War and Society
Paying for War

Branislav L. Slantchev
Department of Political Science, University of California, San Diego

Last updated: April 21, 2014

Contents:

Wer den Daumen auf dem Beutel hat, der hat die Macht.

Otto von Bismarck[1]

Although "war as part of a political bargaining process" is a useful concept, when it comes to fighting there is one thing that Clausewitz's notion of *absolute war* has going for it: if one cannot hope to impose enough costs on the opponent or destroy its armed forces, then fighting would not be a very useful instrument (since it will be unlikely to move the opponent to offer better terms). The ability to fight is a crucial requirement for the instrument to function, and this ability is predicated not simply on the battle quality of one's armed forces and the tactical and strategic genius of their command but on rather more mundane factors usually encompassed by logistics.

Logistics (which comes from the Greek word *logistikos*, which means "skilled in calculating") is a rather comprehensive subject that goes beyond merely supplying the army. At its most general, it also includes the procurement and storage of materiel (equipment, subsistence, fodder, clothing, ammunition, and supplies), the planning, procurement, development, and maintenance of facilities and infrastructure for it, securing its transport, and the provision of services in support of the armed forces. As we shall see, the amount of materiel consumed by an army can be truly staggering, and often superior logistics would determine outcomes of campaigns more than pitched battles. As Eisenhower once said,

> You will not find it difficult to prove that battles, campaigns, and even wars have been won or lost primarily because of logistics.

We, of course, are not going to make a detailed study of this rather difficult (and not nearly as glamorous as battles) topic. What we are interested in is the much simpler and yet fundamental point that all of the activity that logistics encompasses and that is so vital to the conduct of war has to be paid for. Governments can do this through regular means by compensating private agents who deliver the services and products or employing on their own. They can also do this less directly and more intrusively, by administrative expansion of their regulatory powers that transfers costs onto private agents. And, of course, in a pinch, they can do it through outright coercion by confiscating the resources or expropriating the means of production. As we shall see, even the seemingly market-based compensation often includes an element of coercion because governments rarely pay "fair" market prices and because they often intervene in the economy in a way that distorts prices in their favor. All of these activities depend on the existing political and economic institutions, and the search for revenue to pay for war always exerts pressure precisely on these institutions as well, and so this is where we shall look for effects of war.

One might wonder why war gets such pride of place in the analysis of the evolution of socio-political institutions. To put it crudely and bluntly, war is important because it was for fighting that rulers mobilized the vast majority of resources they laid their hands on, and it was military activity that justified their existence and value to society. War created the demand for resources and provided the opportunity to extract them. The fiscal strains of

[1] "He who has his thumb on the purse, he has the power." Bismarck made this statement in a speech to the North German Reichstag on May 21, 1869.

war-making stressed existing institutional arrangements and prompted innovations, sometimes gradual but sometimes abrupt and revolutionary. We shall, of course, have the opportunity to examine the evidence for these assertions. For now, it will suffice to mention that the governments of all early modern states of some consequence were spending the lion's share of their income either directly on the military or to service debts incurred in order to pay for the military.[2]

Before continuing, it is important to note that for most of history governments did not have anything like a budgeting process that we would recognize today. This was not merely because of administrative deficiency, but also because of the way rulers approached policy-making. Instead of determining the expected revenue and then deciding on a budget within the confines of that income (perhaps allowing for some deficit spending to be covered by debt), rulers tended to do just the opposite. They would first decide on what goals they wanted to achieve and would then cast about to obtain the funds they thought would be necessary to achieve them. That is, instead of revenue determining which policies to pursue, the desired policies determined the revenue they had to raise.[3]

When policy-making is decided more or less independently of revenue, the potential for a serious mismatch between political ambitions and fiscal abilities is great. Expenditures could easily overshoot revenue, creating a fiscal crisis, and with it escalating demands for tax income and credit. In this crisis atmosphere rulers would often resort to expedient solutions — they would reach for whatever deals could provide the necessary funds without due regard to possible long-term consequences. It was either this or the alternative of abandoning the policy for fiscal reasons. For this reason, the evolution of fiscal institutions is haphazard, context-specific, and largely unpredictable *ex ante* even if legible *ex post*.

