

## 1 Introduction

Writing in 1922, Ludwig von Mises argued that “[s]ociety has arisen out of the works of peace; the essence of society is peacemaking. Peace and not war is the father of all things. Only economic action has created the wealth around us; labor, not the profession of arms, brings happiness. Peace builds, war destroys” (1922: 59). As this suggests, peace is foundational to advanced civilization, while conflict poses a fundamental threat to human well-being. Given this, exploring the nuances of the relationship between defense, peace, and war is of crucial importance. Those working in the Austrian tradition have made valuable contributions to understanding these issues.<sup>1</sup> The purpose of this Element is to explore these contributions by situating them in the field of defense, peace, and war economics and for understanding their ongoing relevance.<sup>2</sup>

I first provide an overview of the field of defense, peace, and war economics (Section 2). I discuss treatments of war and peace by the classical economists (Section 2.1) before moving on to the rise of a distinct field of study in the 1960s (Section 2.2) and more recent issues covered in the field (Section 2.3). The purpose of this survey is to provide an overview of the emergence of the field and also to provide a foundation to situate the Austrian contribution. The relevant scholarship of those working in the Austrian tradition is purposefully excluded from this survey since it receives dedicated treatment in subsequent sections.

The discussion of Austrian contributions to defense, peace, and war economics (Section 3) contains six subsections. The first (Section 3.1) presents the idea of economic calculation as a foundation for subsequent subsections. I then discuss the nature of the war economy with specific focus on the knowledge problem (Section 3.2.1) and the power problem (Section 3.2.2). The knowledge problem arises from the inability of planners in the managerial-administrative state to rely on economic calculation outside of the market context. The power problem emerges because planners must be granted significant discretionary power to implement their blueprint and deal with unforeseen consequences. I discuss how the power problem can adversely affect the domestic economy.

---

<sup>1</sup> For other discussions of the contributions of Austrian economics to matters of conflict, defense, and peace, see Kjar and Anderson (2010), Westley, Anderson, and Kjar (2011), and Anderson, Kjar, and Yohe (2012).

<sup>2</sup> Brauer (2017) provides an overview of the different intellectual currents that constitute the field over time. He breaks these currents into several categories – defense, conflict, military, security, and peace economics – based on their points of emphasis. The labels of these categories are often used interchangeably and Brauer highlights the differences and overlap between the categories.

Next, I consider problems with the public good justification for the state provision of defense (Section 3.3). In economics, national defense is *the* textbook example of a public good. I first question whether state-provided defense satisfies the requirements for being a public good and conclude that it often does not (Section 3.3.1). I then extend the logic of economic calculation and the knowledge problem to the state provision of defense and consider how this precludes government planners from providing military activities in the optimal quantities and qualities (Section 3.3.2). This poses an issue for the public good justification for state provision that is grounded in arguments for state efficiency relative to alternative options.

The subsequent section (Section 3.4) considers the seen and unseen costs of war and the war economy. Some costs of war – for example, the loss of life, monetary expenditures, the reallocation of capital and labor, and so on – are evident but others are not. I discuss the various sources of changes in resource allocations in capital and labor and the implications for the seen and unseen costs of war. I also critically engage the notion of “wartime prosperity” – the idea that preparing for and engaging in war can contribute to improved citizen well-being through increased spending, employment, and output – and consider why relying on aggregate economic measures misses the underlying nuances of changes to the pattern or resource allocation.

Next, I turn to discuss the concept of the liberal peace, which refers to the idea that a system of liberty, grounded in private property, fosters peace both within societies and across societies (Section 3.5). I discuss the various channels through which a liberal system may foster peace and reduce conflict. I also discuss the contemporary literature that explores various aspects of the liberal, or capitalist, peace.

Finally, I discuss how insights from the Austrian tradition can shed light on the feasibility of foreign interventions, which refers to the use of discretionary power by one government to intervene in the affairs of another society (Section 3.6). Focus is placed on the knowledge problem, both over institutions and within institutions, facing interveners. The design and reform of institutions suffers from a knowledge problem because interveners lack access to the context-specific information of the informal rules and arrangements that allow designed institutions to operate in the desired manner. In addition, they suffer from the knowledge problem of how to best allocate scarce resources to their highest valued use within a given set of institutions due to the absence of economic calculation. Together, these dual knowledge problems place hard limits on what foreign interventions can achieve. I discuss these knowledge problems in the context of different types of interventions including military occupation and nation building, and the provision of aid and assistance to alleviate human suffering.

