Money Is Not A Weapons System: Inflation, Economic Distortion, and Counterinsurgency Failure

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Abstract

The American experiences in Iraq and Afghanistan, together with new work in the quantitative study of rebellion and civil war, have revitalized the study of counterinsurgency. While the initial wave emphasized "classical" and population-centric counterinsurgency strategies, subsequent work has explored a fuller range of counterinsurgency dynamics, strategies, and sources of failure. This paper explores one under-examined and under-theorized dimension of counterinsurgencies (and expeditionary third-party population-centric counterinsurgencies in particular): the effect that counterinsurgent-generated inflation and economic distortion has on the stability, legitimacy, and long-term prospects of the client state. Using cases from Vietnam, Afghanistan, and Iraq, I analyze the political economy of counterinsurgency, and the relationship between American and client-state efforts, their economic impacts, and subsequent self-defeating externalities. I find that economic distortion had significant effects for counterinsurgency outcomes, while disaggregating mechanisms linking particular kinds of short-run distortions and their long-run consequences.

1 Introduction

Why do great powers fail in counterinsurgencies against ostensibly weak adversaries? In the wake of troubled American interventions, this question continues to rear its head. As the counterinsurgency research agenda has matured, there has been an increasing focus on deeper structural factors that present hidden and often un-avoidable dilemmas to would-be great power interveners.[1] Recent research has emphasized the factors making great power, third-party interventions much riskier ventures than they initially appear, highlighting selection biases in client choice and the difficulties constraining great power (and democratic in

[1]For a general critique of the early over-focus on doctrine, training, or tactics, see Jones and M. Smith 2010.

particular) counterinsurgency strategy choice and resolve.[2] Besides these general theories of counterinsurgent failure, other recent work has shown the extent to which two-level games and the difficulties of managing the patron-client relationship contribute to counterinsurgent failure.[3] In addition, work has drawn our attention to the diversity of underlying dynamics driving insurgencies, and thus optimal strategies against them: the focus on winning "hearts and minds" has given way to more sophisticated views of the relationship between coercion, co-optation, intelligence, and violence, depending in part on the factors motivating the insurgency.[4] Regardless of one's position on the underlying mechanisms (legitimacy, coercion, changed expectations, economic incentives) or the appropriate targets for counterinsurgency strategy (ranging from the population as whole to elite networks), there is a broad recognition that competitive governance, In this way, tje success of host nation intervention is tied to institutional development and governance capacity within the target state, and relative

[2] Simpson underscores the vital role selection effects play in generating counterinsurgent failure, and includes the surprising finding that weaker states are *more* likely to succeed (Simpson 2010). Arreguin-Toft highlights the military specialization and state socialization generating strategic mismatch (Arreguín-Toft 2005). Sullivan uses a careful analysis of the Militarized Interstate Disputes strategy to argue that counterinsurgents especially fail when their political goals are not amenable to resolution by physical force (Sullivan 2012). Merom argues that liberal democracies generate normative social consensuses that undermine resilience in counterinsurgencies (Merom 2003).

[3] See Hazelton 2018; Harkness and Hunzeker 2015; Ladwig III 2017.There are actually two problems here: training or utilizing a host-nation force *for the benefit of the intervener* and doing so for the ostensible benefit of the host-nation. In the first case, the intervener generates host-nation forces outside of the normal command structure for use as irregular augments to its own forces. This kind of activity, often practiced by American Special Forces, creates its own set of issues and potential resentments (in Vietnam, for example, ARVN forces operating alongside US units resented that Kit Carson Scouts - former Viet Cong defectors embedded as scouts within US military units - received better medical care than they did). In the second case (the one more commonly discussed and almost universally assumed), the interveners provides trainers and military advisors in order to build up a sustainable host-nation force 'for its own sake'. There is a kind of middle ground: interveners have typically faced trade-offs in terms of when and how to stand-up host-nation forces that can act independently and those acting within or alongside the intervener's forces. In the American case, training local militias or regular infantry has proved easier than building logistics or air support capability, partially for reasons discussed later in this article.

[4] The combination of data access and the causal identification/empiricist movement has led to sophisticated work parsing out the relationship between violence (targeted and untargeted, insurgent or counterinsurgent generated), information, tactics and force employment, and aid (examples include Berman and Matanock 2015; Berman, Jacob N. Shapiro and Felter 2018; Condra and Jacob N. Shapiro 2012; Dell and Querubin 2018; Kocher, Pepinsky and Kalyvas 2011; Lyall and Wilson 2009; Lyall, Blair and Imai 2013; Lyall, Zhou and Imai 2018; Lyall 2018). And there is a vibrant research agenda exploring the relationship between insurgent motivations, social structure, and counterinsurgency strategies (Kalyvas and Kocher 2007; Toft and Zhukov 2015; Lyall, Shiraito and Imai 2015; Staniland 2014; Jacob N Shapiro 2013).

to insurgent governance.[5]

But, despite the glut of counterinsurgency-related literature, one vital factor shaping counterinsurgent success has been completely ignored: There has been no systematic attention paid to the international political economy of counterinsurgency and the macroeconomic consequences of large-scale third party interventions in counterinsurgencies and civil wars.[6] This is not to suggest that no one has examined aspects of the problem, as we will see.[7] But no one has theorized the relationship between large-scale third-party counterinsurgent military and economic activity and its effects on government and insurgent institutional development, nor the boom-and-bust dynamics of third-party counterinsurgent drawdown upon those institutions. States in general and great powers in particular bring enormous resources to bear in these conflicts, but in so doing they create a number of inescapable side effects, which may undermine the institutional development of the client state. In the sections below, I provide a political economy of large-scale third-party intervention in counterinsurgencies (with a focus on macroeconomic effects) before showing how these dynamics played out during the American intervention in Vietnam and laying out a future research agenda (the full paper will include cases in Iraq and Afghanistan, and non-American shadow cases for extensibility).

Arguably, this gap has had serious consequences. In the cases we will examine below, insufficient attention to or compensation for the macroeconomic impacts of intervention had, I will argue, the effect of fatally undermining the outcomes counterinsurgents hoped to achieve. When this occurred, an inattention to the political economy of counterinsurgency led to confused beliefs about the sources of failure and unhelpful and erroneous narratives highlighting domestic political factors or the supposed perfidy or corruption of local partners, when something more structural was at work.

