

# How Do States Pay for War?

POSC 3610 – International Conflict

Steven V. Miller

Department of Political Science



## Goal for Today

*Discuss what we know about how states finance war.*

## Confrontation of the Day: MIC#0089 (Franco-Spanish War)



- *Who*: France vs. Spain (Sept. 21, 1822 - Nov. 13, 1823)
- *Why*: Restoration of Ferdinand VII
- *What happened*:
  - 6 April: fighting starts on the banks of the Bidassoa
  - 21 August-27 September: surrender of A Coruña, Pamplona, San Sebastián
  - 31 August: Battle of Trocadero
  - 23 September: Cortes dissolves itself
  - 13 November: France finally leaves Spain

## The Fall out of MIC#0089

Spain actually defaults after this war.

- Ferdinand VII refused to honor debts accumulated by the liberal Cortes.
- This included £12.9 million to Haldimand and Sons, among a few other private lenders (prominently in the UK).

However, this was more a practicality than a “stand.”

- Spain's finances led to the Florida sale (1819), the revolution in 1821, and accelerated the independence movements in Latin America.
- Spain couldn't secure a loan afterward from the Rothschild bank.

## How Do States Pay for War?



Debt. The answer is debt.

# The Centrality of Debt to War Finance

Debt is the foremost form of war finance.

- Almost 9 of 10 war participants resort to some form of borrowing to pay for war.

Debt is increasingly held externally.

- Before 1950, about 70% of states borrowed domestically. After 1950: about 40%.
- For external debts: 52% before 1950, 72% afterward.

# Why Debt?





## Some Assumptions

1. Citizens like to keep their money.
2. Leaders want to hold onto power.

## Some Takeaways

Citizens are willing to sacrifice their income, or at least say they are.

- Caveats: probably limited to unique (WW2) moment in time, and likely hypothetical and conditional.
- Strategic leaders assuredly know this, and try not to press their luck.

Leaders avoid interacting citizens with war finance where they can.

- Domestic taxation for war is effectively a new tax.

Table 1: How the U.S. Has Financed Its Wars

	<b>Dom. Taxation</b>	<b>Dom. Borrowing</b>	<b>Printing Money</b>	<b>Dom. War Finance</b>	<b>Money Abroad</b>	<b>Plunder</b>
Mexican-American	<25%	50-75%	None	>75%	None	
World War I	25-50%	50-75%	None	>75%	None	None
World War II	25-50%	50-75%	None	>75%	None	None
Korean	>75%	None	None	>75%	None	None
Vietnamese	<25%	50-75%	<25%	>75%	None	None
Invasion of Afghanistan	None	50-75%	None	50-75%	25-50%	None
Invasion of Iraq	None	50-75%	None	50-75%	25-50%	None

*Note:*

Data: Confronting the Costs of War Project, v. 2.0

# State Capacity and the Endogeneity of War Finance

“War makes the state and the state makes war” (Tilly, 1990).

- Taxation may be optimal for financing war, but that depends on state capacity.
- War, in turn, increases state capacity for revenue extraction.
- However, this may attract the attention of a belligerent (e.g. Japan v. China in the late 1930s).
- This in turn drives up interest for (external) borrowing.

# Sovereign-to-Sovereign Lending

Private lenders were more common in the past; now it's sovereign lenders.

- Indeed, the rise of sovereign lending is central to understanding the global monetary system as a whole.

Sovereign lending comes with associated quirks.

- Sidesteps “guns vs. butter” trade-off for recipient.
- Revenue potential for lender.
- Creates post-war dependency.
- Permits issue linkage.

Paul Poast  
@ProfPaulPoast

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Russia seems to be following the British WWI financial model.

That didn't end well for Britain...or the World economy.

[THREAD]





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Financially, fighting in "The Great War" cost the British A LOT. How much? It \*only\* took 100 years to pay off the debt



[cnbc.com](https://www.cnbc.com)

**UK finally finishes paying for World War I**

Almost 100 years after the debt was issued, the U.K. government has finally finished paying for World War I.