The final section (Section 4) concludes with a summary of the key contributions of Austrian economics to defense, peace, and war economics. I also discuss open areas for future research.

## 2 Defense, Peace, and War Economics: A History

### 2.1 Early Treatments: The Classical Economists

Issues of defense, peace, and war have been discussed by economists for centuries (see Brauer 2017). Adam Smith discussed these issues in a variety of contexts in *An Inquiry into the Nature and Causes of the Wealth of Nations*. For example, in “Of the Expence of Defence” (book V, chapter 1, part 1), Smith discusses the role of a military force in protecting against external invasion. The cost of preparing, maintaining, and deploying such a force, he argues, will vary depending on the type of society – for example, hunters, shepherds, or agricultural-based – and whether that society is at peace or war. Smith also extended his discussion of the division of labor and specialization to war and defense in two ways.

First, he argued that specialization and the division of labor placed a limit on the number of people in a society who could become soldiers. The underlying logic is based on the opportunity cost of labor reallocated to military purposes. The maintenance of an army depends on the output and wealth created by those engaged in specialized, productive employment. However, shifting resources from private production to military affairs causes output to fall. At some point reallocating labor from value-added production to the military would reduce output such that the army, and society, could no longer be sustained. As Smith puts it, “the number of the former [soldiers] can never exceed what the latter [private, value-added producers] can maintain” (1776: 657). Smith’s logic can be summarized as follows. Increases in wealth due to specialization and the division of labor makes defense against outside threats to that wealth increasingly valuable. At the same time, increased wealth allows a society to field an army. Fielding an army, however, involves an opportunity cost in terms of forgone production that is wealth reducing.

Second, Smith noted that an advanced society could benefit if a certain class of people specialized in preparing for war-making to hone their skills. He discusses two options for sourcing this warrior class. One option, a militia approach, involves all people of a certain age participating in military affairs. An alternative approach is a standing army, which, relative to the militia option, involves a more permanent structure with focus on specialization of a smaller group of soldiers. Smith believed that the specialization, unity, and permanence of the standing army made it preferable to the militia option in terms of providing for a society’s defense.

According to Smith, the state was necessary to create a dedicated class of warriors because, left to their own devices, individuals would pursue their own interests compared to providing defense for the public interest. As Smith noted, the private citizen

who, in time of profound peace, and without any particular encouragement from the public, should spend the greater part of his time in military exercises, might, no doubt, both improve himself very much in them, and amuse himself very well; but he certainly would not promote his own interest. It is the wisdom of the state only which can render it for his interest to give up the greater part of his time to this peculiar occupation. (1776: 659)

Here one sees the foundations of modern arguments by economists for state-produced military. This argument is grounded in the logic of public good provision, which holds that public goods will be undersupplied by private individuals due to free riding and pricing issues (a topic discussed further in Section 3.3). The state, it is argued, can overcome these issues and ensure that public goods are provided in adequate amounts.

Smith identifies two main costs associated with a standing army. The first is the monetary costs that, Smith argues, is likely to be greater than the militia alternative. This greater expense is due to the permanence of the standing army, which requires constant expenditures for maintenance. Moreover, a specialized standing army is more likely to use specialized, technical equipment, which is costlier to produce, maintain, and transport.

The second cost is nonmonetary and relates to the internal threat of a standing army to domestic liberties. Where the interests of political leaders align with those of citizens, then a standing army can be used to defend the person, property, and liberties of citizens. However, when there is divergence between the interests of leaders and the citizenry, then a standing army can be used to undermine the very things it is intended to protect. The purpose of a standing army is to specialize in force and control against external threats. But, as Smith noted, these same tools of coercion can be turned inward against the citizenry to bring about oppression.

Beyond his exploration of the various costs of defense, Smith also offered insight into the political economy of the imperialism of the British Empire (see Coyne and Hall 2014a). In doing so, he concluded that the British colonies were a net cost. This conclusion was based on several related arguments.

One aspect of Smith's treatment of the British colonies focused on the logic of special interests, which holds that well-organized groups can manipulate the political system to concentrate benefits on their members while dispersing costs on nonmembers. In this context, Smith argued that the main beneficiaries of

colonization were British merchants who were able to obtain monopoly privileges over the supply of goods and services to those in the colonies. The result of restriction of competition for supplying the colonies was monopoly profits accruing to the merchants. At the same time, the merchants incurred only a minimal part of the overall cost of establishing and maintaining the colonies. The bulk of these costs fell on citizens who did not benefit from the establishment of the monopoly privilege conferred to merchants.