[5]This is not to stipulate that governance *quality* is the primary issue here (see Hazelton 2017); the ability to govern territory and resource extraction is essential to state-ness in the long-term (Weber 1959).

[6]This is a growing literature addressed later on the microeconomics of insurgency; while this work contributes to the claims being staked here, the limitations of the microeconomic focus will become clear below.

[7]See the review of the microeconomics of insurgency and limited macroeconomic work below.

2 Why Focus on the International Political Economy of Counterinsurgency

Counterinsurgencies, involving as they do both the pressures of war and those of state formation, are deeply connected with the economic management of the state; thus, third-party interventions have deeper impacts than can be understood from a focus on conflict or government legitimacy alone. The intuition is that large-scale third-party interventions (in this case, counterinsurgencies) have a substantial economic impact. They usually entail large aid flows (foreign aid, humanitarian aid, and military aid) to target states and significant real economic activity and spending within the economy. These flows have the same kinds of macroeconomic effects that any sudden increase in the real economy would have. On top of the flow-based effects, third-party intervention can transform the financial economics of the target state. An increase in aggregate money demand due to the growth in the real economy will lead to steady inflation. Intervener activity will modify expectations (domestic and foreign) about the client state, artificially (relative to a scenario without intervention) driving down the expected future inflation rate (and therefore, the interest rates). Interveners may lend to client states, directly or indirectly supply more of their own currency for use as foreign reserves, and otherwise act in ways that stabilize client-state currency in the international economic system. The aggregate effects of intervention will be economic flows and incentives that distort the client-state economy and provide client states certain powerful advantages against the insurgencies they face. If and when there is a substantial reduction in intervention size, a significant economic correction will ensue, weakening the client state at the very moment it must begin to stand on its own, contributing to a loss of legitimacy and capacity, insurgent endurance, and possible state collapse.

In intervening to bolster their clients, third-party counterinsurgents cannot avoid macroeconomic consequences or externalities. The economic distortions caused thus may overwhelm whatever positive goals counterinsurgents have, contributing to strategic failure. By failing to include the current and future political economic effects of intervention, counterinsurgents may undertake self-defeating strategies or settle for an unsustainable illusion of success.

This paper draws inspiration from recent work on the political economy of security to extend the analysis from great powers to their clients and targets. Within international relations, there is an increasing attention to the politics of economy: the use of economic statecraft, sanctions, and weaponized interdependence to accomplish state goals.[8] And there is an emerging literature on the modern political economy of security in great powers, with a special focus on financial flows.[9]

But there has been almost no work towards an understanding of the political economy of great power intervention targets, and how economic structures shape and constrain interveners and targets alike. Given the intrinsic connection between economic activity, state-building, and legitimacy in counterinsurgency, this failure is surprising. In the American case, it is perhaps all the more surprising given the role that counterinsurgencies played in precipitating two of the most important financial crises in modern American history: the demise of the Bretton Woods system and subsequent stagflation and the 2008 Financial Crisis.[10]

While I am not aware of any literature examining the overarching political economy of counterinsurgency (especially the macroeconomic dimension), there is a growing literature on the microeconomics of counterinsurgency, one which supports and contributes to my macroeconomic analysis. Researchers affiliated with the Empirical Studies of Conflict (ESOC) project have explored where and how aid reduces violence and influences information mech-

[8] Drezner 2015; Farrell and Newman 2018.

[9] Caverley 2009; Caverley 2014; Kreps 2018; Zielinski 2016; Oatley 2015; Connolly 2016.

[10] (See Zielinski 2016, Ch. 3). During Iraq and Afghanistan, the Federal Reserve slashed interest rates and kept the economy running "hot", initially justified to thwart any bearishness caused by 9/11, but also unavoidably helpful to the Bush administration as it borrowed hundreds of additional billions to pay for the wars. This period of extremely cheap money – combined with securitization and derivatives practices – kick-started both sub-prime lending at unsustainable interest rates (which, after teaser rates expired and the adjustable rates spiked upwards, lit the fuse on the crisis) and the emergence of a new model of investment banking wherein banks borrowed long and invested short. In addition, debt-fueled "military Keynesianism" significantly contributed to the capital flows imbalance which, among other things, led to major foreign investments in American mortgage securities, one of the factors that globalized and metastacized from an American housing crisis into a global financial crisis (Oatley 2015, pp. 2–3).

anisms in counterinsurgency, highlighting the role of small, local projects, communications infrastructure, and aid within secured areas.[11] Lyall finds that ISAF-funded aid in the wake of civilian casualties reduced violence against ISAF but had no impact on levels of violence against government forces, and that cash transfer programs alone create boom-and-bust cycles of government support, while their embeddedness in other programs creates a "credit capture" effect, where citizens revise upwards their estimates of government effectiveness.[12] Lee and Kendall find that American bureaucratic budget politics led to high levels of spending at the end of the fiscal year in Iraq and Afghanistan, and that this spending was much less likely to reduce violence.[13] This work provides evidence "that political economy problems do not just result in inefficiencies in battlefield effectiveness but may be in fact counterproductive," but little work has gone beyond microeconomic studies to the broader political economy of counterinsurgency.[14] The emphasis on causal identification strategies has led to right-censorship and a lack of analysis of long-term and aggregate effects (even where we might have difficulty conducting full-blown causal inference).[15]

Work connecting counterinsurgency with governance, state formation, and contentious politics should have clued us in to the importance of examining the political economy of counterinsurgency. Scholars increasingly see counterinsurgency and civil wars as processes of contentious state formation. Different "wartime social orders" shape the kinds of social contracts that emerge between those controlling territory and civilian actors, leading belligerents to adopt different co-optive and coercive strategies and to provide different levels of

[11] Berman, Jacob N. Shapiro and Felter 2018.

[12] Lyall 2018; Lyall, Zhou and Imai 2018.

[13] Lee and Kendall 2018.

