

GIVE LINCOLN CREDIT: HOW PAYING FOR THE CIVIL WAR TRANSFORMED THE UNITED STATES FINANCIAL SYSTEM

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“[N]o duty is more imperative on . . . Government, than the duty it owes the people, of furnishing them a sound and uniform currency.”

Abraham Lincoln¹

“[T]here’s no money in poetry, neither is there poetry in money.”

Robert Graves²

INTRODUCTION

We know him as the Great Emancipator and the Savior of the Union, but we could add Financier Extraordinaire to complete Abraham Lincoln’s trinity of titles. Prosaic as money may seem, Lincoln could not have recaptured the South and released the slaves from bondage had he not figured out how to finance the War. His pragmatic approach first preserved and then replaced the U.S. banking system, presented a model of America-first money management for future Presidents, and paved the way for a broad interpretation of the Necessary and Proper Clause in the U.S. Constitution. It also set the country on a course that led to an intertwining of the financial sector with the federal government. Centralization of power at the national level saved the Union, but it also led people to look to Washington in money matters.

What follows is a description of the U.S. financial system at the time Lincoln became President and evidence of his opinions about its flaws. The article then turns to Lincoln’s options for financing the War and the choices he made, along with an analysis of the strength of his influence. It ends with a discussion of Lincoln’s financial legacies.

I. THE FINANCIAL SYSTEM LINCOLN INHERITED AND WHAT HE THOUGHT ABOUT IT

When Lincoln took office in March 1861, he inherited a financial crazy quilt of 1,600 state-chartered banks,³ circulating

¹ Speech on the Sub-Treasury (Dec. 26, 1839), *in* 1 COLLECTED WORKS OF ABRAHAM LINCOLN 159, 164 (Roy P. Basler et al. eds., 1953) [hereinafter COLLECTED WORKS].

² Mammon: Annual Oration (Dec. 6, 1963), *in* ROBERT GRAVES, MAMMON AND THE BLACK GODDESS 3, 3 (1965) (internal quotation marks omitted).

³ 3 HISTORICAL STATISTICS OF THE UNITED STATES: EARLIEST TIMES TO THE PRESENT 3-633 tbl.Cj149–157 (Susan B. Carter et al. eds., Millennial ed. 2006) [hereinafter HISTORICAL STATISTICS OF THE U.S.].

some 10,000 different types of banknotes,⁴ plus an independent Federal Treasury that received and disbursed only specie (gold and silver) via sub-treasuries located in multiple cities.⁵ Federal debt stood at nearly \$65 million, and customs duties—virtually the only source of federal revenue—fell dramatically in the last quarter of James Buchanan’s presidency, in part because southern customs houses failed to send in their proceeds.⁶

A. Lincoln’s Views of the Shortcomings of the Independent

⁴ Richard Sylla, *Reversing Financial Reversals: Government and the Financial System Since 1789*, in GOVERNMENT AND THE AMERICAN ECONOMY: A NEW HISTORY 115, 134 (Price Fishback et al. eds., 2007).

⁵ See, e.g., Jerry L. Mashaw, *Administration and “The Democracy”: Administrative Law from Jackson to Lincoln, 1829–1861*, 117 YALE L.J. 1568, 1586–87 (2008). After Andrew Jackson torpedoed the Second Bank of the United States, he deposited federal funds into state “pet” banks. *Id.* A series of efforts to create a federal repository finally succeeded with the passage of the Independent Treasury Act in 1846. Act of Aug. 6, 1846, ch. 90, 9 Stat. 59. The Act required “all duties, taxes, sales of public lands, debts, and sums of money accruing or becoming due to the United States, and also all sums due for postages or otherwise . . . be paid in gold and silver coin only, or in treasury notes” and that “every officer or agent engaged in making disbursements on account of the United States . . . shall make all payments in gold and silver coin, or in treasury notes, if the creditor agree to receive said notes in payment.”

§§ 18, 19, 9 Stat. at 64. Although the Act provided for the use of treasury notes, it could not compel this alternative because these notes were not recognized as legal tender. The treasury consequently conducted virtually all transactions in specie. For a history and discussion of the workings of the independent treasury, see generally DAVID KINLEY, *THE HISTORY, ORGANIZATION AND INFLUENCE OF THE INDEPENDENT TREASURY OF THE UNITED STATES* (1893). The United States was officially on a bimetallic standard, but operatively was on a gold standard. For good explanations, see MILTON FRIEDMAN, *MONEY MISCHIEF: EPISODES IN MONETARY HISTORY* 51–79 (1992) and Lawrence H. Officer, *The Floating Dollar in the Greenback Period: A Test of Theories of Exchange-Rate Determination*, 41 J. ECON. HIST. 629, 630–31 (1981).

⁶ 5 HISTORICAL STATISTICS OF THE U.S., *supra* note 3, at 5-80 to -81 tbl.Ea584–587 (providing federal debt numbers). The debt included Texas indemnity stock and Navy bonds from the War of 1812. Richard Roll, *Interest Rates and Price Expectations During the Civil War*, 32 J. ECON. HIST. 476, 476 (1972). Customs duties yielded 90% of federal income in the decade ending in 1860, but declined sharply in the last quarter of 1860. BRAY HAMMOND, *SOVEREIGNTY AND AN EMPTY PURSE: BANKS AND POLITICS IN THE CIVIL WAR* 31–32 (1970) [hereinafter HAMMOND, *SOVEREIGNTY*]. Although the federal debt number may seem large, compare it to 1860’s Gross Domestic Product (GDP) of \$4.485 billion—this shows how small the government was, relative to the rest of the economy. Today, federal debt nearly equals the annual GDP. U.S. CENSUS BUREAU, *STATISTICAL ABSTRACT OF THE UNITED STATES: 2010*, at 459 fig.9.1 (2010), <http://www.census.gov/prod/2009pubs/10statab/fedgov.pdf> (providing debt numbers). GDP is recorded at the Bureau of Economic Analysis. See, e.g., Press Release, Bureau of Econ. Analysis, *Gross Domestic Product: Fourth Quarter 2009 (Advance Estimate)* (Jan. 29, 2010), http://www.bea.gov/newsreleases/national/gdp/2010/pdf/gdp4q09_adv.pdf.

Treasury

Although the Civil War exposed the glaring inability of existing institutions to cope with large-scale federal expenditures, Abraham Lincoln had monetary reform on his mind long before he was elected President. In his well-known 1839 speech attacking the Independent Treasury (and indirectly praising the Second Bank of the United States), he stated his position forcefully:

We do not pretend, that a National Bank can establish and maintain a sound and uniform state of currency in the country, in *spite* of the National Government; but we do say, that it has established and maintained such a currency, and can do so again, by the *aid* of that Government.⁷

He further complained that the Independent Treasury reduced the quantity of money in circulation and thus injured the common people, going so far as to say that Judas “was the Sub-Treasurer of the Saviour and his disciples.”⁸

The young Lincoln’s rhetoric seems a trifle overblown. But his reasoning is fundamentally sound: by forcing the federal government to operate with coin rather than paper, the Independent Treasury system idled substantial quantities of gold and silver.⁹ Had this been deposited in a fractional-reserve bank,

⁷ Speech on the Sub-Treasury (Dec. 26, 1839), *supra* note 1, at 164. The speech was delivered at the Hall of the House of Representatives in Springfield, Illinois, during the first session convened in the new capital city, in response to Stephen Douglas’s defense of the sub-treasury system. *See id.* at 159 n.1. This speech may be better known for its bombastic invective against the Democrats:

I know that the great volcano at Washington, aroused and directed by the evil spirit that reigns there, is belching forth the lava of political corruption . . . while on its bosom are riding like demons on the waves of Hell, the imps of that evil spirit, and fiendishly taunting all those who dare resist its destroying course

Id. at 178. The move to Springfield from Vandalia came about chiefly through the efforts of Lincoln and his friends. The vote to move the capital occurred on February 25, 1837 and the first brick laid on July 4 of that year. JOSEPH H. JONES, ILLINOIS STATE CAPITALS (2007), <http://genealogytrails.com/ill/capitols.html>. Many scholars argue that Lincoln only expanded his power in war time but would not necessarily have done so in peacetime. *See, e.g.*, Arthur Schlesinger, Jr., *War and the Constitution: Abraham Lincoln and Franklin D. Roosevelt*, in LINCOLN, THE WAR PRESIDENT 144, 157 (Gabor S. Boritt ed., 1992). These words of Lincoln suggest that he may well have tried to reform the money and banking system regardless of the Civil War. Regardless of what might have happened, the changes that did occur set a new institutional structure in place.

⁸ Speech on the Sub-Treasury (Dec. 26, 1839), *supra* note 1, at 167.

⁹ The U.S. Treasury held \$3.9 million in specie in June 1860 and \$2.8 million in December 1860. 3 HISTORICAL STATISTICS OF THE U.S., *supra* note 3, at 3-602 tbl.Cj26-41. Total specie held in December was \$259.2 million, of which \$87.7

it would have been available for loans. Instead, as New York Representative Elbridge Spaulding later put it, the Independent Treasury “isolated the Government from . . . the accumulated capital of the country.”¹⁰

The intent of the Independent Treasury was to keep government funds secure. Yet it provided no more a lockbox than the recent one proposed for the Social Security Trust Fund.¹¹ Had sub-treasurers deposited government revenues in banks, they would have been charged as felons and embezzlers. But because they had nowhere to put wagonloads of gold, they often had to beg local merchants or bankers to store coins in a safe or vault. This left government money open to theft or (perhaps worse to a Jacksonian) surreptitious lending by bankers, who would then pocket the proceeds.¹²

The mature Lincoln faced a thornier problem than reduced circulation or foregone interest on specie held in a sub-treasury: he could only spend the specie he had on hand. This hamstringing of the federal government budget mimicked the

million was held in state banks. *Id.* Governments that require gold backing of their paper money are said to be on a gold standard; currency backed only by something like the full faith and credit of a government is called fiat money. *See* BRUCE CHAMP & SCOTT FREEMAN, *MODELING MONETARY ECONOMIES* 15 (2d ed. 2001). The United States only rarely departed from the gold standard until Richard Nixon officially turned to fiat money on August 15, 1971. FRIEDMAN, *supra* note 5, at 15. One such departure occurred during the Civil War, when President Lincoln authorized the issuance of the fiat money known as greenbacks. *See* FRIEDMAN, *supra* note 5, at 105. For definitions of money types, see CHAMP & FREEMAN, *supra*; FRIEDMAN, *supra* note 5, at 3–50. Greenbacks are discussed in more detail later in the article. *See infra* notes 70–76 and accompanying text.

¹⁰ John W. Million, *The Debate on the National Bank Act of 1863*, 2 J. POL. ECON. 251, 295 (1894) (quoting CONG. GLOBE, 37th Cong., 3d Sess. 1115 (1863) (statement of Rep. Spaulding)). Bray Hammond was more colorful: he likened the government and the private sector to “an oxcart dragging behind it a locomotive and a train of cars.” Bray Hammond, *The North’s Empty Purse, 1861–1862*, 67 AM. HIST. REV. 1, 3 (1961) [hereinafter Hammond, *The North’s Empty Purse*]. As he phrased it in his book, “[t]o keep relations between the government and the economy ‘pure’ and wholesome, tons of gold had to be hauled to and fro in dray-loads, with horses and heavers doing by the hour what bookkeepers could do in a moment.” HAMMOND, *SOVEREIGNTY*, *supra* note 6, at 23.

