The Century Of Total War Coincided With The Century Of Central Banking

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The 20th century was the century of total war. Limitations on the scope of war, built up over many centuries, had already begun to break down in the 19th century, but they were altogether obliterated in the 20th. And of course the sheer amount of resources that centralized states could bring to bear in war, and the terrible new technologies of killing that became available to them, made the 20th a century of almost unimaginable horror.

It isn't terribly often that people discuss the development of total war in tandem with the development of modern central banking, which — although antecedents existed long before — also came into its own in the 20th century. It's no surprise that Ron Paul, the man in public life who has done more than anyone to break through the limits of what is permissible to say in polite society about both these things, has also been so insistent that the twin phenomena of war and central banking are linked. "It is no coincidence," Dr. Paul said, "that the century of total war coincided with the century of central banking."

He added:

*If every American taxpayer had to submit an extra five or ten thousand dollars to the IRS this April to pay for the war, I'm quite certain it would end very quickly. The problem is that government finances war by borrowing and printing money, rather than presenting a bill directly in the form of higher taxes. When the costs are obscured, the question of whether any war is worth it becomes distorted.*

For the sake of my remarks today I take it as given that Murray Rothbard's analysis of the true functions of central banking is correct. Rothbard's books *The History of Money and Banking: The Colonial Era Through World War II*, *The Case Against the Fed*, *The Mystery of Banking*, and *What Has Government Done to Our Money?* provide the logical case and the empirical evidence for this view, and I refer you to those sources for additional details.

For now I take it as uncontroversial that central banks perform three significant functions for the banking system and the government.

First, they serve as lenders of last resort, which in practice means bailouts for the big financial firms.

Second, they coordinate the inflation of the money supply by establishing a uniform rate at which the banks inflate, thereby making the fractional-reserve banking system less unstable and more consistently profitable than it would be without a central bank (which, by the way, is why the banks themselves always clamor for a central bank).

Finally, they allow governments, via inflation, to finance their operations far more cheaply and surreptitiously than they otherwise could.

As an enabler of inflation, the Fed is ipso facto an enabler of war. Looking back on World War I, 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."

No government has ever said, "Because we want to go to war, we must abandon central banking," or "Because we want to go to war, we must abandon inflation and the fiat money system." Governments always say, "We must abandon the gold standard because we want to go to war." That alone indicates the restraint that hard money places on
governments. Precious metals cannot be created out of thin air, which is why governments chafe at monetary systems based on them.

**Governments can raise revenue in three ways.** Taxation is the most visible means of doing so, and it eventually meets with popular resistance. They can borrow the money they need, but this borrowing is likewise visible to the public in the form of higher interest rates — as the federal government competes for a limited amount of available credit, credit becomes scarcer for other borrowers.

Creating money out of thin air, the third option, is preferable for governments, since the process by which the political class siphons resources from society via inflation is far less direct and obvious than in the cases of taxation and borrowing. In the old days the kings clipped the coins, kept the shavings, then spent the coins back into circulation with the same nominal value. Once they have it, governments guard this power jealously. Mises once said that if the Bank of England had been available to King Charles I during the English Civil War of the 1640s, he could have crushed the parliamentary forces arrayed against him, and English history would have been much different.

Juan de Mariana, a Spanish Jesuit who wrote in the 16th and early 17th centuries, is best known in political philosophy for having defended regicide in his 1599 work *De Rege*. Casual students often assume that it must have been for this provocative claim that the Spanish government confined him for a time. But in fact it was his *Treatise on the Alteration of Money*, which condemned monetary inflation as a moral evil, that got him in trouble.

Think about that. Saying the king could be killed was one thing. But taking direct aim at inflation, the lifeblood of the regime? Now that was taking things too far.

In those days, if a war were to be funded partly by monetary debasement, the process was direct and not difficult to understand. The sequence of events today is more complicated, but as I've said, not fundamentally different. What happens today is not that the government needs to pay for a war, comes up short, and simply prints the money to make up the difference. The process is not quite so crude. But when we examine it carefully, it turns out to be essentially the same thing.

