War Causes Inflation …

And Inflation Allows The Government to Start Unnecessary Wars

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War almost always causes inflation.

As liberal economist James Galbraith wrote in 2004:

> War causes inflation.
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> Every major war in the past century brought inflation to some degree. And so did two upheavals in the Middle East, the Yom Kippur War of 1973 and the Iranian Revolution of 1979, which did not directly involve the United States, except through their effect on the price of oil. Why is this so? The big reason is that wars must be paid for, somehow. They require resources that civilians would otherwise use. Those resources must be diverted to the war effort. Usually, inflation is the easiest way. World War I was largely financed by inflation, and so were the Revolutionary and Civil Wars before that. So, though on a smaller scale, was Vietnam.
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> Inflation applies the law of the jungle to war finance. Prices and profits rise, wages and their purchasing power fall. Thugs, profiteers and the well connected get rich. Working people and the poor make out as they can. Savings erode, through the unseen mechanism of the "inflation tax" — meaning that the government runs a big deficit in nominal terms, but a smaller one when inflation is factored in.
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> There is profiteering. Firms with monopoly power usually keep some in reserve. In wartime, if the climate is permissive, they bring it out and use it. Gas prices can go up when refining capacity becomes short — due partly to too many mergers. More generally, when sales to consumers are slow, businesses ought to cut prices — but many of them don't. Instead, they raise prices to meet their income targets and hope that the market won't collapse.
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> Is there another way? The answer is yes, but it isn't easy.
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> In wars past — notably in World War II and Korea — the job was done by steeply progressive taxes including taxes on excess profits, by "forced saving" (which was an essentially compulsory private holding of public debt), and by price control. Interest rates were frozen at 2 percent on government bonds — and essentially at 0 on bank deposits. The principle was: No one profits from the war.
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> This combination kept inflation down — prices were stable from 1942 through 1945. Not many grew rich off that war. Instead, my generation grew up with

> series EE bonds to our names. They were the promise that those working to win the war would see some of the material fruits of their labor later, when peacetime production returned.

Libertarian Congressman Ron Paul agreed in 2007:

> Congress and the Federal Reserve Bank have a cozy, unspoken arrangement that makes war easier to finance. Congress has an insatiable appetite for new spending, but raising taxes is politically unpopular. The Federal Reserve, however, is happy to accommodate deficit spending by creating new money through the Treasury Department. In exchange, Congress leaves the Fed alone to operate free of pesky oversight and free of political scrutiny. Monetary policy is utterly ignored in Washington, even though the Federal Reserve system is a creation of Congress.
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> The result of this arrangement is inflation. And inflation finances war.
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> Economist Lawrence Parks has explained how the creation of the Federal Reserve Bank in 1913 made possible our involvement in World War I. Without the ability to create new money, the federal government never could have afforded the enormous mobilization of men and material. Prior to that, American wars were financed through taxes and borrowing, both of which have limits. But government printing presses, at least in theory, have no limits. That's why the money supply has nearly tripled just since 1990.
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> For perspective, consider our ongoing military commitment in Korea. In Korea alone, U.S. taxpayers have spent $1 trillion in today's dollars over 55 years. What do we have to show for it? North Korea is a belligerent adversary armed with nuclear weapons, while South Korea is at best ambivalent about our role as their protector. The stalemate stretches on with no end in sight, as the grandchildren and great-grandchildren of the men who fought in Korea give little thought to what was gained or lost. The Korean conflict should serve as a cautionary tale against the open-ended military occupation of any region.
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> The [hundreds of billions] we've officially spent in Iraq is an enormous sum, but the real total is much higher, hidden within the Defense Department and foreign aid budgets. As we build permanent military bases and a $1 billion embassy in Iraq, we need to keep asking whether it's really worth it. Congress should at least fund the war in an honest way so the American people can judge for themselves.