There are numerous ways governments can finagle the resources they need for military purposes, and inventive rulers have resorted to many different schemes at various times, depending on circumstances. We shall examine the ways of paying for war separately for analytical convenience. At the broadest level, government can either rely on the resources of their own polity or on those of others.

1 Foreign Sources

It is always nice if someone else can pay for one's war. The most straightforward way is to find a sponsor who is interested in supporting one's fight and is willing to provide a **subsidy**. Some famous examples that we shall encounter are the English subsidies to various anti-French coalitions on the continent. Britain paid the Prussian King Frederick the Great an annual subsidy of £670,000 during the Seven Years War. It also funded all sorts of combinations against Napoleon, with the subsidy amounting to £30 million between 1812 and 1815, a vast sum by contemporary standards, and one that amounted to about 30% of government expenditure over that period, and that required the introduction of an income tax to sustain. The French, of course, duly reciprocated. King Louis XIV advanced funds to the Stuart Pretender James II, and even though this did not work (James was defeated by

[2] Carolyn Webber and Aaron Wildavsky. 1986. *A History of Taxation and Expenditure in the Western World.* New York: Simon and Schuster, Table 6, p. 289.

[3] Richard Bonney, Ed. 1995. *Economic Systems and State Fiance.* Oxford: Oxford University Press, p. 13.

King William III of Orange), a later subsidy that King Louis XVI advanced to the Americans during the Revolution did. In that last instance, the French provided both loans (about $6.4 million) and a direct subsidy ($2 million).

Subsidies can be an important source of funds but they do come with strings attached. At the very least, the recipient has to pursue political and military goals that are congruent with the interests of the paymaster. This means that if those interests change due to domestic strife or a new government coming to power, payments can be delayed, reduced, or canceled altogether. As we shall see, the French subsidy to the Swedes during the Thirty Years War had to be terminated because of domestic disturbances that required the attention and resources of the French Crown. Similarly, parliamentary in-fighting interfered with the British subsidy to Prussia during the Seven Years War. Finally, it might not be easy to get involved in a war that would interest a wealthy donor, especially one who is willing to give the recipient a relatively free hand politically and operationally.

If a foreign power willing to act as a paymaster is not readily available, then governments can try to attract foreign funds by offering profitable rates of return; i.e., they can **borrow from foreigners**, either on the international credit markets (Geneva, Amsterdam, London, Paris, New York) or from wealthy foreign bankers. You might recognize some of the names of these famous banking dynasties: the German Fuggers (who financed many Habsburg activities), the Italian Medici (who financed not just much of the Renaissance but their own rise to power), the German Rothschilds (who bankrolled much of the English operations against Napoleon and whose branches lent as far as Japan for its war against Russia in 1904), and so on. From the perspective of the ruler, the acquisition of such credit was attractive because it provided funds without cumbersome and politically difficult negotiations that might be required to raise the money domestically (for example, Catholic French kings would borrow from Protestant Swiss).

Moreover, should the ruler decide to default on the debt (either repudiate it outright or forcibly restructure it to lower the interest rates or eliminate part of the principal), the foreign actors had very little recourse. If the ruler was not powerful enough and the creditors had important political connections, the ruler could find gunboats blockading his ports or even bombarding his cities until payment was made. Although everyone cites the famous 1902 case when English, German and Italian ships imposed a naval blockade that forced Venezuela to agree to honor its debts, such activities were, in fact, not very common.[4] The much more common outcome when a sovereign ruler refused to honor his debt was for the creditors to absorb the losses if they could or go bankrupt if they could not, as the Fuggers eventually did when Phillip II of Spain defaulted on his debts four times. Even though the Genovese used this opportunity to step in as creditors to the Habsburgs, Spain's eventual decline dragged down Genoa with it as the Crown became increasingly unable to meet its debt obligations.