Central banks, established by the world's governments, allow those governments to spend more than they receive in taxes. Borrowing allowed them to spend more than they received in taxes, but government borrowing led to higher interest rates, which in turn can provoke the public in undesirable ways. When central banks create money and inject it into the banking system, they serve the purposes of governments by pushing those interest rates back down, thereby concealing the effects of government borrowing.

But central banking does more than this. It essentially prints up money and hands it to the government, though not quite so directly and obviously.

First, the federal government is able to sell its bonds at artificially high prices (and correspondingly low interest rates) because the buyers of its debt know they can turn around and sell to the Federal Reserve. It's true that the federal government has to pay interest on the securities the Federal Reserve owns, but at the end of the year the Fed pays that money back to the Treasury, minus its trivial operating expenses. That takes care of the interest. And in case you're thinking that the federal government still has to pay out at least the principal, it really doesn't. The government can roll over its existing debt when it comes due, issuing a new bond to pay off the principal of the old one.

Through this convoluted process — a process, not coincidentally, that the general public is unlikely to know about or understand — the federal government is in fact able to do the equivalent of printing money and spending it. While everyone else has to acquire resources
by spending money they earned in a productive enterprise — in other words, they first have to produce something for society, and then they may consume — government may acquire resources without first having produced anything. Money creation via government monopoly thus becomes another mechanism whereby the exploitative relationship between government and the public is perpetuated.

**Now because the central bank allows the government to conceal the cost of everything it does, it provides an incentive for governments to engage in additional spending in all kinds of areas, not just war.** But because war is enormously expensive and because the sacrifices that accompany it place such a strain on the public, it is wartime expenditures for which the assistance of the central bank is especially welcome for any government. The Federal Reserve System, which was established in late 1913 and opened its doors the following year, was first put to the test during World War I. Unlike some countries, the United States did not abandon the gold standard during the war, but it was not operating under a pure 100 percent gold standard in any case. The Fed could and did engage in credit expansion. On Mises.org we feature an article by John Paul Koning that takes the reader through the exact process by which the Fed carried out its monetary inflation in those early years. In brief, the Fed essentially created money and used it to add war bonds to its balance sheet. Benjamin Anderson, the Austrian-sympathetic economist, observed at the time, "The growth in virtually all the items of the balance sheet of the Federal Reserve System since the United States entered the war has been very great indeed."

**The Fed's accommodating role was not confined to wartime itself.** In *America's Money Machine*, Elgin Groseclose wrote:

*Although the war was over in 1918, in a fighting sense, it was not over in a financial sense. The Treasury still had enormous obligations to meet, which were eventually covered by a Victory loan. The main support in the market again was the Federal Reserve.*

**Monetary expansion was especially helpful to the US government during the Vietnam War.** Lyndon Johnson could have both his Great Society programs and his overseas war, and the strain on the public was kept — at first, at least — within manageable limits. So confident had the Keynesian economic planners become that by 1970, Arthur Okun, one of the decade's key presidential advisers on the economy, was noting in a published retrospective that wise economic management seemed to have done away with the business cycle. But reality could not be evaded forever, and the apparently strong war economy of the 1960s gave way to the stagnation of the 1970s.

There is a law of the universe according to which every time the public is promised that the boom-bust business cycle has been banished forever, a bust is right around the corner. One month after Okun's rosy book was published, the recession began.

Americans paid a steep cost for the inflation of the 1960s. The loss of life resulting from the war itself was the most gruesome and horrific of these costs, but the economic devastation cannot be ignored. As many of us well remember, years of unemployment and high inflation plagued the US economy. The stock market fared even worse. Mark Thornton points out that in May 1970, a portfolio consisting of one share of every stock listed on the Big Board was worth just about half of what it would have been worth at the start of 1969. The high flyers that had led the market of 1967 and 1968 — conglomerates, computer leasers, far-out electronics companies, franchisers — were precipitously down from their peaks. Nor were they down 25 percent, like the Dow, but 80, 90, or 95 percent.
... The Dow index shows that stocks tended to trade in a wide channel for much of the period between 1965 and 1984. However, if you adjust the value of stocks by price inflation as measured by the Consumer Price Index, a clearer and more disturbing picture emerges. The inflation-adjusted or real purchasing power measure of the Dow indicates that it lost nearly 80% of its peak value.