Blanchard Economic Research pointed out in 2001:

> War has a profound effect on the economy, our government and its fiscal and monetary policies. These effects have consistently led to high inflation.
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> David Hackett Fischer is a Professor of History and Economic History at Brandeis. [H]is book, The Great Wave, Price Revolutions and the Rhythm of History … finds that … periods of high inflation are caused by, and cause, a breakdown in order and a loss of faith in political institutions. He also finds that war is a triggering influence on inflation, political disorder, social conflict and economic disruption.
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> The type of inflation that is associated with wars usually arises from increases in aggregate demand. In time of war, government spending for military

purposes stimulates demand throughout an economy, at the same time that a shift of workers from productive labor into war production causes a decline in aggregate supply.

War also causes the type of inflation that results from a rapid expansion of money and credit. “In World War I, the American people were characteristically unwilling to finance the total war effort out of increased taxes. This had been true in the Civil War and would also be so in World War II and the Vietnam War. Much of the expenditures in World War I, were financed out of the inflationary increases in the money supply.” (See “American Economic History,” Scheiber, Vatter and Faulkner)

War usually leads to the type of inflation which is caused by inflationary expectations. Professor Fischer explains:

“It occurs when people begin to raise prices not because of actual changes in supply or demand or cost or the size of the money supply, but out of fear that some such changes might happen.”

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Professor Fischer also provides an interesting perspective on war-related inflations in the 20th century:

> “Inflation surged after America joined World War I in 1917, then declined after 1919, but to pre-war levels. After World War II, Korea and Vietnam, war-inflations were not followed by a decline at all. Prices continued to climb.”

Professor Fischer had some interesting things to say about the Korean War:

> “In its economic impact the Korean War was similar to the world wars that had preceded it. Once again, inflationary pressures surged throughout the world. In 1950, wholesale prices jumped 12% in the United States, 18% in Germany, 21% in Britain, 28% in France, and 32% in Sweden.”

Professor Fischer discusses the inflation that took place as part of the Vietnam War and as part of the 1973 Yom Kippur War. He says that the Vietnam War was not the pivotal event in the acceleration of inflation during the 1960s, although he admits that the Johnson administration’s decision to expand public spending for social welfare at the same time that it fought a major war in Southeast Asia, without a large increase in taxes, was a major miscalculation.

Other economists agree with Professor Fischer’s link between inflation and war.

James Grant, the respected editor of Grant’s Interest Rate Observer, supplies us with the most timely perspective on the effect of war on inflation in the September 14 issue of his newsletter:

> “War is inflationary. It is always wasteful no matter how just the cause. It is cost without income, destruction financed (more often than not) by credit creation. It is the essence of inflation.”

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Roger Bootle, in his book, The Death of Inflation, also traced the historic link between inflation and war in America's 225-year history:

> "This country's first two experiences with high inflation were during the American War of Independence (1775-83) and during the Civil War. There was also high inflation associated with the First World War; the unifying theme running through inflation episodes are the occurrence of bad times, often as a result of war or its aftermath."

"After the Second World War, inflation became the norm everywhere in the industrial world. There was another surge of inflation during the Korean War, which took inflation in the U.S. above 9% in 1951 (and wholesale price inflation into double digits)."

"The inflation that accompanied the Vietnam War and the Yom Kippur War, and oil price shocks in the 1970s, led people to increase their inflationary expectations, which aggravated inflation itself."

Similarly, in her book, Money Meltdown, Judy Shelton also traces the relationship between war and inflation from the Civil War through Vietnam:

> "'We tried to finance the Vietnam War and the Great Society programs without a tax increase,' admits Charles L. Schultze, Johnson's budget director at the time, 'and clearly that started our course of inflation.'"
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> "Political leaders always have tended to take the view that in time of war the nation must do whatever is necessary to succeed, and the financial repercussions can be dealt with later. Johnson was only following the pattern that had been adhered to by his predecessors …."

Libertarian economics writer Lew Rockwell noted in 2008:

> You can line up 100 professional war historians and political scientists to talk about the 20th century, and not one is likely to mention the role of the Fed in funding US militarism. And yet it is true: the Fed is the institution that has created the money to fund the wars. In this role, it has solved a major problem that the state has confronted for all of human history. A state without money or a state that must tax its citizens to raise money for its wars is necessarily limited in its imperial ambitions. Keep in mind that this is only a problem for the state. It is not a problem for the people. The inability of the state to fund its unlimited ambitions is worth more for the people than every kind of legal check and balance. It is more valuable than all the constitutions every devised.
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> The connection between war and inflation, then, dates long before the creation of the Federal Reserve.