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The war was costly not only because of its length, but because the intensity of the fighting quickly depleted the allies existing stock of war material. More supplies were needed, and quickly.



[journals.sagepub.com](https://journals.sagepub.com)

Errors and Omissions in Franco–British Co-operati...

The opening weeks of the First World War depleted stocks of guns and munitions for all belligerents. F...



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Early on, the British were essentially the financial arm of the allied effort. This made sense, since, as @NormaCohen3 and co-authors point out, Britain was the wealthiest of the allies (France, Russia, and eventually Italy being the other main allies).

**OVER-SUBSCRIBED WAR LOAN.**

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Another and still more profitable Investment  
now open to disappointed subscribers.

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**4½% with guaranteed appreciation of Capital.  
Repayable in Ten Years.**

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<p>Actuated beyond all question by motives of patriotism no less than by thought of securing a good investment, the British Public has offered the Government every penny it asked for—and more. The loan</p>	<p>will be greatly appreciated by anyone seeking a really safe and profitable investment.</p> <p><b>4½% WITH APPRECIATION OF CAPITAL.</b></p>
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[voxeu.org](http://voxeu.org)

The extraordinary story of Britain's early efforts to finance the Financing World War I required the UK government to borrow the equivalent of a full year's GDP. But its first effort to raise capital in the...

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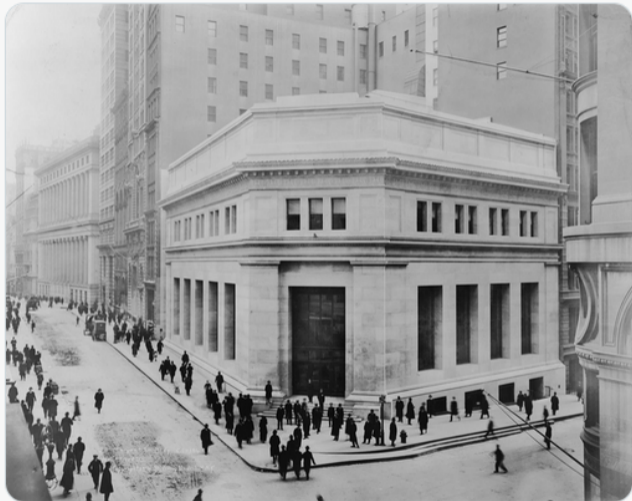




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But Britain couldn't rely on its own assets to cover these costs. It had to start borrowing. For that, it turned to a neutral market...Wall Street.





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Replying to @ProfPaulPoast

As @adam\_tooze writes in "The Deluge":

"As of 1915...the most powerful states in Europe were now borrowing from private citizens in the United States and anyone else who would provide credit."



★★★★★ 338

amazon.com

The Deluge: The Great War, America and the Remaking of the Global ...



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By "Wall Street", I really mean J.P. Morgan.



cambridge.org

A Private Bank at War: J.P. Morgan & Co. and Fran...

A Private Bank at War: J.P. Morgan & Co. and  
France, 1914–1918 - Volume 74 Issue 1



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Relying on private markets was proving expensive and unsustainable. By late 1916, the British were close dire financial straights. Consider the warning of then Chancellor of the Exchequer Reginald McKenna.



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He warned in October 1916,

"We ought never to be so placed that only a public issue in American within a fortnight stands between us and insolvency. Yet we are quickly drifting in this direction..."



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...If things go on as present, I venture to say with certainty that by next June or earlier the President of the American Republic will be in a position, if he wishes, to dictate his own terms to us."

Quote from Kathleen Burk's essential history



amazon.com

Britain, America and the Sinews of War 1914-1918 ...

Britain, America and the Sinews of War 1914-1918

(RLE The First World War)



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By early 1917, McKenna's fears were being realized. As of 1 April 1917, Britain had only enough dollars to last three more weeks.

More private funds weren't coming (why keep throwing good money after bad, right?)



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Fortunately, the British received a "reprieve" the next day: Wilson's speech calling for the United States to enter the war.