[14] Ahmad examines markets for security in civil wars, and shows why Islamist militias uniquely skilled at lowering costs and out-competing for business in security markets (Ahmad 2015). Dube and Vargas show how different commodity price shocks affected violence in Colombia depending on the nature of the commodity (2013). Dube and Naidu suggest that American foreign military aid may end up leaking into the local economy in ways that support armed nonstate groups and weaken state development (2015). Nunn and Qian prove that US food aid is positively correlated with increased intrastate conflict, though not conflict onset (2014). Bazzi's study of export price shocks found that economic shocks, while they "may not trigger new wars... may play an influential role in existing ones" (2014).

[15] In the conclusion, I address possible research designs bringing empirical work back in.

goods and services.[16] Given the tight connection between conflict, state formation and state finance,.[17] But the war-making/tax-making/state-making process occurs in an increasingly globalized context; thus, we need to bring third-party interveners back in.[18] Methodologically, the political economy and macroeconomic toolkits allow us to re-integrate military strategy and social context; they also allow us an empirically grounded and theoretically justified way to incorporate future expectations (including expectations of government and insurgent performance) into our analyses of counterinsurgency dynamics.[19] Below, I provide a typology of macroeconomic effects intensive interveners have on client states in counterinsurgencies.

3 How Large-Scale, Third-Party Counterinsurgency Causes Economic Distortion

Modern counterinsurgency theory and practice emerges from the perceived failings of "imperial policing" and "counterguerilla" strategies to deal with the social and political unrest emerging in the third world during decolonization. Killing insurgents would fail as a strategy, and even backfire, if the underlying weaknesses of the state were not dealt with using comprehensive military, economic, and socio-political strategies.[20] Often using the British intervention in Malaya as a *locus classicus*, these interventions aimed to solve the social grievances driving the insurgency through economic opportunity, development, education, employment and other means of betterment.[21] While counterinsurgency theorists were circumspect about the

[16] Arjona 2014.

[17] Tilly 1990; Spruyt and Goodin 2011.

[18] Leander 2004.

[19] Frydman and Phelps 2013.

[20] Gventer, Jones and M. L. R. Smith 2014.

[21] For an excellent historiographical and theoretical critique of this use of the Malaya case, see Hazelton 2017. It is notable that even critical accounts of the use of Malaya in counterinsurgency thinking have tended to ignore the political economy of the Malay Emergency, and particularly the role that strong tin and rubber exports (buoyed by Korea and early Cold War military expenditures) in sustainably raising standards of living and improving government revenues, in a way no British program could (see Jackson 2008, pp. 505–508). Evidence on export price shocks in civil conflicts suggests that this rise in income would have shortened

utility of force in counterinsurgency, they endorsed a seemingly limitless provision of "soft power". To the extent that third-party counterinsurgents could "overprovide" non-kinetic lines of effort, it was only by crowding out host nation efforts or doing for them what they ought to do for themselves.[22] There was no recognition that large-scale intervention itself (regardless of the tactics employed) could provide the seeds of its own destruction.[23]

But almost every aspect of governance-oriented or population-centric counterinsurgency carries with it significant economic impact: aid to the host nation, development projects, civil action, infrastructure development (economic or military), military logistics, troop presence, and more. Counterinsurgents generate substantially increased real economy activity, distort economic geography, change expectations, modify prices of goods and labor, require new international financial operations, and often shape host nation development towards unsustainable structures and strategies.

Activity of any kind that involves the creation or expenditure of resources will nearly always contribute to the real economy in a host nation state. This is obvious in the case of foreign aid and development, but it is true of other kinds of activity as well. Transportation and logistics to support a counterinsurgent force will soak up raw materials and labor, and may also lead to further infrastructure development, which will also occur "on the economy." Sustainment for counterinsurgent forces will also provide employment in local communities, and the aggregate effect will be to increase demand for local factors, thus raising prices. Even when they are not spending money on development or other projects, counterinsurgency activities will contribute to the real economy. Civil action projects, building infrastructure, providing security, advising local forces: each of these substitutes counterinsurgent efforts for host-nation efforts, freeing up more resources for the host-nation government or other actors. Working with the host-nation may require complicated agreements that include terms for import-export or currency operations that may artificially prop-up government revenues or

the conflict in favor of the government (Bazzi and Blattman 2014).

[22] US Army 2006, Ch. 1.

[23] Michaels provides a useful overview of the paradoxes of large-scale counterinsurgency as such, but does not address the economic dimension in depth (Michaels 2014).

currency stability. Intense counterinsurgent activity exists in a political disequilibria: intense activity is likely to show battlefield results (in the form of security gains and insurgent group degradation), which will create the illusion of victory and escalate political pressure within the intervening state (and sometimes even within the client state) for drawdown. Counterinsurgent activity can result in the following distortions (some arising during periods of high activity, some emerging during drawdown):

Inflation Third party interventions cause two kinds of inflation. First, in the midst of intervention, the growth in the real economy caused by all of the activity associated with standing up and running the third-party counterinsurgency campaign (to include logistics, engineering, civic action, etc.) increases the aggregate money demand as well as the demand for labor, output, and raw materials.[24] In addition, at the local or national level, interveners (directly or indirectly) often pay above market wages and soak up labor supply, which also leads to rising wages and upward pressure on the price level. Second, in the wake of counterinsurgent withdrawal, states experiencing fiscal shock (see below) may end up spending at higher levels than they can support through aid or taxation, leading to deficit spending and currency inflation (fueled essentially by printing money) and sharp decreases in real wages. The resulting inflationary cycle, due as it is to government activity and expected future government activity, can dramatically raise consumer expectations of future price levels or uncertainty about the future political situation, increasing the velocity of money and potentially leading to hyperinflation. These dynamics occur without regard to and on top of the kinds of inflationary pressures traditionally associated with wars (military spending raises aggregate demand, while the possibility of conflict and loss causes consumers to draw down savings, hold more wealth in cash and increase spending on goods and portable stores of wealth).[25] While some counterinsurgents have taken direct anti-inflationary

[24]Economists define aggregate money demand primarily in terms of the interest rate, the price level, and the real national income (Krugman and Obstfeld 2009, p. 355).