¹¹ Social Security Lock-Box Act of 2009, S. 86, 111th Cong. (2009). This bill is only the most recent in a series allegedly designed to safeguard the Social Security Trust Fund.

¹² HAMMOND, *SOVEREIGNTY*, *supra* note 6, at 21 (noting that Democrats in all six presidential campaigns from 1840 to 1860 declared that separating the money of government from banks was indispensable for the safety of government funds). Hammond also recounted the storage dilemma faced by sub-treasurers. *Id.* at 20–21.

constraints of ordinary people—and state governments—confined to a hard-money world and helped explain why state banks flourished and state banknotes proliferated after the demise of the Second Bank of the United States.¹³

B. Fractional-Reserve Banks: Benefits and Costs

Essentially, antebellum state banks acted as financial intermediaries, taking deposits and making loans on a fractional-reserve basis. Banks lent by printing up banknotes that anyone could return in exchange for specie, so the notes themselves could circulate freely outside the bank if people considered them sound. Consequently, although state banknotes were not official legal tender, confidence in a particular bank could be sufficient to render its notes acceptable as IOUs. The supply of “money” could therefore respond quickly to shifts in demand, and ordinary people—though not the federal government—could smooth out their consumption via borrowing and saving.

This is not the end of the story, of course, because fractional-reserve banking is built on a fiction: it works only as long as ordinary people have faith in it. In one influential scholar’s words, fractional-reserve banking’s “essence is that a very large number of persons agree to trust a very few persons”¹⁴ If you suddenly want to withdraw your deposits and so does everyone else, banks must scramble to find sufficient funds. Some banks may fail, leaving their notes worthless. So fractional-reserve banking has the benefits of flexibility and widespread gains from matching borrowers to lenders, but the potential hazard of wiping out noteholder and depositor wealth.

C. Lincoln’s Desires for Development, Sound Currency, and

¹³ U.S. CONST. art. I, § 10, cl. 1 (prohibiting states from issuing notes directly). States can, however, charter banks that can issue notes. States can then borrow via bonds funneled through the state banks. Banks originally had to obtain charters from state legislatures after establishing their good moral standing. Free banking laws in the 1830s regularized and standardized the procedure; entities simply had to fill out paperwork and deposit some bonds with the state authorities. For descriptions, see BRAY HAMMOND, *BANKS AND POLITICS IN AMERICA FROM THE REVOLUTION TO THE CIVIL WAR* 572–604 (1957); Howard Bodenhorn, *Antebellum Banking in the United States*, EH.NET ENCYCLOPEDIA, Mar. 26, 2008, <http://eh.net/encyclopedia/article/bodenhorn.banking.antebellum>.

¹⁴ WALTER BAGEHOT, *LOMBARD STREET: A DESCRIPTION OF THE MONEY MARKET* 76 (Scribner, Armstrong & Co. 1906) (1873). Walter Bagehot was the leading nineteenth-century authority on central banking.

Functional Credit

Lincoln was well aware of the pros and cons of fractional-reserve banking. Even before his sub-treasury speech, he recognized that a sound currency and a functioning credit system were key elements in financing public infrastructure like roads, canals, and railroads—projects that generated present costs and future benefits. And economic development, so dear to Lincoln's heart, required these internal improvements.¹⁵ His first fully published address in 1837 concerned the preservation of a state-based system of money, credit, and banking—in it, Lincoln laid out his fears for the little man should such a system fail:

You cannot injure . . . the Stockholders But by injuring the credit of the [Illinois State] Bank, you will depreciate the value of its paper in the hands of the honest and unsuspecting farmer and mechanic [S]uppose you could wipe the Bank from existence [W]e should . . . annihilate the currency of the State; [and] render valueless in the hands of our people that reward of their former labors¹⁶

Lincoln's famous leap from the window of Springfield's Second Presbyterian Church was a desperate attempt to defend the banks of his home state.¹⁷

But Lincoln took office in 1861 with a larger goal than ridding himself of the Independent Treasury and safeguarding the credit mechanism associated with existing state banks. He wanted a national financial system with the stability of the Independent Treasury and the flexibility of fractional reserves, and he said so long before he became President. In his 1839 sub-treasury speech, he cleverly argued that, if the Constitution did not expressly authorize a national bank as necessary to exercise the power to tax, by the same reasoning it did not support the

¹⁵ Gabor Boritt succinctly made this point. Gabor Boritt, *Introduction*, in *LINCOLN ON DEMOCRACY* 1, 5 (Mario M. Cuomo & Harold Holzer eds., 1990).

¹⁶ Speech in the Illinois Legislature Concerning the State Bank (Jan. 11, 1837), in 1 *COLLECTED WORKS*, *supra* note 1, at 61, 69.

¹⁷ See WILLIAM HERNDON & JESSE WEIK, *HERNDON'S LIFE OF LINCOLN* 161–62 (1983). Illinois banks had suspended specie payments in the wake of the financial crisis of 1839; the legislature approved this as legal up until the adjournment of its special session. *Id.* at 161. To postpone the vote to adjourn, Lincoln and others tried to leave the building. *Id.* at 161–62. Finding the door locked, they jumped out the window. *Id.* at 162. Despite their bold act, the debt burden associated with railroad and canal building was too large for the banks to handle and they failed two years later. See generally John Wallis, *What Caused the Crisis of 1839?* (Nat'l Bureau of Econ. Research, Historical Paper No. 133, 2001) (offering a detailed account of the travails of the late 1830s and early 1840s).

establishment of an Independent Treasury.¹⁸ Lincoln thought that both were constitutional, but that a national bank would be more practical. He leaned on constitutional language to reinforce his rationale:

Upon the phrase “*necessary and proper*,” in the Constitution, it seems to me more reasonable to say, that *some* fiscal agent is *indispensably necessary*; but, inasmuch as no *particular sort* of agent is thus *indispensable*, because some *other* sort might be adopted, we are left to choose that sort of agent, which may be most “*proper*” on the grounds of expediency.¹⁹

Throughout Lincoln’s career, he made clear that his support for a well-functioning, stable capital market derived fundamentally from his desire to protect the fruits of hard work and to give others the same chances he had enjoyed. His first State of the Union address offers his eloquent reasoning:

Labor is prior to, and independent of, capital. Capital is only the fruit of labor [T]here is, and probably always will be, a relation between labor and capital, producing mutual benefits. . . .

. . . The prudent, penniless beginner in the world, labors for wages awhile, saves a surplus with which to buy tools or land for himself; then labors on his own account another while, and at length hires another new beginner to help him. This is the just, and generous, and prosperous system, which opens the way to all—gives hope to all, and consequent energy, and progress, and improvement of condition to all.²⁰

II. PAYING FOR THE WAR

The exigencies of carrying out a civil war permitted Lincoln to fulfill his desire to establish national banks and a uniform currency. He blessed the federal income tax and he experimented with the use of fiat money, although doing so made him uncomfortable. In short, Abraham Lincoln shaped U.S. monetary and fiscal policy into a distinctly modern form. But he did more than this: by adopting a Hamiltonian rather than a Jacksonian approach to finance, Lincoln inextricably bound the nation’s financial system to the federal government.

Naturally, states’ rights advocates found this appalling. But many Northerners also looked askance at this expansion of federal power. An 1862 editorial in the *New York Times* offered a

¹⁸ Speech on the Sub-Treasury (Dec. 26, 1839), *supra* note 1, at 171.

¹⁹ *Id.* at 172.

²⁰ Annual Message to Congress (Dec. 3, 1861), in 5 COLLECTED WORKS, *supra* note 1, at 35, 52.

particularly expressive lament:

[W]e must bid adieu to the golden era in our history in which we were scarcely conscious that we had a Government, so lightly did its burdens rest upon us, and enter upon that in which the almost sole problem of a statesman will be to make the credit balance the debit side of the national ledger.²¹

A. Initial Conditions

Fort Sumter fell on April 13, 1861.²² Lincoln immediately called for a special congressional session to begin on July 4th.²³ The eighty-day gap gave legislators plenty of time to get to Washington, but it also gave Lincoln a window of opportunity. He issued a flurry of proclamations to requisition troops and blockade southern ports, trusting “that Congress would readily ratify them.”²⁴ Implicit in these requests was a promise to pay, as

²¹ Editorial, *The National Finance: The New Era of Taxation*, N.Y. TIMES, Jan. 8, 1862, <http://www.nytimes.com/1862/01/08/news/the-national-finance-the-new-era-of-taxation.html?scp=1&sq=The%20National%20Finance:%20The%20New%20Era%20of%20Taxation&st=cse>.

²² *Fort Sumpter Evacuated*, N.Y. TIMES, Apr. 13, 1861, reprinted in LINCOLN IN THE TIMES: THE LIFE OF ABRAHAM LINCOLN AS ORIGINALLY REPORTED IN THE NEW YORK TIMES 98, 98 (David H. Donald & Harold Holzer eds., 2005) [hereinafter LINCOLN IN THE TIMES].

²³ Lincoln convened Congress in a proclamation issued April 15th. Proclamation Calling Militia and Convening Congress (Apr. 15, 1861), in 4 COLLECTED WORKS, *supra* note 1, at 331, 332.

²⁴ Message to Congress in Special Session (July 4, 1861), in 4 COLLECTED WORKS, *supra* note 1, at 421, 429; see *First Income Tax*, in LINCOLN IN THE TIMES, *supra* note 22, at 129, 129; *Presidential Prerogatives*, in LINCOLN IN THE TIMES, *supra* note 22, at 117, 117–18. As one legislator put it, Congress converted itself into a giant Ways and Means Committee to support Lincoln’s requests and pass bills retroactively. DAVID HERBERT DONALD, LINCOLN 305 (1996) [hereinafter DONALD, LINCOLN]. Perhaps the most well-known proclamation during this period was the April 27 permission to suspend the writ of habeas corpus. Letter to Winfield Scott (Apr. 27, 1861), in 4 COLLECTED WORKS, *supra* note 1, at 347, 347. Lincoln issued a proclamation on April 15 to ask for 75,000 men from state militias. Proclamation Calling Militia and Convening Congress (Apr. 15, 1861), *supra* note 23, at 332. Proclamations issued April 19 and 27 blockaded southern ports. Proclamation of a Blockade (Apr. 19, 1861), in 4 COLLECTED WORKS, *supra* note 1, at 338, 338–39; Proclamation of a Blockade (Apr. 27, 1861), in 4 COLLECTED WORKS, *supra* note 1, at 346, 346–47. On May 3, Lincoln also asked for 42,034 volunteers for three years, enlistment of 22,714 into the regular Army, and 18,000 seamen. Proclamation Calling for 42,034 Volunteers (May 3, 1861), in 4 COLLECTED WORKS, *supra* note 1, at 353, 353–54. Proclamations carry the same weight of law as executive orders, but they are aimed at those outside rather than inside government. Both delegate the President unilateral powers. Descriptions of Lincoln’s actions appear in STEPHEN B. OATES, WITH MALICE TOWARD NONE: THE LIFE OF ABRAHAM LINCOLN 245–53, 428 (1977); David Currie, *The Civil War Congress*, 73 U. CHI. L. REV. 1131, 1133–35 (2006); and

Lincoln well knew. In his message to the special session, he ruefully remarked, “One of the greatest perplexities of the government, is to avoid receiving troops faster than it can provide for them.”²⁵ As the War dragged on, the promises piled up: Chart 1 shows the mounting federal expenditures.²⁶

B. Lincoln’s Options

1. Taxes and Debt

Then as now, government had three ways to meet current expenses: taxes, debt, and money creation. The first two are closely related. Taxes yield revenue immediately. Issuing debt in the form of bonds or notes generates revenue today by promising to pay the lender back later. Private parties are willing to hold this debt because they know the government has the power to tax later.²⁷ So at first glance government debt is simply deferred taxes.