And for all the talk of the Fed's alleged independence, it is not even possible to imagine the Fed maintaining a tight-money stance when the regime demands stimulus, or when the troops are in the field. It has been more than accommodating during the so-called War on Terror. Consider the amount of debt purchased every year by the Fed, and compare it to that year's war expenditures, and you will get a sense of the Fed's enabling role.

Now while it's true that a gold standard restrains governments, it's also true that governments have little difficulty finding pretexts — war chief among them — to abandon the gold standard. For that reason, the gold standard in and of itself is not a sufficient restraint on the government's ambitions, at home and abroad.

As we look to the future, we must cast aside all timidity in our proposals for monetary reform. We do not seek a gold-exchange standard, as existed under the Bretton Woods system. We do not seek to use the price of gold as a calibration device to assist the monetary authority in its decisions on how much money to create. We do not even seek the restoration of the classical gold standard, great though its merits are.

In the 1830s, the hard-money Jacksonian monetary theorists coined the marvelous phrase "separation of bank and state." That would be a start. **What we need today is the separation of money and state.**

There are some ways in which money is unique among goods. For one thing, money is valued not for its own sake but for its use in exchange. For another, money is not consumed, but rather is handed on from one person to another. And all other goods in the economy have their prices expressed in terms of this good.

But there is nothing about money — or anything else, for that matter — that should make us think its production must be carried out by the government or its designated monopoly grantee. Money constitutes one-half of every non-barter market transaction. People who believe in the market economy, and yet who are prepared to hand over to the state the custodianship of this most crucial good, ought to think again.

**Interventionists sometimes claim that a particular good is just too important to be left to the market.** The standard free-market reply turns this argument around: the more important a commodity is, the more essential it is for the government not to produce it, and to leave its production to the market instead.

**Nowhere is this more true than in the case of money.** As Ludwig von Mises once said, the history of money is the history of government efforts to destroy money. Government control of money has yielded monetary debasement, the impoverishment of society relative to the state, devastating business cycles, financial bubbles, capital consumption (because of falsified profit-and-loss accounting), moral hazard, and — most germane to my topic today — the expropriation of the public in ways they are unlikely to understand. It is this silent expropriation that has made possible some of the state's greatest enormities, including its wars, and it is all of these offenses combined that constitute a compelling popular brief against the current system and in favor of a market substitute.

**The war machine and the money machine, in short, are intimately linked.** It is vain to denounce the moral grotesqueries of the US empire without at the same time taking aim at the
indispensable support that makes it all possible. If we wish to oppose the state and all its manifestations — its imperial adventures, its domestic subsidies, its unstoppable spending and debt accumulation — we must point to their source, the central bank, the mechanism that the state and its kept media and economists will defend to their dying days.

The state has persuaded the people that its own interests are identical with theirs. It seeks to promote their welfare. Its wars are their wars. It is the great benefactor, and the people are to be content in their role as its contented subjects.

Ours is a different view. The state's relationship to the people is not benign, it is not one of magnanimous giver and grateful recipient. It is an exploitative relationship, whereby an array of self-perpetuating fiefdoms that produce nothing live at the expense of the toiling majority. Its wars do not protect the public; they fleece it. Its subsidies do not promote the so-called public good; they undermine it. Why should we expect its production of money to be an exception to this general pattern?

As F.A. Hayek said, it is not reasonable to think that the state has any interest in giving us a "good money." What the state wants is to produce the money or have a privileged position vis-à-vis the source of the money, so it can dispense largesse to its favored constituencies. We should not be anxious to accommodate it.

The state does not compromise, and neither should we. In the struggle of liberty against power, few enough will oppose the state and the conventional wisdom it urges us to adopt. Fewer still will reject the state and its programs root and branch. We must be those few, as we work toward a future in which we are the many.

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