[25]Krugman and Obstfeld 2009, pp. 371–372.

measures (as we will see in the case of Vietnam), these have further knock-on effects. Inflation due to real economic activity is not susceptible to the same central banking tools as inflation due to changes in the money supply.

Distorted Economic Geography Counterinsurgent presence and activity will reshape the economic geography of client states. Centers of counterinsurgent activity (both field activity and support operations) will grow at a faster rate than other parts of the country, contributing to internal migration, labor specialization to serve counterinsurgent needs, and infrastructure endowments. In addition, a growing economy with externally-funded development investment and levels of government or consumer spending may also reshape economic geography, especially through urbanization.

Distributional Shifts Counterinsurgent activity will not as a rule be evenly distributed geographically or across communities or constituencies. Politically relevant populations (either those sustaining the insurgency or those particularly helpful in counteracting the insurgency) will generally receive more aid (direct or indirect) from third-party counterinsurgents or host governments. If and when there is a reduction in aid or economic activity, they will also disproportionately be harmed.

Currency Speculation Large-scale counterinsurgency exposes client states to increased international financial flows. Foreign aid provision and international activity in the client state financial sector (if only for the purposes of paying contractors, labor, and materials) will distort balance of trade which, along with other inflationary pressures, may devalue the client state currency. Historically, interveners have often taken action to directly or indirectly stabilize the client state currency, which often creates opportunities for arbitrage or currency speculation. In some cases, insurgents may also be able to participate and benefit from currency speculation.[26]

[26] This was especially the case for mid-20th century interventions. Modern currency trading operations and central banking may make this less of a concern, though there is some evidence that ISIS, for example, found ways to participate in and profit from central banking in Iraq. For one humorous example of interna-

Corruption Counterinsurgent spending that outpaces oversight efforts naturally leads to corruption, which can undermine host nation legitimacy at home and abroad. Corruption should be viewed as a symptom of counterinsurgent overactivity, and not as an underlying causal factor. Corruption results from the mismatch between political responsibility, government officials' incentives, and their level of access to resources. There are, of course, a variety of kinds of corruption, some of which may be more damaging than others. By significantly underwriting state capacity, counterinsurgents undermine incentives for clients to pursue politically and economically sustainable governance, in favor of policies that enhance their resources. Moreover, where counterinsurgent long-term presence cannot be guaranteed, host nation government officials may adopt a looting mentality, attempting to take advantage of their position and resources while they still can. The effects of corruption appear to primarily be on government quality, institutional development, and legitimacy: from a purely economic standpoint, corruption is just another form of spending or of tax.

Fiscal Shock In the wake of counterinsurgent drawdown, client states suddenly find themselves under greatly increased financial pressure, which they must make up through raising taxes, printing money, or running deficits. There are at least four mechanisms leading to fiscal shock. 1) a simple reduction in aid 2) a drawdown in the real economic activity surrounding counterinsurgent military forces that directly and indirectly subsidizes government through rents, import tariffs, income taxes, currency operations, etc. 3) a substitution effect with counterinsurgent military forces - the client government must provide for substituting military capacity to fill in for departing counterinsurgent forces (all things being equal, they need to do more to stay at the same level of security) 4) an indirect effect on goods and services provision (the host nation government will take over the tasks of building and maintaining infrastructure,

tional currency speculation tied to the political economy of counterinsurgency, see Chavez-Dreyfuss 2012 on American amateur investment in the Iraqi dinar.

providing services to the population, supporting their military logistics etc.) There are political as well as economic considerations in play here. Even under peacetime circumstances, foreign aid has been shown to increase government spending; rather than substituting for existing revenue, foreign aid encourages states to do more.[27] Fiscal shock forces client governments to prioritize which constituencies it will continue to serve.

Tax Shock States receiving foreign aid are already under reduced pressure to increase domestic revenue effort. States facing insurgencies have additional incentives to limit taxation. Tax revenues will be difficult to collect (require greater enforcement capacity) than in territories with no conflict, and low or nonexistent taxation can be a source of advantage against insurgents that are still required to tax to support themselves. However, the net result is a general atrophying of the tax enforcement infrastructure, a drop in capabilities required to run a tax system, and unsustainable population expectations or practices about tax. Faced with fiscal shock during intervener draw down, states find that they must suddenly rely on tax revenues more (tax shock), a process which does not go smoothly and which reverses reputational gains caused by being "low-tax" when subsidized by third parties.[28]

Government Capacity Correction Client-state governance capacity may be underwritten by third-party interveners in all kinds of ways. Third parties may directly supply governance goods or services (including medical clinics, infrastructure, education, etc.), they may substitute for client-state military forces in ways that allow resources to be devoted to other things (every additional third-party soldier engaged in counterinsurgency enables a marginal decrease in client-state resources targeted at the same thing), and they may directly subsidize client-state governance. Faced with both fiscal shock and a loss of direct support during third-party counterinsurgent drawdown, client-state

[27] Remmer 2004.
[28] Boogaard et al. 2018; Thornton 2014.

governance capacity will adjust sharply downward, and political leaders will need to make difficult decisions about the geographical regions or functional areas in which to cut capacity. This reversion to the real (e.g. unaided/unsubsidized) capacity of the state will hamper territorial control, security provision, and legitimacy relative to insurgent groups.

Robust Insurgent Incomes All things being equal, government control of the monetary system presents certain advantages. The government can print and spend money (Seigniorage), taxing the economy (and the insurgents) through inflation.[29] But in many cases, insurgents develop a tax infrastructure to tax real goods (as opposed to inflating currency) and have the capacity to bring those goods to market outside of the government taxation system. Moreover, if the prices of insurgent-taxed goods rise faster than overall inflation, inflation will paradoxically *benefit* insurgent groups.[30]

As should be clear, these factors interact with and intensify each other, shaped by political dynamics between patron and clients states, insurgent groups, and underlying social groups. The theory of large-scale counterinsurgency is that interveners buy time to build institutional capacity and damage or outlast insurgent groups. But the subsequent corrections when the leave can undermine whatever institutional capacity was built, and the large the intervention, the larger the correction. These dynamics can be clearly seen at work in the American intervention in Vietnam.