Thus, even though there were enormous fortunes to be made from lending to sovereigns, there were also serious risks: lenders initially had to depend on the ruler's word that the debt would be repaid and when the strains of military defeat or protracted war emptied the ruler's coffers, such word would often prove insufficient. Since this inability to credibly

[4]Michael Tomz. 2007. *Reputation and International Cooperation: Sovereign Debt across Three Centuries.* Princeton: Princeton University Press, Chapter 6, "Enforcement by Gunboats" pp. 114–57.

promise to repay the debt was evident to the lenders, they normally compensated for it by demanding higher interest rates for the risks they were assuming. This increased the fiscal burden on the rulers and made it even more likely that they would not be able to maintain their creditworthiness. When high interest rates increase the risk of default, lenders might also respond by **credit rationing**: they would deny credit even when offered high rates because these only increase the likelihood that they will not get their money back.[5] In other words, lending sources might dry up even when the government is willing to offer high interest rates. Only governments where debt was backed by taxes (the Dutch were the first, soon followed by the British in this) could enjoy access to low rates because repayment could be guaranteed from the tax revenues.

As we shall see, the development of cheap credit and the resulting mountains of **national debt** went hand in hand with the establishment of modern-type bureaucracies to handle government matters and the achievement of primacy of representative assemblies over monarchs in financial matters. For now, however, it is important to remember that for most of the period we are going to study, rulers' access to foreign credit was as good as their word (or, more appropriately, as good as their history of honoring their debts). When the fiscal situation was dire, rulers would often have to secure funds at precisely the moment when their commitment (and ability) to repay debts would be in gravest doubt. This meant extortionary interest rates even if the ruler was lucky enough to get any credit whatsoever, making this source of income less preferable.

When voluntary sources of foreign income — subsidies or foreign debt — are not available, governments can resort to involuntary extraction of wealth by **exploiting conquered territories**. This can be done through outright plunder and perhaps enslavement of the local population. The Nazis have become the modern epitome of such behavior, to the point that some scholars have asserted that the expropriation of wealth from German Jews and the extraction of resources from the conquered Eastern European lands enabled the regime to sustain the war effort at little cost to its own citizens. Even if one does not accept this extravagant claim — as we shall see, the Germans were only behind the Russians in the extent of their mobilization for the war — the income derived from these territories was quite substantial.[6]

Even the Nazi-style ruthless exploitation of conquered lands could not spare the Germans the burden of war. When one also considers the military resources necessary to maintain the degree of control such extraction requires, then perhaps slave labor is not the most eco-

[5] For a formal statement of this argument, see Jonathan Eaton and Mark Gersovitz. 1981. "Debt With Potential Repudiation: Theoretical and Empirical Analysis," *Review of Economic Studies,* 48(2): 289–309.

[6] The claim about the Nazis fighting on the backs of Eastern Europeans instead of Germans can be found in Götz Aly. 2005. *Hitler's Beneficiaries: Plunder, Racial War, and the Nazi Welfare State.* New York: Henry Holt. The comprehensive critique is by Adam Tooze. 2005. "Economics, Ideology, and Cohesion in the Third Reich: A Critique of Goertz Aly's *Hitlers Volkstaat*." English version of the essay for Dapim Lecheker HaShoah, University of Cambridge. The problem with Aly's line of reasoning is that he looked only at taxes and so concluded that the Germans paid no more than 30% of the costs of the war. However, when one includes other sources of domestic finance (e.g., loans), the share of national income from domestic sources climbs to 60%, and since by the end of the war the German government was spending about 76% of that income on the war, Germany was just as heavily mobilized as the Soviet Union. See Table 3 in Mark Harrison. 1988. "Resource Mobilization for World War II: the U.S.A., U.K., U.S.S.R., and Germany, 1938–1945." *Economic History Review,* 41(May): 171–192.

nomical way of taking advantage of one's conquests. A method less coercive than plunder is the extraction of **contributions** from enemy citizens under one's control. This form of tribute can come to resemble regular taxation, and often the occupying force would, in fact, base its demands on the taxes that the polity had been paying to its own government before the war. We shall see how military entrepreneurs like Wallenstein came to rely on a system of contributions to fund their armies during the Thirty Years War, just like the French would do later under Louis XIV, and even later under Napoleon, the armies of both of whom subsisted on the locals in Germany.