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During the speech, Wilson received applause (it's noted in the Congressional Record) when he said that US cooperation with the allies will involve "the extension to those governments of the most liberal financial credits"



archives.gov

Joint Address to Congress Leading to a Declaratio...

EnlargeDownload Link Citation: President Wilson's Declaration of War Message to Congress, April 2, ...



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The War Bond Act (the First Liberty Loan), passed on April 24, authorized the Treasury to buy the debt of "foreign governments then engaged in war with the enemies of the United States." US government money started flowing to the allies, specifically Britain, immediately.





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So the war effort could continue. That's great for Britain, right?

Not really. Recall the warning by McKenna (who was now out of government): that the British would be in a position where the US President "if he wishes, to dictate his own terms to us."



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That was now happening. And Wilson was well aware of it. Indeed, that was a goal of the loans.



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On 21 July 1917, Wilson, in a correspondence with Colonel House, confirmed that the idea of offering loans gives the United States the ability to exercise leverage over the European powers in crafting the peace after the war.





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Wilson wrote, "England and France have not the same views with regard to peace that we have by any means. When the war is over we can force them to our way of thinking, because by that time they will, among other things, be financially in our hands."

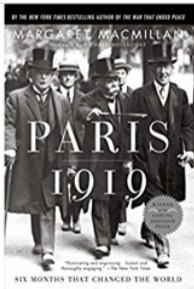


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In other words, Wilson didn't trust the Europeans to craft a post-war settlement that would be acceptable to the United States.

The loans could provide post-war leverage at the negotiating table.



★★★★★ 885



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This is a key reason why the British hoped (pleaded) for the loans to be converted to grants or just forgiven following the war: that would alleviate American leverage after the war. But the US refused.

[online.ucpress.edu/phr/article-ab...](https://online.ucpress.edu/phr/article-ab...)

# The British War Debts to the United States and the Anglo-Japanese Alliance, 1920-1923

Roberta Allbert Dayer



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The result was that the British didn't have the financial strength they needed to push back on French demands for reparations from Germany after the war.



amazon.com

Reparation in World Politics: France and European...

Reparation in World Politics: France and European Economic Diplomacy, 1916-1923



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At this point, I think most folks know how the rest of the story goes.

The reparations were viewed (even at the time) as a bad idea...

the Peace



books.google.com

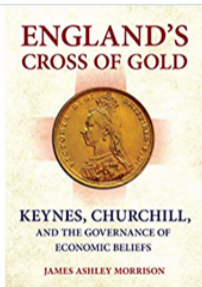
The Economic Consequences of the Peace



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...the British economy had lost its dominant position in the global economy (which would have consequences for when they tried to reestablish the gold standard later that decade)...



[amazon.com](https://www.amazon.com)

England's Cross of Gold: Keynes, Churchill, and the Governance of Ec...

England's Cross of Gold: Keynes, Churchill, and the Governance of Economic Beliefs (Cornell Studies in Money)

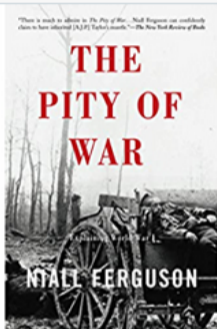




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...and the British were also no longer in a financial position to maintain its empire (though that collapse would take time).



★★★★★ 131

[amazon.com](https://www.amazon.com)

The Pity Of War: Explaining World War I

The Pity Of War: Explaining World War I





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Most of all, Britain was now clearly the client state of the United States. The "special relationship" is one in which the US could largely dictate the terms of cooperation.

[jstor.org/stable/2148010...](https://www.jstor.org/stable/2148010)

The United States and  
British Bankruptcy, 1944-19  
Responsibilities Deferred\*



# Conclusion

States must finance war.

- Lot of recent energy into this topic. Data are playing catch-up.
- Leaders try to play “hide-and-seek” strategy (from public) with war finance.
- Debt, prominently sovereign-to-sovereign debt, is central to war finance.
- Wartime loans are an instrument of international power.

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## Conclusion