Debt can be a particularly effective way to raise revenue if the government uses either a carrot or a stick approach to enlarge the market for its obligations. Examples include offering sweeteners to hold the debt—enhanced yields or protection from seizure in the event of the holder’s bankruptcy, for example—or requiring certain business entities to own government debt as a prerequisite for operation. As we shall see, Lincoln used both.

One important potential difference between debt and tax as methods of public finance is the effect on an economy’s accumulation of capital. Taxes take away from private consumption and private savings.²⁸ Depending on how the

Schlesinger, *supra* note 7, at 145–78. Incidentally, Lincoln did secure congressional approval and eventually judicial approval as well in the Prize Cases, where the Supreme Court approved Lincoln’s actions by saying “[t]he President was bound to meet [the Civil War] in the shape it presented itself, without waiting for Congress to baptize it with a name.” Prize Cases, 67 U.S. (2 Black) 635, 669 (1862).

²⁵ Message to Congress in Special Session (July 4, 1861), *supra* note 24, at 432. Secretary of War Simon Cameron said the United States had 16,006 regular Army personnel in April and 600,000 in December. HAMMOND, SOVEREIGNTY, *supra* note 6, at 134.

²⁶ See *infra* app., at chart 1. Note that the numbers are for fiscal years. FY1861, for example, covers the months October 1860 through September 1861.

²⁷ As one scholar noted, “[N]o borrowing scheme can support the public credit. Public credit exists, and therefore borrowing can take place.” Million, *supra* note 10, at 257.

²⁸ See, e.g., Editorial, *The Stimulus Time Machine*, WALL ST. J., Jan. 26, 2009, at A14.

government spends tax revenues—on consumption or on investment—capital accumulation could differ from what takes place in a no-tax world. If the government devotes proceeds to consumption and investment in the same proportion as private citizens would have, capital accumulation arguably remains the same with or without taxes. If the government spends relatively more on consumption than the private sector would have, capital accumulation is lower than it otherwise would have been.²⁹

But things are even more complicated when the government borrows. If the holders of the debt perceive the borrowing simply as deferred taxes, the effect on capital accumulation is the same as if taxes had been the means of revenue-raising.³⁰ Instead, suppose debt holders consider it to be wealth. At the extreme, suppose also that the government spends all proceeds on current consumption whereas private borrowers would have put the money into productive enterprises that yielded future profits.³¹ Then public borrowing “crowds out” private borrowing, and capital accumulation is less than it otherwise would have been. Not only does this imply that government borrowing drives up current interest rates (because of greater demand for borrowed funds), but it also means that less capital is available in the future to pay back lenders than if the private sector had done the borrowing.³²

²⁹ See Robert J. Barro, *Are Government Bonds Net Wealth?*, 82 J. POL. ECON. 1095, 1096 (1974).

³⁰ This concept is known as Ricardian equivalence, after nineteenth-century economist David Ricardo. James M. Buchanan, *Barro on the Ricardian Equivalence Theorem*, 84 J. POL. ECON. 337, 341 (1976).

³¹ The analysis holds as long as the government invests relatively less than the private sector would have.

³² One test for Ricardian equivalence, then, is whether additional government debt is associated with higher interest rates. In diagram 1, in the Appendix, D (private) indicates the demand for funds by private borrowers and D (private & gov't) includes both private and public demand for funds. See *infra* app., at diagram 1. The quantity of government borrowing contemplated in this graph is thus $Q_1^{nw} - Q_0$. If suppliers of funds—that is, savers—consider government bonds to be wealth, the supply curve remains the same regardless of the nature of the borrower. As the graph makes clear, interest rates therefore increase (from i_0 to i_1) when government borrowing goes up. If savers do not consider government borrowing to constitute wealth, however, they will cut back on their own consumption because they realize that government borrowing simply means higher taxes in the future—in effect, they save the present value of anticipated future taxes. Consequently, the supply of funds shifts out by exactly the amount of government borrowing to S (gov't bonds not wealth) and the interest rate remains unchanged. In this analysis, the interest rate is considered to be the real cost of borrowing funds. The analysis becomes more complicated in a world of inflation, as discussed later in the article. See notes 30–38 and accompanying text. For additional discussion, see Barro, *supra* note

2. Money Creation

Money creation is a different animal from taxes or borrowing, at least upon initial inspection. The fractional-reserve state banking present in the early part of Lincoln's presidency "created" money, but not the sort that yielded federal revenue. Paper currency backed by specie can only generate a certain amount of money because regulation or banker prudence requires banks to hold reserves.³³ Suppose, for example, a banker believes that he can meet depositor demands only if he keeps \$4 in vault gold for every \$10 of gold deposited. In June 1861, for example, state banks in the North held \$101 million of specie and \$243 million of deposits.³⁴ Then the maximum amount of money associated with a \$1 gold deposit is \$2.50, or \$1.50 of "created" money.³⁵ In such a regime, no additional money can be created unless the reserve ratio falls or the amount of gold deposited increases. And none of the "created" money in 1861 had anything to do with the federal government.

The principal method by which a government can obtain funds via money "creation" is if it resorts to fiat money. In other words, it must cut loose from specie backing.³⁶ How can this increase

29, at 1096.

³³ Free banking statutes passed in various states had some capitalization requirements. The Forstall system in Louisiana required commercial banks to hold specie reserves equal to one-third of deposits. Private networks such as the Suffolk system and the New York Clearinghouse also imposed requirements on their members. For background, see Bray Hammond, *Long and Short Term Credit in Early American Banking*, 49 Q. J. ECON. 79 (1934); Gary Gorton, *Clearinghouses and the Origin of Central Banking in the United States*, 45 J. ECON. HIST. 277 (1985); Hugh Rockoff, *The Free Banking Era: A Reexamination*, 6 J. MONEY, CREDIT, & BANKING 141 (1974); Arthur J. Rolnick & Warren E. Weber, *New Evidence on the Free Banking Era*, 73 AM. ECON. REV. 1080 (1983).

³⁴ 3 HISTORICAL STATISTICS OF THE U.S., *supra* note 3, at 3-602 tbl.Cj26-41. The total money supply of \$558 million included specie held by the public outside banks. *Id.*

³⁵ The money multiplier, m , equals the inverse of the reserve requirement (R : $m = 1/R$). This formula stems from the fact that the sum of the amounts loaned out can be expressed mathematically as a geometric series with a common ratio of $1-R$. Here is a simple example: suppose you deposit \$100 into the bank. The bank puts \$40 in reserve and lends out \$60. The borrower pays off debt and creditors potentially re-deposit the entire \$60 into the banking system. The bank then places 40% of the \$60 (\$24) in reserve and lends out the remaining \$36. Again, a maximum of \$36 could return to the banking system, against which the bank would reserve \$14.40 and lend out \$21.60. Taking this progression to the limit, a maximum of \$150 is created from the original \$100, leading to a total amount of money equaling \$250.

³⁶ Taking over paper money operations from the states puts some power into federal hands to create money, but it does not yield ongoing revenue.

government income? In the simplest form, the government merely prints pieces of paper and requires its suppliers and creditors to take them in lieu of any other form of payment.³⁷ In a sense, the government raises revenue out of thin air. The end effect of more pieces of paper, of course, is higher prices for goods. So continued money creation can produce a sort of tax in that it generates inflation.³⁸

The story becomes a little more complicated with the addition of financial intermediaries, although the thin-air aspect of revenue-raising with fiat money remains. Departure from a specie standard arguably releases banks from an obligation to hold vault gold and silver. Yet earning the trust of depositors requires banks to keep something in reserve. One possibility is fiat money if people consider it sufficiently sound; one way to make fiat money more attractive is to bestow legal-tender status on it—and convince people that this status means something.

Civil War money creation had a particularly complex relationship with other forms of revenue-raising because most people considered the departure from specie backing to be temporary.³⁹ Alien as it may seem to us today, adherence to the

³⁷ These pieces of paper can take the form of familiar zero-coupon currency or interest-bearing notes. During the Civil War, the United States used both. G. Thomas Woodward, *Interest-Bearing Currency: Evidence from the Civil War Experience*, 27 J. MONEY, CREDIT & BANKING 927, 927–98 (1995) (discussing the interest-bearing notes).

³⁸ Who bears this “tax” depends on how much people anticipate it. Unanticipated inflation falls on creditors, because they agree to lend a given amount of money today in exchange for the return of that money later. If the money itself is devalued because of inflation, the creditor receives less in the way of purchasing power than he initially advanced. Jeffrey G. Williamson said that greenbacks hurt savers because they did not anticipate inflation. Jeffrey G. Williamson, *Watersheds and Turning Points: Conjectures on the Long-Term Impact of Civil War Financing*, 34 J. ECON. HIST. 636, 649 (1974). By fooling savers, long-term debt financing was relatively cheap. Wesley C. Mitchell, *Greenbacks and the Cost of the Civil War*, 5 J. POL. ECON. 117, 151–52 (1897) (claiming that a cost of inflation was the reduction in numbers of qualified employees of the federal government as well as lower purchasing power for soldiers and sailors paid with paper).

³⁹ See George T. McCandless Jr., *Money, Expectations, and the U.S. Civil War*, 86 AM. ECON. REV. 661, 663 (1996) (saying that people believed greenbacks would be redeemed at par in gold); Larry Schweikart, *U.S. Commercial Banking: A Historiographical Survey*, 65 BUS. HIST. REV. 606, 627 (1991), (suggesting that greenbacks did not “inflate wildly because they remained tied to a promise to redeem in gold at a future date”); see also IRWIN UNGER, *THE GREENBACK ERA: A SOCIAL AND POLITICAL HISTORY OF AMERICAN FINANCE, 1865–1879*, at 16 (1964); Kristen L. Willard et al., *Turning Points in the Civil War: Views from the Greenback Market*, 86 AM. ECON. REV. 1001 (1996) (undertaking an extensive analysis of the greenback-gold exchange rate during the War).

gold standard was a type of “good housekeeping seal of approval”⁴⁰ among the world’s market economies. Consequently, Lincoln’s greenbacks explicitly counted as part of the federal debt and, like other government borrowing, constituted an implicit form of future taxation.

C. Lincoln’s Choices

1. Taxes: Too Little, Too Late

Taxes offered only a meager source of revenue to Lincoln, especially at the outset of hostilities.⁴¹ Although the first Morrill Tariff kicked in just as Lincoln took office and the second Morrill Tariff (included in the Revenue Act of 1861) passed on August 5, these measures simply did not raise much money.⁴² The August Act also provided for property and income taxation, although proceeds from these taxes did not roll into federal coffers until various amendments occurred and a tax collection mechanism was implemented.⁴³ Income taxes raised only \$20 million in 1864 and \$60 million in 1865.⁴⁴ Despite the yawning gap between tax receipts and federal expenditures—which were nearly \$1.3 billion in 1865⁴⁵—even these relatively low taxes troubled people at the time. The *London Times* scoffed at the Union’s efforts, saying “[i]f this mosquito cloud of taxation ever should get settled upon

⁴⁰ Michael D. Bordo & Hugh Rockoff, *The Gold Standard as a “Good Housekeeping Seal of Approval”*, 56 J. ECON. HIST. 389, 389 (1996).