4 Vietnam

The American intervention in Vietnam was shot through with the inability to control the financial and economic flows unleashed by the scale of American efforts, and it was these flows as much as Viet Cong sappers or North Vietnamese tanks that ultimately destroyed

[29] Buiter 2007.

[30] This is often the case for exported goods that are generating revenues in an interntional currency and high-demand staple goods, especially those for which demand will rise as violence increases.

the South Vietnamese state. Economic distortion explains the paradoxical nature of the end of the Vietnam War (where relative security belayed serious institutional contradictions) and undermines the notion that America won the war in Vietnam only to lose its nerve in supporting the Saigon regime at the last minute. As one American correspondent quipped late in the war, "the more we won, the more we lost".[31] The framework provided here lays out why.

4.1 Buildup

In response to the growing weakness of the South Vietnamese state and the preparations for escalation being made by the Viet Cong and North Vietnamese after the fall of the Diem regime in 1963, American support for South Vietnam escalated to include first bombing and air support and then outright security provision, on top of expansions of pre-existing military advising, foreign internal defense, and civic action missions. While American forces concentrated on providing security and degrading Viet Cong and North Vietnamese military capability to provide a shield for pacification and counterinsurgency, nearly all units also conducted substantial civic action programs (especially during the rainy season, when fighting diminished), providing infrastructure, roads, development, medical services, and more. At the war's height in 1968-1969, almost half a million American military personnel were deployed to Vietnam. In support of American servicemen, and to allay the political costs of deploying draftees to Vietnam, the United States developed an intense logistical system to provision the war effort (American, Free World, and South Vietnamese) and to provide goods to soldiers and South Vietnam in general.[32]

The American escalation was not only military. Civilians and development aid surged into Vietnam. USAID expanded its staff from 732 to 1856 Americans from 1965 to 1967 (accounting for over 10% of its worldwide staff, at the height of its power). Expenditures

[31] Daddis 2017, p. 206.
[32] Lair 2014.

reached \$495 million in 1967 and stayed there until the final drawdown drawdown.[33] Supporting staff and contractors from major American companies (defense, computing, and more) surged into Vietnam to get a piece of the action, encouraged by the anti-inflation import program discussed later.

American intervention and support for South Vietnam exerted tremendous inflationary pressure. According to one estimate, consumer prices rose 900% from 1964 to 1972.[34] In the first two years alone, prices rose 167%.[35] From 1960 on, the major contributor to inflation was the steady growth of the money supply driven by enhanced RVN spending - 88% of the annual rise in prices was caused by changes in the money stock (government deficit spending) and velocity, not changes in real national income.[36] But the effect of inflation on quality of life had been kept within tolerable limits largely by the American importation of goods as an anti-inflationary measure, to solve the problem of too much money chasing too few goods. In addition, American aid was a major contributor to real growth in the economy of South Vietnam, and the presence of large numbers of American troops also reduced monetary velocity by improving public expectations of the regime's durability.[37] One of a number of hidden subsidies for Saigon was the tremendous amount of piasters the Department of Defense purchased for its operations in Vietnam, all at the official exchange rate. Because the RVN turned around and used those dollars on the world markets to import goods and services, it had a deflationary effect.[38]

MACV and the US Mission in Vietnam were well aware of the extent to which inflation and economic distortion threatened the long-term success of the American intervention. A handbook for newly arrived servicemen explained the inflation problem in simple but thorough terms: it is doubtful it made any difference.[39] To fight the high inflation that set

[33] Ekbladh 2010, p. 204.
[34] Bradley 2012a, p. 121.
[35] Herring 1990.
[36] Dacy 1986, p. 147.
[37] Later, the American withdrawal collapsed all three sources of anti-inflationary pressure. Dacy 1986, pp. 147–149.
[38] Helen Nguyen Pho 2016, p. 300.
[39] MACV 1966, p. 33.

in in the first few months of escalation, MACV began in August 1965 to take increasingly drastic steps to quarantine American servicemen's finances. Possession of American dollars was outlawed. Soldiers were paid in a special scrip (Military Payment Certificates, MPCs) only valid in American military facilities; to prevent their exchange on the black market, entire series were suddenly phased out. Soldiers needed to exchange any outstanding MPCs from the old series to the new in a handful of venues, and the exchanges were meticulously registered. But even these practices barely stemmed the tide of the Piaster-MPC-Dollar Trade.

Currency speculation had previously helped undermine French counterinsurgency and destroy support for the war in "l'affair des piastres" which became a symbol of the idea that France was exhausting itself in Vietnam (in part motivating Navarre's bold but failed gambit at Dien Bien Phu.[40] Profiteering on the franc-piaster trade by French banks, French soldiers, and connected South Vietnamese elites had been an open secret for years, but an expose showing how French taxpayers were substantially funding the insurgency finally led to action. The CIA estimated that the Viet Minh had benefited from piastres speculation to the tune of five hundred tons of arms *per month*, sponsored by the Banque d'Indochine. As French colonial soldiers were paid in piasteres, the 1953 devaluation (motivated by increasing political uproar in France) had the direct effect of damaging morale and increasing local support by non-Communist nationalists for independence.[41] While the United States was more proactive in fighting currency speculation than the French had been, the larger scale and developmental focus of American intervention made the job much more difficult.

The essence of currency speculation is arbitrage between currency exchange prices based on privileged access to currency markets or exchange rates, undergirded by demand for different currencies (especially those more likely to retain their value). In Vietnam, there were three currencies: the piaster (rapidly inflating), MPCs (relatively available, but only convertible to piasters or dollars by American GIs), and dollars (stable and liquid, but

[40] Prados 2014.
[41] Logevall 2014, pp. 348–9. See also Hardy 1998.

controlled). Those with access to the official piaster-dollar exchange rate could convert piasters to dollars and then sell the dollars on the black market, where higher market demand placed them at a premium.[42]

Black market middle men man gathered piasters and MPCs from Vietnamese civilians and even members of the Viet Cong, and exchanged them for commodities or dollars with Free World soldiers or civilians.[43] Soldiers would deposit piasters and MPCs in their accounts and have family members wire them dollars from the United States, or access funds or financial instruments in Hong Kong while on R&R.[44] Ultimately, this cycle was underwritten by the American taxpayer. It was profitable because the government used an artificially high exchange rate to incentivize Americans to hold piasters (to help control inflation). When soldiers purchased goods with MPCs and then hawked them, they were taking advantage of artificially low prices encouraged by the military logistics system and the anti-inflation import program.[45]