Contributions, however, involve the same sorts of problems as plunder, albeit on a smaller scale; the distinction is one of degree, not of kind. The demands for tribute made the payers more hostile, necessitating the diversion of military resources to pacification of the conquered territories. Since fighting cannot but destroy wealth, the conquered towns and villages often could not provide more than a fraction of the income they had been able to before the war. Exploitation is costly, unreliable, and possibly subversive of military strategy. It is not surprising that rulers often preferred to find other ways of paying for their armed forces. When foreign sources won't do, then one has to turn to one's own citizens.

2 Domestic Sources

When it comes to unfettered freedom of action, a government can rarely do better than go to war with money it already has. Although not very common — since, as we shall see, governments tend to hover near bankruptcy all too often — this is by no means impossible. For example, when the Prussian King Frederick the Great invaded Silesia in 1740, he did so using the 8-million thaler hoard of cash that his father had accumulated. During the Seven Weeks War of 1866, both Austria and Prussia fought mainly on **war chest** reserves.[7] The problem with reliance on reserves is that except for very short wars, they are never enough. The funds get rapidly depleted, usually much faster than governments plan them to, and if the opponent has not conceded the terms yet, these governments have to cast about for new sources of revenue.[8]

One obvious way to raise money fast is by **selling government property**, which could include lands, offices, and titles. As large land-owners rulers could (and did) often sell portions of their holdings at market prices. This could result in a significant windfall, but of course had serious drawbacks. It decreased the revenue-generating holdings of the ruler, and so depressed his long-term income. It transferred real estate into private hands, increasing the bargaining leverage of the magnates who came to possess it. And in the end, it was a

[7]For the Silesian War, see T.C.W. Blanning. 1996. *The French Revolutionary Wars, 1787–1802.* London: Arnold, pp. 7–8. For the Seven Weeks War, see Christopher Clark. 2006. *Iron Kingdom: The Rise and Downfall of Prussia,* 1600–1947. Cambridge: Harvard University Press, p. 536.

[8]Thucydides provides yet another famous example of this problem. When Athens went to war with Sparta, Pericles' strategy had been to use the Athenian treasury hoarded in the Acropolis to outlast the Spartan will to fight. He recognized that Athens could not hope to defeat the Spartan army in the field, and was therefore hoping that the Spartans would also become discouraged when they failed to conquer Athens. The strategy turned out to be fatally flawed. Plague broke out in Athens and the reserves were quickly depleted, forcing the Athenians to escalate their demands on their allies, which wrecked their coalition. Without an ability to actually hurt the Spartans — who ravaged Attica at will — the Athenian strategy was doomed to fail, especially once they ran out of money. See Donald Kagan. 2003. *The Peloponnesian War.* New York: Penguin Books, p. 54.

one-time deal and so merely a temporary fix.

A slightly better arrangement would be to sell valuable offices in the government apparatus; the so-called **venal offices**. These could be profitable municipal, judicial, administrative, and military posts among others. For offices that handled revenue (e.g., administered taxes), the office-holder would receive a percentage of the money handled as an annual stipend. The price of the office would be fixed at some multiple of that amount (e.g., 10 or 15), so buying the office was equivalent to advancing a loan to the ruler. In return, the stipend acted as service of that loan, so it would be fixed at, say 5%, of that sum per year. For offices that did not handle revenue (e.g., judiciary), the price would be fixed in accordance with the fees customarily assessed for services — the annual payments would then come from the fees that the office-holder charged those that used his services. Posts in the military would allow those owning them to extract payment from the local population where the forces were stationed. Finally, some offices had no fiscal or administrative responsibilities attached to them (e.g., titles of nobility) — these remained unremunerative and the price was set in accordance with the level of elevation the title involved.