⁴¹ Tariffs produced three-quarters or more of federal revenue in antebellum years. Lance E. Davis & John Legler, *The Government in the American Economy, 1815–1902: A Quantitative Study*, 26 J. ECON. HIST. 514, 516 (1966). Total revenue collected by the federal government in 1860 equaled \$56.065 million, of which \$53.188 million came from customs. U.S. CENSUS BUREAU, U.S. DEPT OF COMMERCE, HISTORICAL STATISTICS OF THE UNITED STATES: COLONIAL TIMES TO 1970, at 1106 tbl.Y352–357 (Bicentennial ed. 1975), <http://www2.census.gov/prod2/statcomp/documents/CT1970p2-12.pdf>. Total expenditures equaled \$63.131 million. *Id.* at 1114 tbl.Y457–465.

⁴² Act of Aug. 5, 1861, ch. 45, 12 Stat. 292; HAMMOND, SOVEREIGNTY, *supra* note 6, at 31–32. Vermont Representative Justin Morrill sponsored the first bill during Buchanan’s term; Buchanan signed it into law two days before Lincoln’s inauguration and tariff rates rose one month later. See Reinhard H. Luthin, *Abraham Lincoln & the Tariff*, 49 AM. HIST. REV. 609, 625–26 (1944). Morrill worked with Treasury Secretary Salmon Chase to craft a second bill raising rates even more. See *id.* at 628.

⁴³ Especially important was the Revenue Act of 1862. Act of July 1, 1862, ch. 119, 12 Stat 432.

⁴⁴ Tax History Museum, 1861–1865: The Civil War, <http://www.tax.org/museum/1861-1865.htm> (last visited Mar. 26, 2010).

⁴⁵ U.S. CENSUS BUREAU, *supra* note 41, at 1104 tbl.Y335–338.

the states of the North it will be more effective than any fugitive slave law in preventing any one, black or white, from crossing the border states.”⁴⁶

Lincoln probably would have liked to use progressive income and property taxes more than he did. As an Illinois state legislator, he had pushed—unsuccessfully—for a graduated property tax on the basis of both equity and political feasibility, observing that the “*wealthy few* are not sufficiently numerous to carry the elections.”⁴⁷ But the lack of institutional structure, the controversy surrounding direct taxation and apportionment, and the recalcitrance of Treasury Secretary Salmon Chase meant that federal income and property taxes were difficult to impose and collect.⁴⁸ Despite the relative unimportance of tax revenue to the war financing effort, Abraham Lincoln left at least two lasting contributions to federal taxing powers: he paved the way for the Sixteenth Amendment and he created the Office of the Commissioner of Internal Revenue.⁴⁹

2. Debt: A Strain on the Financial System

Borrowing was Lincoln’s primary means of finance, as chart 2 makes clear.⁵⁰ Per capita federal debt went from \$0.98 in 1857 to

⁴⁶ A. Curtis Wilgus, *Some London Times’ Comments on Secretary Chase’s Financial Administration, 1861–1864*, 26 MISS. VALLEY HIST. REV. 395, 397 (1939). The *Times* later reversed itself, saying that Mr. Chase “made exactly the opposite mistake to that made by our Chancellor of the Exchequer in the Crimean war. Mr. Gladstone thought he could do without loans; Mr. Chase thought he could do without taxes.” *Id.* (internal quotation marks omitted).

⁴⁷ Letter to William S. Wait (Mar. 2, 1839), in 1 COLLECTED WORKS, *supra* note 1, at 147, 148 (internal quotation marks omitted).

⁴⁸ The U.S. Constitution requires all direct taxes to be apportioned among the states according to their population. U.S. CONST. art. 1, § 2, cl. 3. People differed as to whether income taxes constituted direct or indirect taxes. The Sixteenth Amendment settled the matter by carving out income taxes from all other forms of taxation. U.S. CONST. amend. XVI. For reading on Chase’s attitude, see HAMMOND, SOVEREIGNTY, *supra* note 6, at 40–42.

⁴⁹ The Sixteenth Amendment states: “The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.” U.S. CONST. amend. XVI; see Act of July 1, 1862, ch. 119, 12 Stat. 432 (codified as amended at 26 U.S.C. § 7802 (2006)) (creating the Commissioner’s office). Lincoln also issued a series of executive orders creating collection districts and appointed assessors and collectors. Cynthia G. Fox, *Income Tax Records of the Civil War Years*, 18 PROLOGUE MAG. (1986), <http://www.archives.gov/publications/prologue/1986/winter/civil-war-tax-records.html>.

⁵⁰ See *infra* app., at chart 2.

\$2.06 in 1860 to \$76.12 in 1865.⁵¹ But raising revenue via debt issuance was a tricky matter for Lincoln. Recall that, in 1861, the federal government had to conduct all transactions in specie. What is more, it traditionally sold bonds through commercial banks. To purchase bonds, banks therefore had to give up some of their specie reserves.

The staggering amount of borrowing needed to finance the War strained the system. Although commercial banks enjoyed a recent inflow of specie from abroad—European crop failures meant increased food exports from the United States⁵²—they held only \$101 million in specie as of June 1861.⁵³ When Salmon Chase took over the Treasury in March 1861, his predecessors had tried floating a total of \$18 million worth of federal bonds within the previous five months.⁵⁴ Before Congress convened in July, Chase attempted to sell close to \$40 million more in Treasury bonds and notes.⁵⁵ The special session authorized him to borrow another \$250 million, with the Act of July 17 immediately permitting Chase to issue \$50 million in Treasury notes payable on demand.⁵⁶ Several additional tranches were scheduled for issue later in the fall.⁵⁷

Commercial-bank specie reserves would not have been a constraint if at least some of the following had happened: the Treasury quickly paid out specie to commercial banks to retire its own demand notes; the Independent Treasury quickly spent the specie paid by banks for the bonds and people re-deposited specie in banks; or banks quickly re-sold Treasury obligations to the public for specie. Lincoln provided yet another way to grease the skids: he signed a bill in August permitting the Treasury Secretary to deposit borrowed funds into solvent specie-paying banks rather than the sub-treasuries.⁵⁸

⁵¹ See *infra* app., at chart 2; 5 HISTORICAL STATISTICS OF THE U.S., *supra* note 3, at 5-97 tbl.Ea650-661. The denominator equals the entire resident population of the United States, including those living in states that seceded.

⁵² HAMMOND, SOVEREIGNTY, *supra* note 6, at 38.

⁵³ 3 HISTORICAL STATISTICS OF THE U.S., *supra* note 3, at 3-602 tbl.Cj26-41.

⁵⁴ Howell Cobb asked for \$10 million in October 1860 and succeeded raising only \$7 million; John Dix asked for \$8 million in February 1861 and obtained \$7 million in proceeds. HAMMOND, SOVEREIGNTY, *supra* note 6, at 43. Dix even suggested trying to retrieve the federal surplus distributed to the states in 1837. *Id.* at 32.

⁵⁵ *Id.* at 43-44.

⁵⁶ Act of July 17, 1861, ch. 5, 12 Stat. 259; 1 JERRY MARKHAM, A FINANCIAL HISTORY OF THE UNITED STATES 209 (2002).

⁵⁷ HAMMOND, SOVEREIGNTY, *supra* note 6, at 86.

⁵⁸ Act of Aug. 5, 1861, ch. 46, § 6, 12 Stat. 313, 313-14.

It wasn't enough. The Treasury only had \$2 million in specie in June 1861 and could not possibly redeem its own notes in short order.⁵⁹ Chase refused to deposit specie into banks, instead choosing to accumulate gold in the sub-treasuries.⁶⁰ When banks had trouble selling bonds, Jay Cooke stepped in with a plan to market bonds directly to the public.⁶¹ His efforts eventually succeeded, and Lincoln, in his first State of the Union address, thanked "citizens of the industrial classes" for their "patriotism" and "zeal for their country's deliverance from present peril," in sharing their limited resources.⁶² Yet even this was not sufficient to prevent bank reserves from plummeting.⁶³ On September 30, the *New York Herald* reported that specie in local banks dropped from \$48 million to \$37 million over the span of six weeks, whereas additional gold in the local sub-treasury over the same period bulged out by an equivalent \$13 million.⁶⁴ From December 7 to December 28, New York bank gold reserves shrunk by another one-third.⁶⁵

By the end of 1861, things looked bleak for the North. Although Union troops had enjoyed a few limited successes, they had lost significant battles at Wilson's Creek and Ball's Bluff, not to mention Bull Run.⁶⁶ Abraham Lincoln faced political fallout from the Trent affair.⁶⁷ And northern banks were dangerously

⁵⁹ 3 HISTORICAL STATISTICS OF THE U.S., *supra* note 3, at 3-602 tbl.Cj26-41.

⁶⁰ HAMMOND, SOVEREIGNTY, *supra* note 6, at 112-13; Mitchell, *supra* note 38, at 122; see Elbridge Spaulding, *Specie Payments*, N.Y. TIMES, Apr. 27, 1870.

⁶¹ 1 MARKHAM, *supra* note 56, at 211-13 (discussing Cooke's activities); see HEATHER RICHARDSON, THE GREATEST NATION OF THE EARTH: REPUBLICAN ECONOMIC POLICIES DURING THE CIVIL WAR 39-40 (1997).

⁶² Annual Message to Congress (Dec. 3, 1861), *supra* note 20, at 39.

⁶³ See 3 HISTORICAL STATISTICS OF THE U.S., *supra* note 3, at 3-602 tbl.Cj26-41. In part this may have been due to people pulling specie out of banks and using it to buy government obligations, rather than using specie they had on hand outside banks. Specie hoarding by individuals became an even more acute problem later in the War. See *id.* The percentage of specie held by the public went from about 60% in the period June 1861 to December 1862, to 80% or more throughout the remainder of the War. *Id.*

⁶⁴ HAMMOND, SOVEREIGNTY, *supra* note 6, at 116.

⁶⁵ *Id.* at 154; Mitchell, *supra* note 38, at 124.

⁶⁶ Battles took place on the following dates: Bull Run—July 21; Wilson's Creek—August 10; Ball's Bluff—October 21. 1 ALLAN NEVINS, THE WAR FOR THE UNION: THE IMPROVISED WAR, 1861-1862, at 214-23, 298-99, 414 (1959) (providing battle descriptions); American Civil War Timeline 1861, <http://americancivilwar.com/tl/tl1861.html> (last visited Mar. 26, 2010) (providing a list of battles).

⁶⁷ On November 8, U.S. Captain Charles Wilkes boarded HMS Trent and seized two Confederate officials; John Slidell and James Mason. The British bristled at what they considered a violation of sovereignty. The situation was eventually defused when the United States let the captives go and disavowed

close to insolvency. On December 28, New York banks suspended specie redemption; other banks soon followed.⁶⁸

Suspensions had occurred before, most notably in 1837, 1839, and 1857.⁶⁹ But this time the President had a war to worry about. Financial chaos was the last thing he needed. Not only that; the halt in specie outflow from banks meant no market for federal bonds.