The corruption which helped undermine the legitimacy of the South Vietnamese state and ensure its destruction is inseparable from (and was, indeed, primarily fueled by) the inflationary effect of American military and development activity.[46] Budgeting and paying civil servants and soldiers alike was done in Vietnamese piasters. As American-fueled inflation took hold, real wages in the government sector plummeted. An ARVN private saw his real income drop from \$77/month in 1964 to \$30/month in 1972.[47] High-ranking officers in the Vietnamese Army moonlighted as taxi drivers, sometimes driving around prostitutes making several times their military salary.[48] These humiliating distortions built resentment against the American presence and the South Vietnamese regime and encouraged corruption. One way to make up for the loss was to use one's office to capture additional revenues. Sol-

[42] Bradley 2012a, p. 121.

[43] While plenty of Americans participated in this trade, the less wealthy Filipino and South Korean personnel were even more active, relative to their size in theater.

[44] Spector 1992, pp. 265–266.

[45] Helen Nguyen Pho 2016, p. 202.

[46] Helen N. Pho 2016.

[47] Bradley 2012b, p. 120.

[48] Boot 2018.

diers could extort business owners, put ghost soldiers on the roster and pocket their salary, or sell off military supplies. Other civil servants were able to dip into aid revenues, divert imported goods, or accept kickbacks from contractors. Even as billions of American dollars poured into Vietnam to support the war effort, development, and state-building, inflationary distortions undermined the fragile Republic of Vietnam.[49]

If the massive importation of activity, military goods, and currency had more money chasing fewer goods (inflation), one solution was to introduce more goods into the economy. Created in 1955 as a combination (American) export-promotion and anti-inflation measure as American foreign aid to Vietnam increased, the Commercial Import Program allowed South Vietnamse businessmen to access dollars for use in trade at artificially low rates.[50] It provided a windfall for government and local importers alike (some of which surely found its way from the latter to the former). In addition, imports served as a hidden subsidy to the RVN (on top of a number of direct aid programs). Piasters from the piaster-dollar trade were deposited in a fund for the RVN to use to pay government salaries, and import tariffs served as an important source of government revenue. The Army's main logistics hub in Long Binh was built in 1967 in part to dampen economic distortion by isolating American activity. But the American war machine relentlessly imported goods and expanded the South's real economy; port facilities in Saigon had to be expanded to go from importing 1.5 million tons a year to 5 million, and Tan Son Nhut became for several years the busiest airport in the world.[51]

In theory, the fiscal capacity of both the intervener and the host-nation state should present an advantage over insurgents who cannot usually, after all, run their own banking or currency system. In practice, this advantage is moderated by the expropriative capacity of the insurgency. In Vietnam, the Viet Cong generally managed to use taxation in real goods and access to black markets and currency operations to compensate for the inflation being

[49]Helen Nguyen Pho 2016.
[50]Helen Nguyen Pho 2016, p. 18.
[51]Vo 2011, pp. 154–155.

imposed upon them. To avoid further economic imbalances and social dissolution, the US and South Vietnam needed to use fiscal transfers and subsidies to compensate rural South Vietnamese peasants. South Vietnamese farmers living in areas with an active NLF presence often used these subsidies to pay taxes to the Viet Cong, indeed improving their quality of life, but not in the way the United States intended.

Nevertheless, the massive increase in resources on the side of the RVN did present a number of dilemmas to the Viet Cong. As the RVN's effective tax rate significantly dropped, Viet Cong taxation began to look more expropriative. Civilians living in Viet Cong territories wanted to sell their goods in RVN markets, where they would fetch a higher price, but resented "export taxes" imposed by the Viet Cong to do so. Moreover, because economic growth was slower in Viet Cong controlled areas, internal migration undermined the Viet Cong tax base. In 1966 alone, 20% of the villagers in VC-controlled Long Hung migrated to RVN controlled territory for economic reasons.[52] One study found that economic opportunities created directly and indirectly by American involvement was more responsible for generating migration from the countryside and urbanization than war violence.[53]

During the years of the war, the net effect of American activity was at the same time cause and dampen significant inflationary pressure: American support and activity underwrote real income based inflation and the South Vietnamese government's inflationary spending, but American import programs and currency operations kept the resulting inflation at an artificially manageable level. Subsidized economic growth distorted the economic structure and geography of Vietnam, leading to economic migration and urbanization. By the time the United States neared the completion of its drawdown, an astounding 78% of the South Vietnamese economy was in the government and service sector, in what was otherwise a rural, agrarian country.[54] Direct and indirect sources of American aid underwrote the South Vietnamese state and allowed it to maintain artificially low tax rates, improving its attract-

[52]Elliott 2003, pp. 918–920.
[53]Goodman and Franks 1975.
[54]Bradley 2012a, p. 121. See Fig. 1.

iveness relative to the Viet Cong. At the same time, the economic programs needed to control inflation and quarantine American economic activity also led to corruption and fraud that undermined the competency and legitimacy of the RVN.

