with Spain and the acquisition of colonies in the Caribbean and the Pacific marked the beginning of the United States as an imperial power. As foreign affairs began to play a more prominent role in American politics and policy, the executive gained greater power in foreign policy. Woodrow Wilson's presidency was marked by the extension of a protectorate over Nicaragua, the invasion and subjugation of Haiti, and the military occupation of the Dominican Republic. He attempted to manipulate the course of the Mexican civil war. "Two weeks before the assassination of the Archduke, Wilson delivered an address on Flag Day (Raico 2001, p. 218)" that foreshadowed the advent of American internationalism. He announced that the flag would stand for "undisputed national power…for self-possession, for dignity, for the assertion of the right of one nation to serve the other nations of the world. As President, he would "assert the rights of mankind wherever this flag is unfurled." (p. 218-19)"

The Progressive Era, between the Spanish-American War and World War I, was marked by the centralization of power in the United States federal government. Three drastic changes in domestic policy occurred in 1913. One was the establishment of the Federal Reserve System, which placed complete control of the country's monetary and credit policies into the hands of a few non-elected insiders unaccountable to the American people. The other two were Constitutional Amendments. The 16^{th} Amendment instituted the income tax, a direct tax upon the people, greatly enhancing the ability of the federal government to raise revenue. And the 17^{th} Amendment changed the method of selecting U.S. Senators from election by state legislatures to a direct vote of the people, thus removing a constitutional restraint held by the states on the growth of the federal government. But the government made other inroads into the economy as well, e.g., the Bureau of Corporations (1903), the Clayton Antitrust Act and the Federal Trade Commission Act (both 1914), major amendments to the Interstate Commerce Act (1903, 1906, 1910), and the Meat Inspection Act and the Pure Food and Drug Act (both 1906) (Higgs 1987, p. 111).

Britain effectively ended American trade with Germany early in the war when it first expanded the list of contraband to include key raw materials (including food) destined not only for hostile but even for neutral ports and later declared the entire North Sea to be a war zone. Already bound by sentimental ties to Britain, America became increasingly bound financially as well. Wilson warned Germany that America had the right to protect its citizens even when they are traveling on belligerent ships when the sinking of the *Falaba* resulted in one American death. After the *Lusitania* and *Sussex* were sunk, resulting in more American deaths, a promise was extracted from Germany to cease attacking enemy merchant ships without warning. But in 1917, in dire straits, Germany announced that it would resume unrestricted submarine warfare. Wilson then ordered American merchant ships be armed and defended by American sailors, "thus placing munitions and other contraband sailing to Britain under the protection of the U.S. Navy (p. 228)." After a number of freighters were sunk in the declared submarine zone, Wilson called a special session that resulted in a declaration war.

The financing and conduct of the war by the United States fits the model. Gearing up for war, the government "virtually nationalized the ocean shipping industry" and…

> did nationalize the railroad, telephone, domestic telegraph, and international cable industries. It became deeply engaged in manipulating labor-management relations, securities sales, agricultural production and marketing, the distribution of coal and oil, international commerce, and the markets for raw materials and manufactured products. (Higgs 2001, p. 377)

The number of officers and men in the armed forces was built up to four million between 1917 and 1918 (Higgs 2001) and the total active duty military personnel (excluding the coast guard) peaked at nearly 2.9 million in 1918 (see graph above). More than 72 percent of the military personnel added after America declared war were drafted (Higgs 2001). Money stock (M1) increased by 48 percent, from $14.7 billion in 1916 to $21.79 billion in 1919. Taxes were greatly increased. Federal government outlays increased from nearly $712 million in 1916 to nearly $18.5 billion in 1919, an increase of 2,493 percent! The national debt soared from $1.2 billion in 1916 to $25.5 billion in 1919.

The preconditions for World War II were set with the extremely harsh penalties placed upon Germany and the anger and resentment they fostered. Under the Nazi's, Germany's economy was essentially de-facto socialism and highly protectionist; despite property being officially privately owned, the government controlled nearly every aspect of the economy (Mises 1963b). Once again, in the events leading up to the U.S. declaration of war, the government pursued a foreign policy of 'de jure neutrality, de facto belligerency'. "The destroyer deal with the British in September 1940, the lend-lease arrangements given statutory sanction in March 1941, and a series of provocative restrictions on trade with the Japanese edged the country ever closer to war (Higgs 1987, p. 199-200)." Japan, already aggressively nationalist and expansionist, lacking in natural resources and seeking economic self-sufficiency, was at least partly encouraged by the U.S. to expand further and later conduct a surprise attack on Pearl Harbor. The attack on Pearl Harbor was the decisive event that drew America into the war.

Government intervention in the economy during World War II resembled that of World War I but went far beyond it (Higgs 1987, 2001). "Of the sixteen million who served in the armed forces during the war, ten million were conscripts" and "many of the volunteers came forward only because of the draft, some seeking to avoid uncomfortable and dangerous service in the infantry by joining the Navy. (Higgs 1987, p. 202)" Federal government outlays increased from roughly $9 billion in 1940 to nearly $33 billion in 1948, an increase of 264 percent. The money stock (M1) increased from $39.65 billion in 1940 to $112.31 billion in 1948, an increase of 183 percent. The national public debt swelled from nearly $42 billion in 1940 to roughly $258 billion in 1948, an increase of 500 percent.

Conclusion

Foreign policy is not a separate realm divorced from domestic politics. The two, in fact, form an integral whole. Protectionism is a necessary corollary of interventionism, though other factors can bring about protectionist policies as well. With the rise of statism comes a concomitant rise in economic nationalism, manifesting in protectionism as well as other political, economic, and/or military interventions in the affairs of other countries. Conflict is the inevitable result of such policies.

World War I grew out of the competition of increasingly statist countries pursuing policies of aggressive nationalism and imperialism. America had begun to shift away from its isolationist roots in the decades between the Spanish-American War and World War I. The Progressive Era was marked by increasing centralization of power to the federal government and intervention in the economy as well as abroad. By no means as statist as some of the war's other participants, the U.S. had progressed far enough to facilitate its being drawn into the war. World War II was arguably a continuation of the first World War.

Three decades of crises involving World War I & II and the Great Depression resulted in a decisive shift in American foreign policy, from isolationist to internationalist. This dramatic change was made possible, largely I think, by the American government's increasingly statist policies, wartime central planning's apparent success, the illusory prosperity fostered by wartime inflation, and the conflictual international environment leading up to and fostered by World War I (and, consequently, World War II). Space and time considerations prevented me from making this case explicitly.

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