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Before the creation of the Federal Reserve, the idea of American entry into the conflict that became World War I would have been inconceivable. In fact, it was a highly unpopular idea, and Woodrow Wilson himself campaigned on a platform that promised to keep us out of war. But with a money monopoly, all things seem possible. It was a mere four years after the Fed was invented under the guise of scientific policy planning that the real agenda became obvious. The Fed would fund the US entry into World War I.

It was not only entry alone that was made possible. World War I was the first total war. It involved nearly the whole of the civilized world, and not only their governments but also the civilian populations, both as combatants and as targets. It has been described as the war that ended civilization in the 19th-century sense in which we understand that term. That is to say, it was the war that ended liberty as we knew it. What made it possible was the Federal Reserve. And not only the US central bank; it was also its European counterparts. This was a war funded under the guise of scientific monetary policy.

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Reflecting on the calamity of this war, Ludwig von Mises wrote in 1919

> One can say without exaggeration that inflation is an indispensable means of militarism. Without it, the repercussions of war on welfare become obvious much more quickly and penetratingly; war weariness would set in much earlier.

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The story of central banking is one step removed from the story of atom bombs and death camps. There is a reason the state has been unrestrained in the last 100 years, and that reason is the precise one that many people think of as a purely technical issue that is too complicated for mere mortals.

Fast-forward to the Iraq War, which has all the features of a conflict born of the power to print money. There was a time when the decision to go to war involved real debate in the House of Commons or the US House of Representatives. And what was this debate about? It was about resources and the power to tax. But once the executive state was unhinged from the need to rely on tax dollars and did not have to worry about finding willing buyers for its unbacked debt instruments, the political debate about war was silenced.

In the entire run-up to war, George Bush just assumed as a matter of policy that it was his decision alone whether to invade Iraq. The objections by Ron Paul and some other members of Congress and vast numbers of the American population were reduced to little more than white noise in the background. Imagine if he had to raise the money for the war through taxes. It never would have happened. But he didn't have to. He knew the money would be there. So despite a $200 billion deficit, a $9 trillion debt, $5 trillion in outstanding debt instruments held by the public, a federal budget of $3 trillion, and falling tax receipts in 2001, Bush contemplated a war that has cost $525 billion dollars — or $4,681 per household. Imagine if he had gone to the American people to request that. What would have happened? I think we know the answer to that question. And those are government figures; the actual cost of this war will be far higher — perhaps $20,000 per household.

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> If the state has the power and is asked to choose between doing good and waging war, what will it choose? Certainly in the American context, the choice has always been for war.

And progressive economics writer Chris Martenson explains as part of his “Crash Course” on economics:

> Along came a war, the Revolutionary War, and the country found itself unable to pay for the war with the gold and silver to be found in the Treasury.
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> So a paper currency called “continentals” was printed, and at first it was fully backed by a specified amount of real gold and/or silver in the Treasury. But then the war proved to be more expensive than thought, and more and more was printed. Then the British, aware of the corrosive effects of inflation on a society, started counterfeiting and distributing vast amounts of bogus continentals, and soon the currency began to collapse.
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> Before long, massive inflation took hold, and Abigail Adams complained bitterly about this experience, noting that goods were hard to come by, making life difficult.
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> Seen on the inflation chart, the Revolutionary War took the general price level from a reading of “5” to a reading of “8”. After the war, the paper continentals were utterly rejected by the populace, who strongly preferred gold and silver. Most interestingly, price levels promptly returned back to their prewar levels.
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> The next serious bout of inflation was also associated with a war, again due to overprinting of paper currency, and again, upon conclusion of the war, we saw a relatively prompt return of prices to their pre-war levels, where they stayed for an additional 30 years. By now we are nearly 200 years into this chart, and we find that the cost of living is roughly that same as it was in 1665. That’s a truly fascinating concept to entertain.
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> But then a war came along – the Civil War – and it was a doozy. To finance the war, the North had to resort to printing a type of currency that still lends its name to our own currency today. Of course, back then it really did have a “green back.” Again we see a rapid rise of inflation as a direct consequence of war that again returned to baseline after the crisis was over. We are now 250 years into this story and the cost of living is still roughly the same as it was at the start. Can you imagine?
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> But then another war came along, this one even bigger than any before, and again it was a highly inflationary event.
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> And then another war, even **bigger** than any before it, which again proved inflationary. But this time, something odd happened. Inflation did not retreat before the next war began. Why? Two reasons. First, the country was no longer on a gold standard, but instead a fiat paper standard administered by the Federal Reserve, and the populace did not have another form of money to which it could turn. And second, because this was the first time that the war apparatus was not dismantled upon conclusion of hostilities.
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> Instead, full mobilization was maintained and a protracted cold war was fought; certainly as inflationary a conflict as any shooting war ever was.
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> And now if we look at the entire sweep of history, we can make an utterly obvious claim: All wars are inflationary. Period. No exceptions.