4.2 Withdrawal

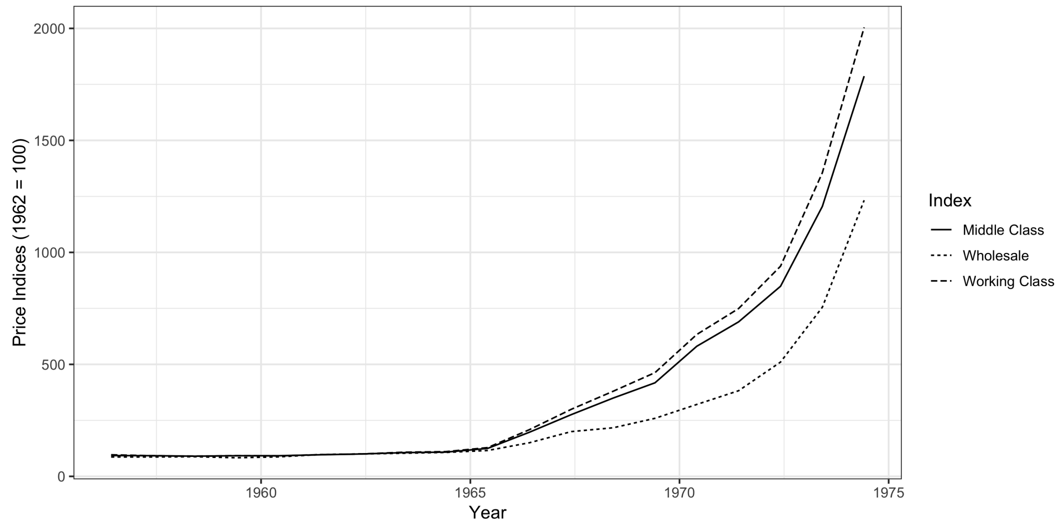
Years of American efforts, combined with the decimation of the Viet Cong in the Tet Offensive, exerted a real toll on the VC and NVA; internal documents attest to 1969-1972 being incredibly discouraging years, characterized by hardship and low morale.[55] Between this apparent success and domestic political pressures, American withdrawal began in 1969 and accelerated in 1970 and 1971. To make up for the drawdown in American forces, military and foreign aid to the RVN increased at first. But these proved politically and economically untenable, and overt aid did not make up for the dramatic loss of indirect sources of support for the Saigon regime.

But even before American withdrawal began in earnest, economic turmoil in the South was taking its toll. Steadily throughout 1970, 60% of South Vietnamese civilians rated financial instability and price increases as their absolute greatest concern; in December 1970, concern for the economic situation was three times greater than concern about security or the war.[56] Consistent inflation also raised accusations of price manipulation and corruption, reducing trust in civil society and in the government. 45% of South Vietnamese civilians blamed price manipulation or corruption for high prices, even though they were substantially caused by macroeconomic pressures..[57]

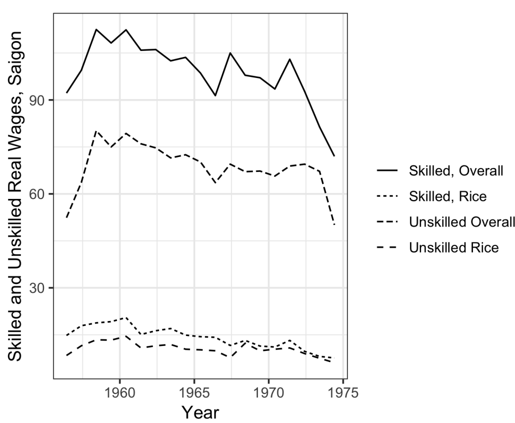
Excessive military aid was a necessary part of the logic of Vietnamization; the RVNAF could only step into the place of the Americans against the fierce and Soviet-armed North Vietnamese if equipped with modern weaponry. But, at the same time, the RVNAF was dependent on military aid to use and maintain its armed force.[58] As 1973 wore on, RVNAF

[55] Nguyen 2012; Elliott 2003.
[56] MACCORDS- Pacification Study Group 1970.
[57] MACCORDS- Pacification Study Group 1970.
[58] Willbanks 2004, p. 202. It is sometimes misleadingly claimed that the United States built an army in

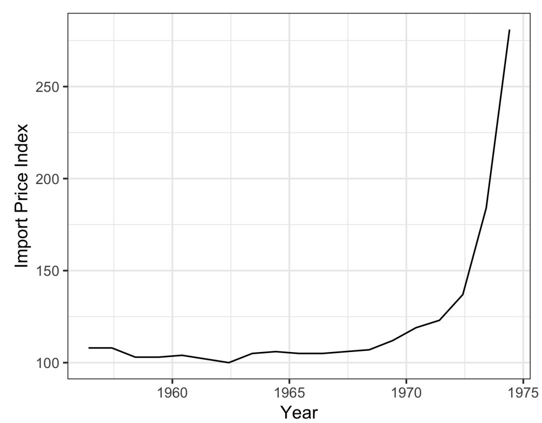
Figure 1: Economic Distortion in Vietnam



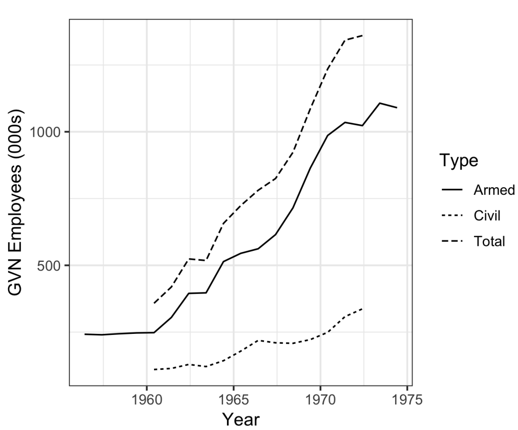
(a) Price Indices



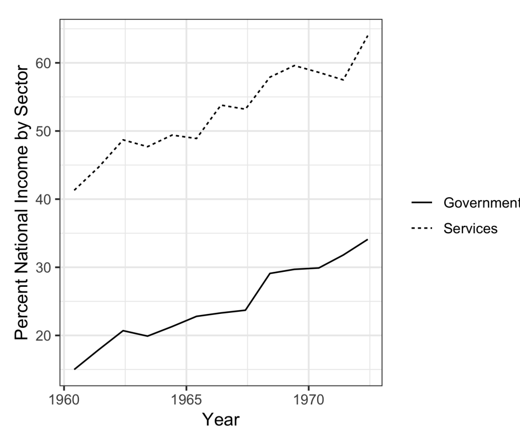
(b) Real Wages



(c) Import Price Indices



(d) Government Employment



(e) Percent National Income by Sector

Data from Dacy 1986.