3. Solution: Greenbacks Plus a New Regime for Money and Banking

Lincoln sprang into action. Often working behind the scenes, he used Secretary Chase and various members of Congress⁷⁰ to conduct a radical overhaul of the nation's financial system. The federal government issued some \$450 million in fiat money (known as greenbacks for the distinctive green ink on the reverse side), designated greenbacks and Treasury notes as legal tender,⁷¹

the Captain's acts. 1 NEVINS, *supra* note 66, at 384, 388, 393.

⁶⁸ This included banks located in Philadelphia, Boston, Albany, and Cleveland. See *Suspension of Specie Payments*, N.Y. TIMES, Dec. 30, 1861, <http://www.nytimes.com/1861/12/30/news/suspension-of-specie-payments-by-the-banks.html?scp=1&sq=Suspension%20of%20Specie%20Payments&st=cse>. No banks existed in the area west of Kansas and Nebraska, so suspension was not an important matter in the Pacific states. Wesley C. Mitchell, *The Circulating Medium During the Civil War*, 10 J. POL. ECON. 537, 538 (1902). California—repository of much of the nation's gold—not surprisingly used gold as the circulating medium even after greenbacks came into general use elsewhere. *Id.* The number of people in the West was fairly insignificant, however. The free population there constituted only 1.6% of the total. See Geospatial and Statistical Data Center, University of Virginia Library, Historical Census Browser, <http://fisher.lib.virginia.edu/collections/stats/histcensus/php/state.php> (last visited Mar. 26, 2010) (showing population figures).

⁶⁹ For discussion of the Panics of 1837 and 1839, see Jenny B. Wahl, *He Broke the Bank, But Did Andrew Jackson Also Father the Fed?*, in CONGRESS AND THE EMERGENCE OF SECTIONALISM 188–203 (Paul Finkelman & Donald R. Kennon eds., 2008). Information about the Panic of 1857 is contained in Jenny Wahl, *Dred, Panic, War: How a Slave Case Triggered Financial Crisis and Civil Disunion* 42–43 (Carleton Coll. Dep't of Econ., Working Paper No. 2009-01, 2009), <http://apps.carleton.edu/curricular/econ/assets/200901.pdf> (arguing that the Panic of 1857 helped lead to the Civil War).

⁷⁰ Supportive House members included Justin Morrill (Vermont), Chair of the House Ways and Means Committee in 1863; Samuel Hooper (Massachusetts), a Boston financier; and Elbridge Spaulding (New York). RICHARDSON, *supra* note 61, at 9. The Senate Finance Committee Chair was first William Pitt Fessenden (Maine), then John Sherman (Ohio), who replaced Fessenden in 1864 when he left for the Treasury to take over for Salmon Chase, who became Chief Justice of the U.S. Supreme Court. See *id.* at 9–10.

⁷¹ Act of Feb. 25, 1862, ch. 33, §§ 3, 5, 12 Stat. 345, 346. Gold was still required to pay customs duties and interest on government bonds. § 1, 12 Stat.

created a national banking system that required capitalization with Treasury bonds,⁷² and taxed state banknotes out of existence,⁷³ leaving the field completely to federal currency.⁷⁴ Table 1 shows the dominance of national banks by War's end.⁷⁵

The United States thus emerged from the War with a far different financial system than it had when conflict began. The nation boasted a uniform currency. It had conducted its first major experiment with fiat money. Perhaps most important, by binding the banks to federal borrowing via mandatory capitalization with Treasury obligations, it bound the bankers to the fortunes of the Union.⁷⁶ But it also tied the federal

at 345. This Act also authorized the issuance of greenbacks, and it clarified that the notes of July 17, 1861 and February 12, 1862, qualified as legal tender. *Id.*; see Act of Feb. 12, 1862, ch. 20, 12 Stat. 338. Additional greenbacks were authorized on January 14, 1863, and March 3, 1863. See, e.g., Act of Mar. 3, 1863, ch. 73, 12 Stat. 709. Demand notes and the later-issued U.S. notes look very much the same except for the removal of the words "on demand" and the addition of the Treasury seal. The Treasury even made ungummed stamps printed on both sides to circulate as replacements for small-denomination coins. Mitchell, *supra* note 68, at 556. For good general information on Civil War currency, see generally HAMMOND, SOVEREIGNTY, *supra* note 6, at 239 and Mitchell, *supra* note 68, at 556. Legal tender status enabled banks to use paper as reserves, as Kenneth W. Dam pointed out. Kenneth W. Dam, *The Legal Tender Cases*, 1981 SUP. CT. REV. 367, 406 (1982).

⁷² The National Bank Act was passed exactly one year after First Legal Tender Act. Act of Feb. 25, 1863, ch. 58, 12 Stat. 665. This law also established the office of the Comptroller of the Currency. 12 Stat. at 665. A second National Bank Act was passed in 1864 to correct some technical problems. Act of June 3, 1864, ch. 106, 13 Stat. 99. National banks could issue national banknotes backed by a deposit of U.S. Treasury securities. The amount of notes depended upon "the bank's capital . . . and the amount of bonds it deposited with the Comptroller," which was its chartering agent. Richard S. Grossman, *U.S. Banking History: Civil War to World War II*, EH.NET ENCYCLOPEDIA, <http://eh.net/encyclopedia/article/grossman.banking.history.us.civil.war.wwii> (last visited Mar. 26, 2010). One attractive feature of the Treasury bonds was that they paid interest in specie. See *id.*

⁷³ The Act of March 3, 1865 imposed a tax of 10% on state notes to take effect July 1, 1866. Act of March 3, 1865, ch. 78, § 6, 13 Stat. 469, 484; see *Veazie Bank v. Fenno*, 75 U.S. (8 Wall.) 533, 539 (1869). The U.S. Supreme Court upheld the Act as complying with the U.S. Constitution in *Veazie Bank*. *Id.* at 548–49.

⁷⁴ As we have seen, the federal government first made Treasury notes and greenbacks legal tender, later setting up national banks and engraving U.S. notes. See Act of June 3, 1864, ch. 106, 13 Stat. 9; Act of Feb. 25, 1863, ch. 58, 12 Stat. 665; Act of Feb. 25, 1862, ch. 33, 12 Stat. 345; HAMMOND, SOVEREIGNTY, *supra* note 6 at 239; Grossman, *supra* note 72.

⁷⁵ See *infra* app., at tbl.1.

⁷⁶ Richard Bensel, *The Intended and Unintended Consequences of the Financial Crisis*, History News Network (2009), <http://hnn.us/articles/63797.html> (arguing that the U.S. financial system became a creature of national government policy, dependent upon the fiscal probity of the U.S.

government to the fortunes of the financial sector, which, as we know today, can have significant economy-wide effects.

D. How Influential Was Lincoln in Financial Matters?

Certainly Lincoln did not accomplish the financial transformation alone. Some scholars have argued that Lincoln took a hands-off attitude toward many matters and left financial issues to Treasury Secretary Chase. Others have pointed to the importance of congressional action.

Yet the historical record suggests that Lincoln's role loomed large and his influence was crucial. One Lincoln expert asserted that the man talked more about economics than anything else, including slavery.⁷⁷ Another quoted Lincoln as saying presciently that “[f]inance will rule th[is] country for the next fifty years.”⁷⁸ What is more, despite self-deprecation about his financial acumen, Lincoln had a firm grasp of monetary and fiscal issues.⁷⁹ And he was unwilling to cede policy decisions to private bankers when a delegation of them came to Washington to push their own agenda after specie suspension.⁸⁰

1. Lincoln Leads Chase

Some commentators focus attention on Secretary Chase rather

Treasury); Dam, *supra* note 71, at 410 (making the point that the legal tender alternative helped keep the banking system alive and solvent, which was an important measure in tying banks to the government).

⁷⁷ Gabor S. Boritt, *Lincoln and the Economics of the American Dream*, in THE HISTORIAN'S LINCOLN: PSEUDOHISTORY, PSYCHOHISTORY, AND HISTORY 87, 87–88 (Gabor S. Boritt ed., 1988). He noted that Lincoln “whiggishly” stayed in the background as President, allowing Congress to shape legislation, but that he clearly had a crucial part in pushing the national banking scheme. *Id.* at 95.

⁷⁸ ALLEN C. GUELZO, ABRAHAM LINCOLN: REDEEMER PRESIDENT 382 (1999) (internal quotation marks omitted). According to Guelzo, Lincoln made this statement to Rep. William Pitt Kellogg (R-IL). *Id.*

⁷⁹ See Dun & Bradstreet, D&B Million Dollar Database, The History of D&B, <http://www.dnbmdd.com/mddi/history.aspx> (last visited Mar. 26, 2010). Dun and Bradstreet notes with pride that Lincoln was one of four Presidents who worked for the company as a business correspondent. *Id.* This experience, along with his legal practice, furnished Lincoln with practical information about the economy. *Id.*

⁸⁰ James Gallatin (son of Albert) headed a group of bankers who suggested that the Treasury deposit its gold in private banks and allow bankers to pay government suppliers with checks, keeping the gold on deposit for the bankers' use. Gallatin also wanted the government to sell banks high-interest bonds for resale to Europe and to tax industry heavily; Lincoln refused. HAMMOND, SOVEREIGNTY, *supra* note 6, at 168–70.

than President Lincoln when it comes to Union finances. Respected Lincoln scholar David Herbert Donald declared, for example, that Lincoln had “little interest in floating bond issues, creating an internal revenue system, inaugurating the first income tax, or establishing a national banking system,” and brushed Chase aside when he tried to bring these matters to Lincoln’s attention.⁸¹ Yet Donald also claimed that Lincoln squelched his Cabinet, treated it as an unnecessary nuisance, and allowed it to “consider only insignificant matters.”⁸² And Chase was no expert on monetary and fiscal affairs. As Bray Hammond acerbically put it, “Chase was a man of impressive appearance and of great capabilities other than financial.”⁸³

A different interpretation of what Lincoln may have done is this: Salmon Chase was a stubborn man convinced of his own superiority, so Lincoln may well have given Chase the illusion that he was in charge while subtly maneuvering him in the direction Lincoln desired.⁸⁴ Professor Donald himself noted that the 37th Congress enacted the National Bank Act with “Chase’s strong urging and with Lincoln’s quiet pressure.”⁸⁵

Perhaps the best evidence of Lincoln’s sway over his Treasury Secretary is Chase’s reversal on the legality of paper money. When Chase dithered about constitutionality, Lincoln reassured him: “I have that sacred instrument [the U.S. Constitution] here at the White House, and I am guarding it with great care.”⁸⁶

⁸¹ DONALD, LINCOLN, *supra* note 24, at 331; DAVID DONALD, LINCOLN RECONSIDERED: ESSAYS ON THE CIVIL WAR ERA 194 (Vintage Books 1961) (1947) [hereinafter DONALD, RECONSIDERED].

⁸² DONALD, RECONSIDERED, *supra* note 81, at 201.

⁸³ Hammond, *The North’s Empty Purse*, *supra* note 10, at 9.