> Why? Simple, really. Any time the government engages in deficit spending, it creates the conditions for inflation. However when the deficit spending is on legitimate infrastructure, such as roads or bridges, that investment will slowly "pay for itself" by boosting productivity and paving the way for the creation of additional goods and services that will 'soak up' the extra cash over time.
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> Wars, however, are special. Vast quantities of money are spent on things that are meant to be blown up. The money stays at home, while the goods get sent off to be blown up. When a bomb blows up, there is no residual benefit to the domestic economy later on. This means war spending is the most inflationary of all spending. It's a double whammy – the money stays behind, working its evil magic, while the goods disappear. Heck, even if the goods aren't blown up, there's practically zero residual economic benefit to such specialized hardware, as amazing as that technology may be.
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> For some reason, the most recent pair of wars have been presented by the US mainstream press as being relatively "pain-free" for the average citizen, despite overwhelming historical odds to the contrary.
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> In fact, on this 15-year-long chart of commodity prices, we observe that prices bounced in a channel, marked by the green lines, for more than 10 years. However, and now hopefully unsurprisingly, shortly after the start of the Iraq War commodity prices began marching higher and have inflated nearly 140% in the five years since. Your gasoline and food bills will confirm this.
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> So if anybody tries to tell you that you haven't sacrificed for the war, let them know you sacrificed a large portion of your savings and your paycheck to the effort, thank you very much.

And see this:

(Click here for larger version.)

The bottom line is that war always causes inflation, at least when it is funded through money-printing instead of a pay-as-you-go system of taxes and/or bonds. It might be great for a handful of defense contractors, but war is bad for Main Street, stealing wealth from people by making their dollars worth less.

And contrary to what many pundits say, war will not lead to an economic recovery.

And as discussed above, liberals such as James Galbraith and conservatives such as Ron Paul agree that we wouldn't get into as many wars – and the wars which we did wage would be ended more quickly – it if the people were required to pay for them directly instead of war being paid out of the "hidden tax" of inflation.

The father of modern economics – Adam Smith – agreed:

> Were the expence of war to be defrayed always by a revenue raised within the year [instead of financing it with long-term public debt], the taxes from which that extraordinary revenue was drawn would last no longer than the war. The ability of private people to accumulate, though less during the war, would have been greater during the peace than under the system of funding. War would not necessarily have occasioned the destruction of any old capitals, and peace would have occasioned the accumulation of many more new. Wars would in

general be more speedily concluded, and less wantonly undertaken. The people feeling, during the continuance of the war, the complete burden of it, would soon grow weary of it, and government, in order to humour them, would not be under the necessity of carrying it on longer than it was necessary to do so. The foresight of the heavy and unavoidable burdens of war would hinder the people from wantonly calling for it when there was no real or solid interest to fight for. The seasons during which the ability of private people to accumulate was somewhat impaired, would occur more rarely, and be of shorter continuance. Those on the contrary, during which that ability was in the highest vigour, would be of much longer duration than they can well be under the system of funding.