As Smith put it, the expense of the colonies

is, in reality, a bounty which has been given in order to support a monopoly. The pretended purpose of it was to encourage the manufactures, and to increase the commerce of Great Britain. But its real effect has been to raise the rate of mercantile profit . . . Under the present system of management, therefore, Great Britain derives nothing but loss from the dominion which she assumes over her colonies. (1776: 581)

Elsewhere he noted that,

[t]o found a great empire for the sole purpose of raising up a people of customers may at first sight appear a project fit only for a nation of shopkeepers. It is, however, a project altogether unfit for a nation of shopkeepers; but extremely fit for a nation whose government is influenced by shopkeepers. Such statesmen, and such statesmen only, are capable of fancying that they will find some advantage in employing the blood and treasure of their fellow-citizens to found and maintain such an empire. (Smith 1776: 579)

And finally, he argued that “[f]or the sake of that little enhancement of price which this monopoly might afford producers, the home-consumers have been burdened with the whole expense” (Smith 1776: 626).

Another aspect of Smith’s argument dealt with the costs of maintaining the colonies. Operating an empire is expensive. It required a large military to control the colonies, protect trading routes, and offer protection from external aggressors. According to Smith, this would lead to significant expenditures that needed to be paid for by British citizens. In the face of mounting costs, Smith argued, the political elite would be tempted to use public debt to hide the true costs of maintaining the colonies and avoid a backlash from raising taxes. “The facility of borrowing,” Smith argued, “delivers them from the embarrassment which this fear and inability [of imposing new taxes] would otherwise occasion. By means of borrowing, they are enabled, with a very moderate increase of taxes, to raise, from year to year, money sufficient for carrying on the war; and by the practice of perpetual funding, they are enabled, with the smallest possible increase of taxes, to raise annually the largest possible sum of money” (1776: 872).

While relying on debt allowed the political elite to mask the immediate costs of empire, it was not a permanent solution. At some point the debt would come due, which would require either a reduction in public expenditure in other areas or an increase in taxes. Attempting to again avoid dissatisfaction on the part of the citizenry, Smith predicted that political rules would attempt to mask the costs of the debt through debasing the currency. As he noted,

When national debts have once been accumulated to a certain degree, there is scarce, I believe, a single instance of their having been fairly and completely paid . . . public bankruptcy has been disguised under the appearance of a pretend payment . . . When it becomes necessary for a state to declare itself bankrupt, in the same manner as when it becomes necessary for an individual to do so, a fair, open, and avowed bankruptcy is always the measure which is both least dishonorable to the debtor, and least hurtful to the creditor. The honour of a state is surely very poorly provided for, when in order to cover the disgrace of real bankruptcy, it has recourse to a juggling trick of this kind . . . Almost all states, however, ancient as well as modern, when reduced to this necessity, have upon some occasions, played this very juggling trick. (Smith, 1776: 882–3)

Smith believed that this “juggling trick” of debt and debasement was a threat to Britain’s fiscal viability.<sup>3</sup>

Smith also pointed out that the British government’s focus on the colonies resulted in a misallocation of resources and the neglect of other profitable opportunities. Along these lines he wrote that “[Trade between European countries] would be, at least, three times more advantageous than the boasted trade with our North American colonies . . . France is a much richer country than North America . . . [and] therefore, could afford a market at least eight times more extensive, and . . . four and twenty times more advantageous than that which our North American colonies ever afforded” (Smith 1776: 463). From this perspective, the narrow focus on the colonies overlooked other existing opportunities for mutual gain and exchange, opportunities that Smith considered to be significantly greater than those offered by the colonies.

Like Smith, David Ricardo recognized that engaging in war could have fiscal and redistributive costs that could have wide effects on a country’s economy. In *On the Principles of Political Economy and Taxation* (1817), he noted that, “[t]axes which are levied on a country for the purpose of supporting war, or for the ordinary expenses of the State, and which are chiefly devoted to the support of unproductive labourers, are taken from the productive industry of the country” (1817: 244). He also recognized that war changed economic activity both within and between countries through the disruption of

<sup>3</sup> For a modern treatment of the political economy of war finance, see Kreps 2018.

trade patterns. “The commencement of war after a long peace, or of peace after a long war,” he noted, “generally produces considerable distress in trade. It changes in a great degree the nature of the employments to which the respective capitals of countries were before devoted; and during the interval while they are settling in the situations which new circumstances have made the most beneficial, much fixed capital is unemployed, perhaps wholly lost, and labourers are without full employment” (1817: 265).