⁸⁴ John Niven, *Lincoln and Chase, a Reappraisal*, 12 J. ABRAHAM LINCOLN ASS’N 1, 11 (1991). Niven acknowledged that Lincoln gave Chase the freedom to develop and execute financial policies, but also stated that Lincoln was “as well-informed as any public man of his day on finance and fiscal policy.” *Id.*; see also GUELZO, *supra* note 78, at 382 (contending that “Lincoln managed Chase more carefully than any cabinet member besides Seward”).

⁸⁵ DONALD, LINCOLN, *supra* note 24, at 424.

⁸⁶ 1 CARL SANDBURG, ABRAHAM LINCOLN: THE WAR YEARS 652 (1939) (internal quotation marks omitted). The Constitution gives the federal government the power to coin money and says that states cannot coin money or issue bills of credit. But it makes no mention of banks or paper currency. U.S. CONST. art. I, § 8, cl. 5; § 10. The Tenth Amendment says: “The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.” U.S. CONST. amend. X. Andrew Jackson and others viewed this as requiring the Constitution to state all federal powers explicitly. See ROBERT REMINI, ANDREW JACKSON AND THE BANK WAR: A STUDY IN THE GROWTH OF PRESIDENTIAL POWER 30 (1967). This interpretation gave Jackson permission to deny a re-charter of the Second Bank

Chase then enthusiastically embraced the issuance of greenbacks. When Chase ascended to the Supreme Court, however, he flip-flopped. Writing for four of eight justices, Chase decided in *Hepburn v. Griswold*⁸⁷ that Congress lacked the power to make paper money legal tender.⁸⁸ What happened under Lincoln clearly carried the President's imprimatur. Once Chase left the executive branch, he showed his true colors.

2. Lincoln Guides Congress

Professor Donald argued that Congress, like Secretary Chase, was far more active than the President: Lincoln proposed few specific bills and vetoed only two measures outright.⁸⁹ According to Donald, Lincoln clung to the idea that the President should not try to usurp legislative power or make recommendations to Congress.⁹⁰ In contrast, James McPherson contended that Lincoln was “one of the principal architects of th[e] capitalist revolution.”⁹¹

Lincoln undoubtedly had strong support in Congress. Just after specie suspension, Lincoln's war order for an early general offensive made raising revenue imperative.⁹² The next day,

of the United States. *Id.* at 81. Alexander Hamilton was a leading proponent of an alternative interpretation of the Tenth Amendment—that the Constitution implicitly gives some powers to the federal government even if it does not contain explicit language. RON CHERNOW, *ALEXANDER HAMILTON* 353–54 (2004) (providing a comprehensive biography of Hamilton and descriptions of his beliefs).

⁸⁷ 75 U.S. (8 Wall.) 603, 625 (1869), *overruled in part by* Legal Tender Cases, 79 U.S. (12 Wall.) 457 (1870). A fifth judge concurred in a separate opinion. *Id.* at 626 (Miller, J., concurring). Robert Spector suggests that Chase took his reasoning from a manuscript written by Roger Taney. See Robert Spector, *Lincoln and Taney: A Study in Constitutional Polarization*, 15 AM. J. LEGAL HIST. 199, 208 (1971).

⁸⁸ 75 U.S. (8 Wall.) at 625. Another example of Lincoln's control of his Cabinet over financial matters is the episode regarding private purchases using government funds. Secretary of War Simon Cameron was censured for having entrusted a private citizen with large sums of money to buy military supplies. But, in a special message to Congress, Lincoln took full responsibility for Cameron's actions. Lincoln stated that the government was infested with disloyal officers, and, although he knew his decision did not have the authority of law, he simply wanted to save the government from overthrow. Special Message to the Senate and the House of Representatives (May 26, 1862), in 5 COLLECTED WORKS, *supra* note 1, at 240, 240–43.

⁸⁹ DONALD, RECONSIDERED, *supra* note 81, at 192.

⁹⁰ *Id.* at 193, 199.

⁹¹ JAMES M. MCPHERSON, *ABRAHAM LINCOLN AND THE SECOND AMERICAN REVOLUTION* 40 (1991).

⁹² President's General War Order No. 1 (Jan. 27, 1862), in 5 COLLECTED

Representative Elbridge Spaulding opened the debate on the legal tender bill and urged prompt action as the Treasury only had funds for a few days.⁹³ Representative Samuel Hooper shook his head at those who viewed coin as the country's currency; anyone could see that state banknotes constituted the nation's money, he expostulated.⁹⁴ Just over a year later—two weeks before the national banking bill passed—Senator John Sherman's speech demonstrated his alignment with the President:

The policy of this country ought to be to make everything national as far as possible; to nationalize our country, so that we shall love our country. If we are dependent upon the United States for a currency and a medium of exchange, we shall have a broader and more generous nationality. The want of such nationality, I believe, is one of the great evils of the times. . . . [I]t has been that principle of State rights, that bad sentiment that has elevated State authority above the great national authority, that has been the main instrument by which our Government is sought to be overthrown.⁹⁵

Ever the consummate politician, Lincoln shared the limelight by complimenting Congress for making U.S. notes a “universal currency” and satisfying “the long felt want of an uniform [sic] circulating medium, saving thereby to the people, immense sums in discounts and exchanges.”⁹⁶

But Lincoln did much more than pat Congress on the back. He set the agenda, recommending both the national banking system and the tax on state banknotes.⁹⁷ One scholar suggested that Lincoln actually “strong-armed” Congress.⁹⁸ Another contended that Lincoln looked to Congress less than any other President before or since.⁹⁹

WORKS, *supra* note 1, at 111, 111–12.

⁹³ CONG. GLOBE, 37th Cong., 2d Sess. 522, 523 (1862) (statement of Rep. Spaulding).

⁹⁴ HAMMOND, SOVEREIGNTY, *supra* note 6, at 188.

⁹⁵ CONG. GLOBE, 37th Cong., 3d Sess. 843 (1863) (statement of Rep. Sherman).

⁹⁶ Annual Message to Congress (Dec. 1, 1862), *in* 5 COLLECTED WORKS, *supra* note 1, at 518, 522.

⁹⁷ Currie, *supra* note 24, at 1163 (noting Lincoln's crucial role.); Saul Levmore, *Voting Paradoxes and Interest Groups*, 28 J. LEG. STUD. 259, 260, 262 (1999) (discussing the importance of agenda-setting); Terry M. Moe & William G. Howell, *The Presidential Power of Unilateral Action*, 15 J.L. ECON. & ORG. 132, 145 (1999) (suggesting that one of the major foundations of presidential power is the ability to offer policy proposals as focal points for congressional action).

⁹⁸ GUELZO, *supra* note 78, at 383.

⁹⁹ Lawrence H. Chamberlain, *The President as Legislator*, 283 ANNALS OF THE AM. ACAD. POL. & SOC. SCI. 94, 96 (1952). Chamberlain also said Lincoln was

Lincoln's words provide supportive evidence of his leadership role. He specifically requested the establishment of national banks capitalized by federal bonds in his Second Annual Message to Congress:

Is there . . . any . . . mode in which . . . the great advantages of a safe and uniform currency [are] secured?

I know of none which promises so certain results, and is, at the same time, so unobjectionable, as the organization of banking associations, under a general act of Congress To such associations the Government might furnish circulating notes, on the security of United States bonds deposited in the treasury.¹⁰⁰

Lincoln pointedly followed up on this appeal in a special message six weeks later, saying that in order to "raise money by way of loans most easily and cheaply" he wanted a "uniform currency" to be "furnished by banking associations . . . as suggested in [his] message."¹⁰¹

Lincoln showed his acute understanding of how this method would reassure him of a market for federal obligations: "The public credit . . . would be greatly improved, and the negotiation of new loans greatly facilitated by the steady market demand for government bonds . . ." ¹⁰² Two years later, he cannily proposed that public debt could escape taxation and stand ahead of private debt so as to guarantee an even larger market: "I suggest . . . provid[ing] that a limited amount of some future issue of public securities might be held by any bona fide purchaser exempt from taxation, and from seizure for debt . . ." ¹⁰³ Requiring bank capitalization with federal bonds was a figurative stick; offering special treatment for federal obligations was a proposed carrot.

Professor Donald minimized Lincoln's role in shaping legislation by pointing to his limited use of veto power.¹⁰⁴ This

acutely aware of the importance of public opinion. *Id.* at 101.

¹⁰⁰ Annual Message to Congress (Dec. 1, 1862), *supra* note 96, at 522–23. This idea did not make bankers happy. Nearly a year before this message, the New York Superintendent of Banks expressed his displeasure in his annual report (December 26, 1861), saying that federal bonds had a lower market price than eastern state bonds with the same par value. HAMMOND, SOVEREIGNTY, *supra* note 6, at 147. As a consequence, banks would take a bath if they had to sell state bonds to buy federal ones, especially if they had to dispose of state bonds at fire-sale prices. *Id.* at 147–48. He argued as well that national banks were unconstitutional. *See id.* at 167–68.

¹⁰¹ Message to the Senate and House of Representatives (Jan. 17, 1863), *in* 6 COLLECTED WORKS, *supra* note 1, at 60, 61.

¹⁰² Annual Message to Congress (Dec. 1, 1862), *supra* note 96, at 523.

¹⁰³ Annual Message to Congress (Dec. 6, 1864), *in* 8 COLLECTED WORKS, *supra* note 1, at 136, 143.

¹⁰⁴ DONALD, RECONSIDERED, *supra* note 81, at 192.

had to do in part with Lincoln holding the reins in the first place. Given Lincoln's restraint in exerting the veto, it is telling that his only substantive veto pertained to money. Although the issue was on its face unimportant—having to do with the use of small-denomination banknotes in the District of Columbia—Lincoln's message is consistent, loud, and clear: "During the existing war it is peculiarly the duty of the national government to secure to the people a sound circulating medium."¹⁰⁵

Lincoln also appreciated the value of holding a monopoly over the medium of exchange. In his Fourth Message to Congress, he openly advised Congress to do something about state banknotes. The Treasury could not conduct its business satisfactorily, he said, "unless the government can exercise a restraining power over the bank-note circulation of the country."¹⁰⁶

Restraint over state banknotes was not his only concern. Despite his endorsing the use of greenbacks, Lincoln was wary of the possible hazards of uncoupling federal paper from specie:

A return to specie payments, however, at the earliest period compatible with due regard to all interests concerned, should ever be kept in view. Fluctuations in the value of currency are always injurious [P]rompt and certain convertability into coin, is generally acknowledged to be the best and surest safeguard against them.¹⁰⁷

Two days after signing off on the second installment of greenbacks, Lincoln sent Congress an urgent letter, saying:

It seems very plain that continued issues of United States notes . . . without adequate provision for . . . funding the issues . . . must soon produce disastrous consequences. And this matter appears to me so important that I feel bound to avail myself of this occasion to ask the special attention of Congress to it.¹⁰⁸

Lincoln's fears were borne out, as chart 3 and table 2 make clear.¹⁰⁹ Unhinging U.S. currency from specie and nearly tripling

¹⁰⁵ Message to the Senate (June 23, 1862), in 5 COLLECTED WORKS, *supra* note 1, at 282, 282.

¹⁰⁶ Annual Message to Congress (Dec. 6, 1864), *supra* note 103, at 143–44.

¹⁰⁷ Annual Message to Congress (Dec. 1, 1862), *supra* note 96, at 522.