leadership increasingly put controls in place on the use of fuel, ammunition, and supplies. Still, units began running out of fuel, ammunition, and parts. By the end of 1973, these supplies had been reduced 60% from the same time the previous year, and they decreased by another 44% by mid 1974. At the same time, the government of South Vietnam was forced to cut soldiers' pay, which was further eaten away by spiraling inflation. It was no wonder, then, that desertions skyrocketed, to over 35% by mid-1974, and morale plunged. Many of the soldiers that "stayed" worked out arrangements with their commanding officers to work away from their units to support their families. Others sold their weapons and equipment, or resorted to banditry. Those in command often pocketed their soldiers' salaries (some from "ghost soldiers"), sold "safe" billets, or participated in the looting of their units.[59]

The social unrest from continuing violence and inflation was made worse by collapse of the South Vietnamese economy due to American withdrawal. As American withdrawals accelerated, a significant economic correction took hold. With American forces gone, construction, military services, and contracting firms (including the secondary industry supporting these firms) essentially dried up. US military aid dropped from $2.3 to $1Billion from 1973-1974, and $400 Million of foreign aid vanished as well.[60] Millions (including those who had originally left rural areas for American-backed economic opportunities) of South Vietnamese became unemployed; these became yet another unaffordable burden on the RVN. USAID estimated that a million workers, making up 20% of the civilian work force, were unemployed in 1974. Cost of living surged 65% in 1973, and was even worse in 1974.[61]

Without American aid, imports and currency operations subsidizing the state and soaking

its own image, which then could not afford to continue without American presence. This argument obscures more than it helps. Prior to Vietnamization, RVNAF generally maintained a force structure appropriate for a developing country - the problem was that RVNAF was increasingly outgunned by the North Vietnamese and the Viet Cong, and could not take over the missions the United States wanted, for political reasons, to Vietnamize, especially toe-to-toe fights with the NVA, air support and transportation (Clemis 2018, p. 194). And any military aid RVNAF received was almost definitionally American-made, and therefore expensive; the United States could not very well import Chinese or Soviet arms in order to turn around and give them to RVNAF. But the inevitable result was a dependent military.

[59] Willbanks 2004, pp. 203–205.

[60] Bradley 2012a, p. 170.

[61] Willbanks 2004, p. 206.

up freshly-printed piasters, inflation jumped from an average of 27% per year during the war to 59% and 40% in 1973 and 1974 respectively.[62] And these inflation indices understate the acute problem for South Vietnam's poorer citizens: rice jumped 100% and cooking oil 138%. Gasoline (affected by import duties and the oil embargo) climbed 338%. Yet per capita income *fell* by 25%, and labor shortages in the countryside led to a demand for rice imports.[63] Paradoxically, because they controlled territory and taxed in goods, not RVN piasters, inflation was a boon for the Viet Cong.[64]

The political economy analysis gives the lie to the dolchstosslegend that the United States and South Vietnam had vanquished the Viet Cong and exhausted the North, only for the Americans to abandon their allies due to the media and the Left.[65] The South, rather than standing tall after years American aid, had been fatally weakened by it, its economic structure thoroughly dependent on the United States. As long as the Americans were there, its economic system could not develop in sustainable ways: they would never 'turn the corner.' And whenever the Americans left, a severe economic correction in South Vietnam was inevitable. As the piaster inevitably devalued, real income dropped, and deficit spending soared upwards.[66] The fragile South Vietnamese state struggled with "rising unemployment, ballooning national debt, and looming inflation", and the economic weakness of South Vietnam became part of the North's military calculus.[67] This economic disruption was critical to the South Vietnamese state's late decisionmaking. Years before the collapse, a senior South Vietnamese official working on programs managing the economic crisis painted a daunting picture of the challenges the state faced:

> Extensive war destruction, the swift withdrawal of the USA and other... allies leaving jobless millions of Vietnamese who crowded into the cities and around

[62] Dacy 1986, p. 132.

[63] Willbanks 2004, p. 206. What is going on here? Per capita income fell due to unemployment caused by the American withdrawal, while labor shortages were caused by a mix of Viet Cong gains, refugees, military mobilization, and economic displacement.

[64] Elliott 2003.

[65] Sorley 2007.

[66] 'The Economic Situation in South Vietnam, December 1974' 1974.

[67] Willbanks 2004, pp. 220–229.

> military bases..., the devaluation of the American dollar and the faster devaluation of the Vietnamese piaster along with the rising price of most commodities on the world market, the reduction of American economic assistance, the budget burden imposed . . . by... maintaining a huge army and caring for millions of refugees, widows, and orphans....

If the war in Vietnam was fundamentally a "contest between social orders over political legitimacy", it was the political economy of the South Vietnamese regime that made its survival ultimately untenable, because the institutions generating territorial control and providing governance were built upon quicksand.[68]

5 Afghanistan

In this case, I show how dramatic levels of military spending (at times exceeding 100% of Afghan GDP) led to similar distortions and inflationary effects as American efforts in Vietnam had. I particularly zoom in on the problems that looming fiscal shock, tax shock, and governance capacity correction pose for the Afghan government, and the especially powerful political economy of the opium trade in improving the Taliban's governance capacity.

6 Iraq

In this case, I examine why the glut of spending undertaken by the United States in Iraq did not display most of the same pathologies as Vietnam and Iraq. The answer lies in Iraq's oil economy. Large government revenues from natural resource endowments leads to reduced domestic revenue effort (taxation).[69] *Steadily increasing production (undergirded by capital investment and infrastructure upgrades) substituted , with only moderate pressure on government finances in the years of withdrawal (2009-2012). Instead, I focus on the*

[68] Daddis 2017, p. 207.

[69] Thornton, Bornhorst and Gupta 2008.

distributional effects of American efforts. Because aid projects (whether civilian or military-run) were correlated with American presence, and (guided by the money-as-a-weapons-system approach) the United States was increasingly willing to XXX

7 Conclusion

The paper will conclude using a few shadow cases to test for extensibility and by highlighting the ways in which microeconomic studies of counterinsurgency might be extended to include the macroeconomic effects addressed here. Especially promising are extensions of Lyall's and Shapiro's work to examine what happens when economic correction reduces aid levels in areas that had previously benefited from them, and re-examinations of Vietnam-era data using new macroeconomic tools. The analysis offered here presents a new line of inquiry in ongoing debates about population-centric strategies (which tend to be resource-intensive) vs. coercive strategies (which tend to be resource-light) by highlighting structural limitations on population-centric strategies.

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