Almost every ruler resorted to selling offices. The French kings nearly perfected it — the monarchy managed to create and sell upwards of 40,000 of these — in the tax administration, in the judiciary (the *parlements*), the command of the army, and in the legal profession generally. The bourgeoisie was especially keen on buying these offices because they were prestigious, carried important privileges, and in some cases elevated the office-holder or his descendants into the nobility. The practice was also known in Spain (mostly for municipal posts), in many of the sovereign entities in Germany and Italy, in England, and in the Dutch Republic.[9] As we shall see, in some cases the venal office-holding system evolved functions of a primitive lending institution, and so became very difficult to dislodge without disrupting the ruler's access to credit. The system was, however, notoriously inefficient (offices were duplicated and sold to the highest bidder without regard to ability), corrupt (with fee-for-service, office holders could enrich themselves by favoring those who paid more), entrenched (offices were sold for very long period and often became hereditary), and extremely decentralized (with long-term or hereditary offices, the ruler could exercise little effective control over "his" officials). It was frequently denounced and the office-holders were often hated because they were seen as extracting too much for their own benefit. In countries were rulers did not succeed in eliminating venal office-holding, the practice usually ceased after a revolution or civil war had swept away the old institutions. Because of these problems, many rulers preferred to find other methods of generating revenue domestically. The most common one, of course, is taxation. Since we shall deal with this in some detail, for now it will suffice to mention some of the problems with using tax income to pay for an ongoing war.

The first, and perhaps most common problem, is that the regular **tax income** the governments rely on in peacetime generally falls short of the fiscal demands of war. This means that they have to find new things to tax, expand the tax base, or increase the tax rates. All

[9] Koenraad W. Swart. 1949. *Sale of Offices in the Seventeenth Century.* The Hague: Martinus Nijhoff. The impetus to sell offices often came from war-time exigencies, even in countries like the Dutch Republic that were normally hostile to the practice. See Koenraad W. Swart. "The Sale of Public Offices," in Arnold J. Heidenheimer and Michael Johnston, eds. 2002. *Political Corruption: Concepts & Contexts,* Third Edition. New Brunswick: Transaction Publishers, p. 98.

of these measures generate opposition, some might require the formal consent of parliament, and all would require some type of bargaining, explicit or not, to implement. The resistance to an increased tax burden might spill over into open rebellion especially if the war is unpopular, and this might require the government to divert military resources from the war to quell these domestic disturbances. Even if the government manages to avoid militarized coercion, the need to secure the consent of the taxpayers would require making political concessions that could involve devolution of central authority or even some type of power-sharing with the elites whose support is necessary to implement the taxes. The government also needs a reliable and relatively efficient system of collection, which itself requires a reasonably competent administrative apparatus, all of which has been quite scarce until relatively modern times. Finally, some taxes are seasonal, many can be collected only a few times a year because of high administrative costs, and most have unpredictable yields with high variance especially during war. All of this means that the funds might not be available when they are most needed, and even when some funds are available, they might be critically short of the requirements to sustain the war effort.

When governments run out of cash because their war chests are depleted and the tax coffers are empty, they can try to borrow from their citizens; that is, incur **public debt**. We shall have rather a lot to say about this source of income too, so let us now simply note some of the possibilities and the disadvantages. Unlike foreign borrowing, which is voluntary — lenders do not have to extend credit and must be induced to do so by offering attractive rates and terms of repayment — domestic credit can be coerced. **Forced loans** — requests for credit whose failure to agree to can land the lenders in jail or worse — are really a form of taxation even though governments sometimes do at least pay some interest.

Demanding **voluntary loans** from people over whose well-being the ruler has some power is another form of partially coercive borrowing — these could be office-holders whose tenure in office can be challenged or terminated. If the creditors represent an important segment of society on whom the ruler relies for retaining power, then defaulting on his obligations to them could be very dangerous, especially if these elites are not especially vested with that particular ruler's being in power. This implies that rulers would seek to bind these elites to the "state" so that they have an interest in upholding his rule even when he is squeezing them for funds. A common version of this would be owners of **venal offices** (people who purchase the office from the ruler and are paid an annual stipend fixed at some fraction of the value of the office, along with other privileges that might accrue by virtue of having that office) who might be forced to lend money to the government when the latter simply withholds the payments or threatens to revise the title to their offices. As we shall see, the French Crown sometimes relied on such strong-arm tactics but the political costs of doing so are obvious.