¹⁰⁸ Message to the Senate and House of Representatives (Jan. 17, 1863), *supra* note 101, at 60, 61.

¹⁰⁹ See *infra* app., at chart 3, tbl.2. His understanding of how markets work did not prevent Lincoln from exasperation at gold speculators. GABOR S. BORITT, LINCOLN AND THE ECONOMICS OF THE AMERICAN DREAM 207 (1994). But even Congress could not abolish the working of markets: although it passed the Anti-Gold Futures Act to prevent people from betting against the greenback on June 17, 1864, it had to repeal it less than two weeks later. Act of July 2, 1864, ch. 209, 13 Stat. 344 (repealing the Anti Gold Futures Act); Act of June 17, 1864, ch. 127, 13 Stat. 132; see RICHARDSON, *supra* note 61, at 97–99; Roll, *supra* note 6, at

the amount of money in circulation more than doubled prices.¹¹⁰ And nominal wages did not keep up with prices: real wages did not return to 1860 levels until 1869.¹¹¹

3. Are Government Bonds Net Wealth? Lincoln Waffles

Although Lincoln grasped much that was important about public finance, he was sometimes disingenuous—or naïve—about the nature of government borrowing. In his Fourth Annual Message, for example, he stated, “The great advantage of citizens being creditors as well as debtors, with relation to the public debt [was that m]en readily perceive they cannot be much oppressed by a debt which they owe to themselves.”¹¹² This statement suggests the relationship between borrowing and future taxes—the populace as a whole holds pieces of paper that promise to pay them later, but the payments going into pockets come out of those same pockets. In other words, government bonds are not wealth; they are ways to delay the day of reckoning for current expenditures.

Yet, in the same speech, Lincoln urged measures to encourage “every prudent person to set aside a small annuity [by purchasing government bonds] against a possible day of want.”¹¹³ This implies that government bonds are in fact a form of wealth. They are, arguably, to the individual who holds them, but they are not to society as a whole, and Lincoln wanted to have it both ways.¹¹⁴

480.

¹¹⁰ The North’s stock of money in June 1861 was \$558 million; in November 1864, it stood at \$1,506 million. 3 HISTORICAL STATISTICS OF THE U.S., *supra* note 3, at 3-602 tbl.Cj26-41.

¹¹¹ CLARENCE D. LONG, WAGES AND EARNINGS IN THE UNITED STATES 1860–1890, at 153 app. A (1960); Williamson, *supra* note 38, at 659. After the War, of course, the United States eventually came back to a specie standard: the Resumption Act of January 1875 required redemption of greenbacks for specie at par on and after January 1, 1879. Act of Jan. 14, 1875, ch. 15, § 3, 18 Stat. 296. John Sherman, then Secretary of the Treasury, started accumulating gold reserves in 1877. Prices fell substantially—in part because of real growth in the economy—and the government succeeded in making the greenback convertible by the due date. See generally John P. Dawson & Frank E. Cooper, *The Effect of Inflation on Private Contracts: United States, 1861–1879*, 33 MICH. L. REV. 852, 856 (1935); James K. Kindahl, *Economic Factors in Specie Resumption, The United States 1865–79*, 69 J. POL. ECON. 30, 96 (1961).

¹¹² Annual Message to Congress (Dec. 6, 1864), *supra* note 103, at 143.

¹¹³ *Id.*

¹¹⁴ Professional economists did not confront this issue in depth until Robert Barro published his seminal article in 1974, so we cannot fault Lincoln for failing to work through the full implications of government borrowing. See generally Barro, *supra* note 29, at 1095.

Not only was Lincoln inconsistent, he did not address the likelihood that, if people did consider government bonds net wealth, public borrowing could crowd out private borrowing and reduce capital accumulation. But this is not terribly shocking: Lincoln had more pressing issues on his mind than the size of the future capital stock.

Not surprisingly, federal spending during the Civil War went primarily for current consumption rather than investment.¹¹⁵ Thus, government bonds did not represent true wealth. But how people viewed them at the time is not clear. Greater federal debt was associated with higher interest rates after 1862, as chart 4 shows.¹¹⁶ This might suggest that federal borrowing crowded out private borrowing, implying that individuals considered government bonds wealth. But inflation was mounting as well, as chart 5 indicates.¹¹⁷ Nominal interest rates reflect expected inflation—which is likely related to actual inflation—as well as the real cost of borrowing. So the higher nominal interest rates in later years may simply be due to higher expected inflation rates.

III. LINCOLN'S FINANCIAL LEGACIES

Lincoln revered the Union, not for itself, but for what it “promise[d] for the future.”¹¹⁸ Saving it would test whether a nation conceived in liberty and dedicated to equality could endure.¹¹⁹

Preserving the Union by defeating the South meant innovative public finance. What Lincoln did to pay for the Civil War extended the reach of federal powers, set a precedent for future U.S. Presidents in times of national crisis, and overhauled the country's system of money and banking. To some extent, today's tendency to look to Washington to solve financial problems has its roots in a regime that united the nation's financial structure with the federal government.

¹¹⁵ See Williamson, *supra* note 38, at 651, 659 tbl.7 (arguing that that the diversion of private savings meant a low rate of capital formation during the War). The Civil War did give rise to some improved technologies, particularly for weaponry. One example is the Gatling gun, invented in 1862. See HORACE GREELEY ET AL., *THE GREAT INDUSTRIES OF THE UNITED STATES* 944 (1872).

¹¹⁶ See *infra* app., at chart 4.

¹¹⁷ See *infra* app., at chart 5.

¹¹⁸ Annual Message to Congress (Dec. 3, 1861), *supra* note 20, at 53.

¹¹⁹ *Id.*; Address Delivered at the Dedication of the Cemetery at Gettysburg (Nov. 19, 1863), in 7 *COLLECTED WORKS*, *supra* note 1, at 17, 22.

A. Extension of Federal Powers

Lincoln's reform of the monetary system did more than alter the financial face of the country. Legal scholar David Currie concluded that the Constitution was never the same after Civil War-era programs—including financial innovations—"that challenged preexisting notions of federal authority."¹²⁰ People at the time felt the wind blowing a different direction; an 1863 editorial in the *New York Times* averred that the Legal Tender Act and the national currency bill "crystallized. . . . [a] centralization of power, such as Hamilton might have eulogised as magnificent."¹²¹ After Lincoln, Andrew Jackson's interpretation of the Tenth Amendment was extinct, at least among Washington's leaders.

Significantly, Lincoln's monetary policies later led to a broad reading of the Necessary and Proper Clause via the post-war Legal Tender Cases.¹²² Bray Hammond put it like this: "[T]he authorization of the greenbacks [was] of greater significance in the evolution of federal powers than in monetary history and of greater importance to the student of government than to the economist."¹²³

¹²⁰ Currie, *supra* note 24, at 1225.

¹²¹ Editorial, *The Dead Lion.; The Thirty-Seventh Congress—What It Was and What It Did*, N.Y. TIMES, Mar. 9, 1863, <http://www.nytimes.com/1863/03/09/news/the-dead-lion-the-thirty-seventh-congress-what-it-was-and-what-it-did.html?scp=4&sq=The%20Dead%20Lion&st=cse>. Some contemporary commentators characterize Lincoln as shredding the Constitution. See Charles K. Rowley, *Fragmenting Parchment and the Winds of War: The Constitution of the United States, 1860–2004*, 124 PUB. CHOICE 33, 42, 44 (2005).

¹²² The U.S. Constitution states that Congress shall have the power "[T]o make all Laws which shall be necessary and proper for carrying into Execution the foregoing Powers, and all other Powers vested by this Constitution in the Government of the United States, or in any Department or Officer thereof." U.S. CONST. art. I, § 8, cl. 18. The Legal Tender Cases include: *Hepburn v. Griswold*, 75 U.S. (8 Wall.) 603, 625 (1870) (holding that Congress lacked the power to make paper money legal tender), *overruled by* *Knox v. Lee*, 79 U.S. (12 Wall.) 457, 553 (1871), and *Juilliard v. Greenman*, 110 U.S. 421, 450 (1884) (upholding legal tender legislation) (1870). *But cf.* *Veazie Bank v. Fenno*, 75 U.S. (8 Wall.) 533, 555 (1869) (upholding tax on state banknotes). Professor Dam argues that the Legal Tender Cases are key to understanding current interpretations of the Necessary and Proper Clause. Dam, *supra* note 71, at 390. Gerard Magliocca revisited the issue, concluding that the operative standard in implied power cases comes from the Legal Tender Cases, not *M'Culloch v. Maryland*. Gerard N. Magliocca, *A New Approach to Congressional Power: Revisiting the Legal Tender Cases*, 95 GEO. L.J. 119, 123 (2006).

¹²³ HAMMOND, SOVEREIGNTY, *supra* note 6, at 227. Hammond went on to say that "the federal government did not resort to a stealthy deceit, as sovereignties had often done, but performed a miracle. It openly did the impossible." *Id.* And

Lincoln's actions helped revise the Constitution in at least one other way: he paved the path for the passage of the Sixteenth Amendment. By pushing through an income tax to help pay for the Civil War, he raised the issue of what defined a direct tax and thus required apportionment according to a state's population.¹²⁴

B. A Model of America-First Finance

Fiat money—greenbacks—constituted a public-finance experiment for the United States. It was not the first time: the nation had tried it on a limited scale during the War of 1812, although land warrants for veterans proved a more effective alternative to hard money than scrip.¹²⁵

But fiat money was something more than an attempt to raise revenue; it was also a way of preserving national interests by disregarding—at least temporarily—international effects. Going off the gold standard when most of the rest of the world remained wedded to it allowed the United States to orchestrate domestic monetary policy as it saw fit. Decoupling from gold also had the potential to play havoc with the purchasing power of U.S. money abroad, however.¹²⁶ Some wanted to continue this experiment after the Civil War ended, although Treasury Secretary Hugh McCulloch quickly scuttled that idea.¹²⁷

Later Presidents adopted Lincoln's strategy of going off gold in

by doing so, "it affirmed that the American government would not be too weak to maintain its own existence," although it may have become too strong for the liberties of its people, according to Hammond. *Id.*

¹²⁴ Before the Supreme Court's decision in *Pollock v. Farmers' Loan & Trust Co.*, income taxes were treated as indirect excise taxes, although not everyone agreed with this designation. The *Pollock* ruling made the source of the income relevant in determining whether the tax imposed was direct (and required apportionment) or indirect. 157 U.S. 429, 557, 573–74 (1895), *vacated by* 158 U.S. 601 (1895). To impose a tax on non-labor income thus required an amendment to the Constitution. See U.S. CONST. amend. XVI.

¹²⁵ RECORDS OF THE BUREAU OF LAND MGMT., WAR OF 1812: MILITARY BOUNTY LAND WARRANTS 1815–1858, *microformed on* Nat'l Archives & Records Serv. (Nat'l Archives Microfilm Pubs. 1975), <http://www.slcl.org/branches/hq/sc/images/dps-pdf/M848-all.pdf> (providing a description of land warrants).

¹²⁶ For discussions of how a nation generally needs fiat money to conduct discretionary monetary policy in an international world, see FRIEDMAN, *supra* note 5, at 249–60, and GEORGE MACESICH, POLITICAL ECONOMY OF MONEY: EMERGING FIAT MONETARY REGIME (1999).