Moreover, movements between war and peace, and vice versa, involve an adjustment process that can impose significant economics costs. “The duration of this distress,” Ricardo argued, “will be longer or shorter according to the strength of that disinclination, which most men feel to abandon that employment of their capital to which they have long been accustomed. It is often protracted too by the restrictions and prohibitions, to which the absurd jealousies which prevail between the different States of the commercial commonwealth give rise” (1817: 265). While Ricardo was aware of this potential suffering during the shift from war to peace, he believed that we should expect that after a period of “temporary suffering, the nation will again advance in prosperity” (R1817: 265). He also believed that the government could implement policies – such as a tax on imports that decreased over time – to soften the blow of the reallocation process on domestic producers (Ricardo 1817: 266–7).

Like Adam Smith, John Stuart Mill also discussed the costs of the British Empire. While Smith concluded that the British Empire was a net cost, Mill reached the opposite conclusion. He believed that outward expansion by the British government was in the best interests of Britain and the world (see Bell 2010, Coyne and Hall 2014a).<sup>4</sup> His reasoning was based on several arguments.

First, Mill argued that Britain suffered from pressures created by increases in its population that threatened its long-term growth potential. As he wrote, “[a] conscientious or prudential restraint on population is indispensable, to prevent the increase of number from outstripping the increase of capital, and the condition of the classes who are at the bottom of society from being deteriorated” (Mill 1848: 753). To avoid this stagnation, Mill argued that Britain should turn to the colonies that presented new investment and trading opportunities. Along these lines, he noted that “[i]f one-tenth of the labouring people of England were transferred to the colonies, and along with them one-tenth of the circulating capital of the country, either wages, or profits, or both,

<sup>4</sup> It should be noted that Mill’s position on imperialism changed over the course of his life. Initially he was convinced of Adam Smith’s arguments against empire. His position changed toward a position of support for liberal imperialism for the reasons discussed in the text. Late in his life he became more pessimistic about the feasibility of liberal imperialism although he never fully rejected his support for the imperialist project (see Bell 2010).



would be greatly benefited, by the diminished pressure of capital and population” (Mill 1848: 749).

Mill went on to argue that Britain’s involvement in the colonies would contribute to the broader, liberal peace by facilitating peaceful trade and relationships between people in different geographic locations. Specifically, he argued that Britain’s connection with the colonies was an important step “toward universal peace and general friendly co-operation among nations. It renders war impossible among a large number of otherwise independent countries, and moreover, hinders any of them from being absorbed into a foreign state . . . It at least keeps the markets of the different countries open to one another, and prevents that mutual exclusion by hostile tariffs” (Mill 1861: 311).

Mill’s analysis of colonies differentiated between what he saw as their stage of development and civilization. He believed that more advanced, white colonies – for example, Australia, Canada – were capable of self-governance. In these cases, Britain should limit its involvement to matters related to their international policies. For those colonies that were less advanced, however, Mill argued for direct British rule. As he wrote, “[t]he same rules of international morality do not apply between civilized nations and between civilized nations and barbarians . . . it is already a common and is rapidly tending to become the universal condition of the more backward populations to be either held in direct subjection by the more advanced or to be under their complete ascendancy” (Mill 1874: 252–3). Mill believed that economic relationships with “barbarous” nations were only possible through direct control, management, and investment by Britain (Mill 1848: 313).

Many of Mill’s arguments in support of a liberal empire identified direct benefits to those in Britain, such as easing excess population and capital while creating trading opportunities. But he also made a broader argument about the global, civilizing effect of imperialism. Where the native populations of colonies were unable to engage in self-governance, the British government could fill the gap and foster modernization. He believed that “English virtues,” and institutions would afford security, guidance, and stability to these societies, providing them with opportunities for advancement (Mill 1867: 233–6).

Extending this argument, Mill concluded that the British Empire was necessary for an advanced, global civilization. In his view, imperialism was central to maintaining Britain’s power, which produced significant benefits not just for citizens of Britain, but for the world at large (Mill 1863: 783). From this perspective, imperialism was crucial to maintaining Britain’s standing in the broader geopolitical order, which was necessary for world peace and advancement.