Finally, the government can sell **bonds** to the wider public. Although today government bonds are considered risk-free, at least in the US, this was not the case for many governments over the years. Bonds issued to finance war might be especially risky because a war ending with the government's collapse might well mean the end of the promise to make good on these bonds. This type of borrowing spreads the risks over the entire population of bondholders, which is usually a lot larger than the wealthy elite. Although the effects of default might be even more destabilizing, the bonds do tend to have unifying effects on society as everyone who subscribes is in effect giving their government access to funds that would have been out of reach of ordinary and even extraordinary taxation. Moreover, when this type of debt is paid back through taxes, there is some redistribution of wealth but at least the wealth does not hemorrhage to foreign hands like it does with foreign creditors. Since even ordinary bondholders are aware of the risks their investments might be subject to, governments might find it difficult to raise a lot of funds if the war is not going well for it. In particular, after an initial surge of patriotism results in an amount that often exceeds expectations, further calls to subscribe to government bonds tend to be very disappointing, and falling on deaf ears when the government is nearing defeat. As with other sources of volunteer finance, revenue from this source can become quite scarce at the precise moment when it is needed most.

When the government is out of cash and unable to secure credit, it can, in desperation, resort to "making" money out of thin air. Before paper money, which can be printed in essentially unlimited quantities, rulers could rely on **debasement** of the coinage — meaning they would reduce the content of precious metals in coins while maintaining their face value, or they could rely on **re-coinage** — meaning they would force currency holders to re-mint their money, which would require paying the government the requisite fees. Any short-term bounty that a sudden expansion of the **money supply** can give the government — and this means not simply paying for the waste of war but perhaps increasing its purchases and so employing more people — is often dissipated by the costs of inflation; rising prices can erode the real value of existing taxes far beyond the benefit provided by manipulating the money supply. Since inflation also reduces the real wealth of currency-holders and privileges borrowers over lenders (the former can now pay their nominal debts in depreciated currency), it can have serious political ramifications. Although not attractive as a method of finance, manipulation of the money supply was something many rulers would resort to when pressed for funds.

Finally, when the government cannot afford the war and does not want to manipulate the money supply, it can refuse to pay market prices. There are many ways it can do so, and these range from asking for voluntary restraints on consumption to reducing demand (and so prices), through imposing **price ceilings** (and thus artificially depressing prices despite demand), all the way to **requisition** of resources or **expropriation** of the means of production (both mean outright confiscation).

One common way was to quarter troops and force local communities to support them — enforcement would be immediate and at the hands of the very soldiers the community is supposed to support. This type of revenue extraction could also be used to punish citizens inimical to the government — for example, the French Crown would force the conversion of Protestants back to Catholicism under the threat of billeting troops (requiring private citizens to accept soldiers in their dwellings). This behavior was so common and considered so egregious that the US Constitutions severely restricts it (3rd Amendment).

Since one of the problems a cash-strapped government faces during war is inability to pay market prices (which tend to increase as demand for food and strategic raw materials goes up), another way of dealing with this problem is by imposing price ceilings. This intervention in the normal functioning of the market distorts the economic incentives of the agents and often results in black markets that undermine the effectiveness of rule. Since price ceilings cause demand to exceed supply, the government might intervene even more in society by issuing rationing cards as consumption controls. Thus, such measures have political and social effects that go beyond their economic costs and benefits.

Finally, a government might seize what it needs by requisitioning it or exercising eminent domain (which means it can purchase private property in the name of the public interest even when the owner is unwilling to sell it at the price offered, which is usually much lower than anything the market would yield). Even though the doctrine of eminent domain does allow for compensation of the owner and some even go so far as to claim "just" compensation, the reality is that it is a form of expropriation. Although this practice has had a long and distinguished history, the practice to offer no (or symbolically small) compensation has given way to the somewhat more "fair" version of today that, at least in the US, requires some consideration of market value.

This brief overview shows the myriad issues one would have to consider when working out the financing of war. We cannot possibly examine all of them in any serious detail, and so we have to make some choices. Since we're interested in how societal institutions help fight a war and how war affects these institutions, we shall focus on the two most prominent sources of government revenue: *taxation* and *borrowing*.