¹²⁷ Economist Henry Carey argued to remain off gold in the provocatively titled, THE WAY TO OUTDO ENGLAND WITHOUT FIGHTING HER (1865). The Treasury did reissue about \$26 million in retired greenbacks after the Panic of 1873 before embarking upon a program to achieve parity between gold and greenbacks. Kindahl, *supra* note 111, at 45.

time of war.¹²⁸ Another—very different—Republican President chose to depart from gold permanently. Although the comparison may seem odd, Richard Nixon’s decision to put domestic interests first when it came to monetary policy echoes that of Abraham Lincoln. Lincoln left gold so that he would have the financial flexibility to fight the Civil War. Nixon went off gold in the wake of the Vietnam War and Lyndon B. Johnson’s War on Poverty.¹²⁹ He could have continued defending the dollar as France and Britain decimated U.S. gold reserves; instead, he chose to look inward so as to preserve the ability to conduct discretionary monetary policy.¹³⁰

This article is not claiming that Nixon’s decision to put the United States permanently on fiat money is the direct result of Lincoln’s issuance of greenbacks. In fact, Lincoln himself agonized over this decision—considering it a war measure only—and urged a speedy return to commodity-backed currency. Nonetheless, Lincoln’s preservation of the Union owes something to his pioneering financial techniques, including large-scale use of fiat money.¹³¹

The world now runs on fiat money, which has the benefit of flexibility but the hazard of instability. The electronic nature of money exacerbates the problem: Joel Kurtzman referred to the departure from physical reserves as the “death of money” and

¹²⁸ See Lawrence H. Officer, *Gold Standard*, EH.NET ENCYCLOPEDIA, <http://eh.net/encyclopedia/article/officer.gold.standard> (last visited Mar. 26, 2010) (providing information about and history of the gold standard as used in various countries). The United States, as well as many other countries, went off gold during both World Wars. During the Second World War, the United States hosted the Bretton Woods conference to determine the look of international finance after the War. The countries in attendance decided to peg their currencies to the value of the dollar, and the United States agreed to maintain the gold value of the dollar. In effect, the world remained on a gold standard but relied on the United States to enforce it. *See id.*

¹²⁹ The “Nixon Shock” occurred on August 15, 1971. Craig R. Giesse & Martin J. Lewin, *The Multifiber Arrangement: ‘Temporary’ Protection Run Amuck*, 19 L. & POL’Y INT’L BUS. 51, 96 n.265 (1987).

¹³⁰ Federal spending escalated in the sixties to pay for the Vietnam War and several new domestic programs. When those new dollars flowed across borders, foreign banks sent them back to the United States, asking for gold in return. To preserve the Bretton Woods monetary system, the United States would have had to comply. The country eventually chose not to. *See generally* DAVID FRUM, *HOW WE GOT HERE: THE 70’S: THE DECADE THAT BROUGHT YOU MODERN LIFE (FOR BETTER OR WORSE)* 296 (2000) (providing a lively account of this time period).

¹³¹ Regrettably, Lincoln’s enlargement of federal power created a larger potential for abuse among his successors as well. Nixon provides only one example.

warned of system-wide collapse as early as 1993.¹³²

C. Effect on America's Financial System

Lincoln's greenback experiment is only part of his legacy. He also bequeathed the nation a single currency and an entirely new system of banking.

Some think Lincoln left a structure that helped reduce expenses and increase the availability of loanable funds in a way favorable to industrial growth.¹³³ Uniformity in currency eliminates the costs to individuals of assessing the quality of different banknotes, for example, meaning they can pursue productive activities without worrying about the soundness of the medium of exchange. Although most people might want to live in a world of uniform currency, transaction costs could hinder the transition from a multiple to a single-currency regime. Without U.S. government action, the plethora of state banknotes likely would have persisted longer than it did. By undertaking unilateral action when coordination was costly, the national government arguably made people better off. Lincoln's observation that "[t]he legitimate object of government is 'to do for the people what needs to be done, but which they can not, by individual effort, do at all, or do so well, for themselves,'"¹³⁴ is particularly apt here.

Not everyone agrees that the new scheme was an unalloyed improvement. The New York Clearinghouse and the Suffolk Bank of Boston did a decent low-cost job at evaluating notes and lubricating financial transactions, according to several scholars.¹³⁵

¹³² JOEL KURTZMAN, *THE DEATH OF MONEY: HOW THE ELECTRONIC ECONOMY HAS DESTABILIZED THE WORLD'S MARKETS AND CREATED FINANCIAL CHAOS* (1993). As Kurtzman pointed out, money does not now consist of physical reserves, but rather of complex, electronic valuation of financial assets. *Id.* He also discussed the hazards of new trends in securitization, such as mortgage-backed securities. *Id.* For a discussion of the future of money in a digital world, see ORG. FOR ECON. CO-OPERATION & DEV., *THE FUTURE OF MONEY* (2002), <http://www.oecd.org/dataoecd/40/31/35391062.pdf>.

¹³³ Avery Craven, *The Price of Union*, 18 J. S. HIST. 3, 10 (1952) (noting that the measures undertaken during the Civil War completely overturned the Jacksonian regime and turned the country toward industry, material goods, cities, wealth, and American business); Roll, *supra* note 6, at 498 (suggesting that capital markets during the War performed efficiently); Richard Sylla, *Finance and Capital in the United States, 1850-1900*, 27 J. ECON. HIST. 621, 622 (1967).

¹³⁴ Fragment on Government (July 1, 1854), in 2 COLLECTED WORKS, *supra* note 1, at 221, 221.

¹³⁵ Schweikart, *supra* note 39, at 623 (noting that this appears to be the

Bray Hammond, in his inimitable way, pointed out that no one suggested making a tidier railroad system during the War.¹³⁶ By the same token, the federal government could have used the existing set of banks to effect financial change.¹³⁷ State banks could have implemented the use of a uniform currency, for instance. Instead, the government duplicated infrastructure by requiring a national banking system to do the job.

What is more, central control of financial markets seems impossible in a democratic, profit-based system. From the outset, the national banking system had problems. Restrictions on entry made starting banks in the West and South difficult, and early comptrollers interpreted the National Bank Act as permitting only unit—not branch—banking.¹³⁸ State banks therefore began to re-enter the arena. By the time the United States re-established central banking, the number and assets of state banks far exceeded those of national banks.¹³⁹ Other financial intermediaries also sprang up, some of which added instability.¹⁴⁰ The Panic of 1907—which led to the establishment of the Federal Reserve System—began with the collapse of the Knickerbocker Trust, for instance.¹⁴¹ In a similar fashion, bank alternatives like

consensus view). Schweikart pointed out that “free” banking is a misnomer, because it simply regulated the components of capital rather than the total amount. *Id.* at 621; see Gorton, *supra* note 33, at 278; Bruce D. Smith & Warren E. Weber, *Private Money Creation and the Suffolk Banking System*, 31 J. MONEY CREDIT & BANKING 624, 625 (1999).

¹³⁶ HAMMOND, SOVEREIGNTY, *supra* note 6, at 137.

¹³⁷ *Id.* at 136–37. Hammond suggested that Chase could have dealt with banks as a borrower instead of a dictator; instead, we have a redundant and complex system. *Id.* at 348–49.

¹³⁸ Under the National Bank Act, five or more persons could associate and form a bank with the relatively large threshold of \$50 thousand in capital. If the bank deposited United States interest-bearing bonds of one-third of paid-in capital, the government would engrave 90% of the par value of the bonds in national bank certificates. Thus, national banks had to swallow federal debt that gave a relatively low effective yield. See 2 SANDBURG, *supra* note 86, at 191; Charles Dunbar, *The National Banking System*, 12 Q.J. ECON. 1, 2–3 (1897). The national banking system had trouble meeting peak demand, but it also lacked an effective redemption method. See George A. Selgin & Lawrence H. White, *Monetary Reform and the Redemption of National Bank Notes, 1863–1913*, 68 BUS. HIST. REV. 205, 205–06 (1994).

¹³⁹ The number of state banks in 1913 was 19,197, as compared to 7,473 national banks. Respective asset holdings were \$19.2 billion and \$11 billion. 3 HISTORICAL STATISTICS OF THE U.S., *supra* note 3, at 3-634 tbl.Cj158–168; 5 *id.* at 5-98 tbl.Ea650–661.

¹⁴⁰ Sylla, *supra* note 4, at 127, 133–34.

¹⁴¹ O.M.W. SPRAGUE, HISTORY OF CRISES UNDER THE NATIONAL BANKING SYSTEM, S. DOC. NO. 538, at 89–95 (1910) (concluding that trusts not part of the New York Clearinghouse were primarily responsible for the 1907 Panic).

investment houses and hedge funds contributed to today's financial crisis.¹⁴²

Lincoln's commitment to federalism thus puts the federal government front and center in coping with financial crisis.¹⁴³ Bray Hammond noted that the greenbacker was "disposed . . . as never before to look to Washington for relief from his grievances, to forsake his Jeffersonian fears of 'centralization.'"¹⁴⁴ So, too, do we look to the federal government to solve our financial problems today.

This means particularly knotty issues for a fiat-money system. A fiat regime works reasonably well when the monetary authority can focus on fighting inflation, as the Federal Reserve did for several years. Having a target interest rate indirectly meant controlling the money supply, and thus, prices.¹⁴⁵ The "full faith and credit" of the U.S. government promised people that we would preserve the value of our currency, even without commodity backing. But we have now assigned an additional role to the Fed—safeguarding the financial system.¹⁴⁶ Doing both presents quite a challenge.¹⁴⁷

¹⁴² The *New York Times* in particular has covered the financial meltdown. See, e.g., Edmund L. Andrews, *Fed Shrugged as Subprime Crisis Spread*, N.Y. TIMES, Dec. 18, 2007, at A1.

¹⁴³ E.g., RICHARDSON, *supra* note 61, at 255.

¹⁴⁴ Hammond, *The North's Empty Purse*, *supra* note 10, at 18.

¹⁴⁵ See generally STAFF OF JOINT ECON. COMM., 105th CONG., ESTABLISHING FEDERAL RESERVE INFLATION GOALS: A JOINT ECONOMIC STUDY (1997), <http://www.house.gov/jec/fed/fed/goals.pdf> (outlining the goals of the Federal Reserve); Federal Reserve Board, Monetary Policy, Open Market Operations, <http://www.federalreserve.gov/fomc/fundsrate.htm> (last visited Mar. 26, 2010).

¹⁴⁶ See Donald L. Kohn, Vice Chairman, Bd. of Governors Fed. Reserve Sys., Remarks at the American Economic Association Annual Meeting: Monetary Policy in the Crisis: Past, Present, and Future (Jan. 3, 2010), <http://www.federalreserve.gov/newsevents/speech/kohn20100103a.pdf> (providing the first report on the Fed's credit and liquidity program).

¹⁴⁷ See Ben S. Bernanke, Chairman, Bd. of Governors Fed. Reserve Sys., Speech at the National Press Club Luncheon: Federal Reserve Policies to Ease Credit and Their Implication for the Fed's Balance Sheet (Feb. 18, 2009), <http://www.federalreserve.gov/newsevents/speech/bernanke20090218a.htm> (acknowledging the difficulty of conducting multiple policies simultaneously).

APPENDIX

Graphical data is unavailable in the digital format of this article.