The classical economists touched upon numerous issues that are central to the study of defense, peace, and war economics. These included (1) the monetary costs and financing of fielding an army and engaging in war, (2) the distortionary effects of war on domestic and international trade, (3) the influence of interest groups and other forces on the decision to engage in foreign intervention, (4) the net benefit of imperialism, and (5) the potential effects of state-run military on domestic freedoms and liberties. These, and related, topics would reemerge, starting in the 1950s with the founding of the field of defense, peace, and war economics.

## 2.2 The 1960s: The Rise of a Distinct Field

Following the initial work of the classical economists, a variety of twentieth-century economists continued to write on a variety of issues associated with war. This included scholarship by Veblen (1904, 1915, 1917), Edgeworth (1915a, 1915b, 1918), Pigou (1916, 1921, 1939, 1942), Keynes (1920, 1922), and Robbins (1939, 1947). As Brauer (2017) notes, the focus of this work was not on developing a systemic and unified theory of war and conflict. Instead, emphasis was placed on the economic dislocations created by war. For these scholars “war *per se* rarely was their main concern. Instead, it was the economic dislocations prompted by war that led to deep theoretical debates on trade, money, inflation, business cycles, and the proper role of the state” in these matters (Brauer 2017: 3). This changed in the 1960s. In the midst of the Cold War and the proliferation of nuclear arms, economists began to focus on developing a systemic theory of conflict. During this time several key books were published that served as the foundation for the field of defense, peace, and war economics.

In *The Economics of Defense in a Nuclear Age* (1960) Charles Hitch and Ronald McKean applied the economic concept of allocative efficiency to the military sector. Specifically, they sought to understand how scarce military resources could be allocated to maximize their value. They applied allocative efficiency to three levels – the overall quantity of national resources, the proportion of national resources dedicated to military and security matters, and the efficient use of those allocated resources by the various military bureaus. Across all three levels Hitch and McKean emphasize the importance of employing economic criteria in making decisions.

In *Arms and Insecurity* (1960) Lewis Richardson argued that war was caused by a breakdown in an international equilibrium. Believing that arms races were often preludes to war, Richardson sought to model the logic and implications of an arms race between nations. Using a set of differential equations, he explored the conditions under which an arms race resulted in a stable, or unstable,

outcome. An arms race was stable when there was some equilibrium where governments did not see the need to continue to escalate military armaments beyond the equilibrium. Once such an equilibrium point was reached, the arms race ceases since nations no longer see the need to acquire additional arms. An unstable arms race, in contrast, is one where such an equilibrium is absent, meaning that the action–reaction dynamics of the arms race continues. That is, as one nation increases its armaments, other nations involved in the race respond in kind. The unstable scenario is troubling because of the ongoing accumulation of arms and the possibility that a small act by one government could potentially lead to the onset of large-scale conflict. Richardson’s initial arms model served as a foundation for a subsequent literature that explored various aspects of the arms race (see Sandler and Hartley 1995: 87–109 and Anderton and Carter 2009: 185–221 for summaries).

Thomas Schelling’s *The Strategy of Conflict* (1960) developed game-theoretic notions of deterrence, threats and promises, and strategic interaction between governments. Among his key insights was the idea that the numerous coordination situations that exist in the world often have Nash equilibria. Schelling argued that in these situations, focal points, which refer to some shared expectation by the parties involved, could lead to coordination around one of multiple potential equilibria. This insight is important because it makes clear that historical and environmental factors – for example, relationships, trust, perceived legitimacy, credibility, authority, and so on – matter for bargaining and cooperation.

Schelling also pointed out the importance of credibly binding oneself in bargaining situations. This is important in situations where parties are bargaining but have yet to reach an agreement. Ideally, each party would prefer that the other agreed to their terms. A second-best situation is for each party to agree to the other party’s terms, which still yields some benefit, albeit less than the benefit they would receive under the first best of getting their way. The issue is that if each party remains stubbornly committed to achieving their first best outcome, they may end up with a third-best situation – a stalemate that is worse than the other two options. Schelling pointed out that one party can potentially convince the other party to agree to its (first best) terms by credibly binding its options for further negotiation.

For example, Party 1 must credibly convince Party 2 that there is nothing else that they can do to negotiate more favorable terms. This would involve Party 1 credibly communicating that they are not capable of making any further bargains. If this message is clear and credible, Party 2 might agree to less than ideal terms (their second-best option) because they believe it is the best they can do and prefer that outcome to the third-best option.