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DADDY 'WAR' BUCKS HOW LINCOLN FUNDED THE CIVIL WAR AND FATHERED THE MODERN SYSTEM OF AMERICAN FINANCE

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Abraham Lincoln and Salmon P. Chase recognized that money is power. They mobilized the Treasury Department to win the Civil War, and in doing so, revolutionized American national finance.

I. INTRODUCTION

With the Union in an extremely weak economic state at the start of the Civil War, Lincoln was forced to challenge the way wars were to be financed and expand upon his powers as a president. To accomplish his goals of freeing the slaves and ending secession, Lincoln desperately needed a way to fund his endeavors. Lincoln and his Secretary of the Treasury, Salmon P. Chase, skillfully disrupted the American economy with higher tariffs, development of national banks, income tax, issuance of bonds, and creation of the first Internal Revenue Office to win the Civil War from within the Treasury Department. Lincoln pushed the exercise of federal power beyond anything that had ever been done before and forever shifted the relationship between state and federal government.

II. MONEY, THAT'S WHAT I WANT: THE CONFUSED STATE OF AMERICAN FINANCE

A. COME TOGETHER: STATE V. FEDERAL CONTROL OF BANKS

Arguing about how to manage money is not only a problem among spouses and business partners. Instead, it has been a national issue since the formation of America. The very founders of the Constitution did not include a specific clause for establishing a national system of managing the country's assets. In the 1790s, Alexander Hamilton perceived the system of federal banking as the foundation for a strong economy. Conversely, Thomas Jefferson perceived the federal bank as a violation of the U.S. constitutional limits of government.¹ The passion on both sides of the debate was evident. This issue ran deep in the hearts of both the federalists and states' rights activists. Jefferson said, "I believe that banking institutions are more dangerous to our liberties than standing armies."² As each representative made arguments, President George Washington was "greatly perplexed" as to whether the Constitution allows for the establishment of a "national" bank.³

Over the years, presidents came in and out of office, as did the attempts of establishing a national bank. However, it was not until 1819 when the constitutionality and legitimacy of national banks was officially decided in the landmark case of *McCulloch v. Maryland*.⁴ *McCulloch* determined whether the "necessary and proper" clause of the Constitution provided authority for the establishment and operation of a national bank.⁵ Chief Justice John Marshall construed the "necessary and proper" clause to allow the national government to act in

¹ BRAY HAMMOND, *BANKS AND POLITICS IN AMERICA: FROM THE REVOLUTION TO THE CIVIL WAR* 115-20 (1957).

² THE JEFFERSON MONTICELLO, 1802 LETTER TO SECRETARY OF THE TREASURY ALBERT GALLATIN, <https://www.monticello.org/site/research-and-collections/private-banks-spurious-quotation> (last visited Jan. 12, 2020).

³ William J. Kambas, *The Development of the U.S. Banking System: From Colonial Convenience to National Necessity*, 28 RUTGERS L. REC. 4, (2004) (citing David Jack Cowen, *The Origins and Economic Impact of the First Bank of The United States 1791-1797* 20 n.27 (2000)).

⁴ See generally *McCulloch v. Maryland*, 17 U.S. 316 (1819).

⁵ *Id.*

furtherance of a unified national government through the creation of a national bank as a department of the government. Therefore, "the act to incorporate the Bank of the United States is a law made in pursuance of the Constitution, and is a part of the supreme law of the land."⁶ After this decision, the Second Bank came into existence as the nation's National Bank.

The Second Bank blossomed until the election of Andrew Jackson in 1829. As an "anti-bank" man, Jackson vetoed the Second Bank's re-charter. This was the final blow to the Second Bank and the system of federal banking.⁷ This veto severely undercut the government's ability to control the expansion of credit, which unbeknownst to Jackson, led to a very poor foundation for funding a war. Jackson continued to favor state banks and removed all government deposits from the Second Bank to place them into selected state banks, his 'pet banks' as they came to be called.⁸ State banking systems grew and the federal system was weakened throughout the so-called "free banking era."⁹ The American banking system was now largely unregulated under Jackson. This led to the Panic of 1837, which caused a nationwide depression that lasted until 1843. Not only did the Panic of 1837 result from the unsteady banking system in place, but other factors contributed to the issue, such as the movement of specie from the federal government to state banks, which dispersed reserves and prevented central management; pressures from British banks; and a lack of mechanisms for the stabilization of America's economy, which resulted from dispersed reserves.¹⁰ Even the largest banks crumbled and could not survive the crisis. Proponents of the state banking system began to rethink their positions and realized some government assistance may be needed to regulate banking after all.¹¹

⁶ *Id.* at 424.

⁷ See generally Paul Finkelman, *The Constitution and The Intentions of The Framers: The Limits of Historical Analysis*, 50 U. PITT. L. REV. 349 (1989).

⁸ H. W. BRANDS, *ANDREW JACKSON: A LIFE AND TIMES* 496 (2006).

⁹ See *Briscoe v. Bank of Kentucky*, 11 U.S. 257 (1837) (holding state banks constitutional).

¹⁰ William J. Kambas, *The Development of the U.S. Banking System: From Colonial Convenience to National Necessity*, 28 RUTGERS L. REC. 4 (2004).

¹¹ Edward L. Symons, Jr., *The "Business of Banking" in Historical Perspective*, 51 GEO. WASH. L. REV. 676 (1983) (citing BRAY HAMMOND,

Following Jackson's presidency, Martin Van Buren proposed the establishment of an independent U.S. treasury that would hold all of the government's money in the form of "hard money," gold or silver, and restrict the printing of money at will, with the goal of preventing inflation.¹² This Independent Treasury Act was passed in 1840, repealed in 1841 by the Whigs, and reinstated in 1846. This act led to numerous long-term problems that would later trouble the Lincoln Administration.

Despite the hopes that the Independent Treasury Act would provide some stability, the California gold rush increased wealth and commerce, and the demands on banking were constantly expanding. The country had no way of maintaining a stable system. The ease with which one could obtain a charter and incorporate a bank inevitably led to banking fraud and bad business. Further, the diverse banknotes across state lines made counterfeiting all too easy. "By the 1850s thousands of different types of banknotes, both genuine and counterfeit, were in circulation."¹³ The country continued to struggle, and the independent state banks were unprepared, unqualified, and mismanaged. Thus, maintaining a stable monetary system was not possible.

B. REVOLUTION: PRIOR WARS PROVIDE LITTLE GUIDANCE

President Lincoln had no real guidelines on how to finance a war, especially one of such magnitude, fought within the nation's own borders. Both the War of 1812 and the Revolutionary War were poorly financed—they relied on minimal taxation and upon forms of debt that increased the money supply. Both conflicts resulted in severe inflation. At one time the value of bills of credit that were valued at almost 1,000 specie dropped to 1.¹⁴ The Revolutionary War instigated the national debt, after borrowing money from France and the Netherlands to pay for the war, the U.S. debt totaled over \$43

BANKS AND POLITICS IN AMERICA: FROM THE REVOLUTION TO THE CIVIL WAR (1957)).

¹² Independent Treasury Act of 1840, ch. 41, 5 Stat. 385 (1840).

¹³ Roy Davies & Glyn Davies, *A Comparative Chronology of Money: Monetary History from Ancient Times to the Present Day* (March 13, 2018) <http://www.ex.ac.uk/RDavies/arian/amser/chrono11.htm>.

¹⁴ ROBERT T. PATTERSON, *THE JOURNAL OF ECONOMIC HISTORY*, VOL. 12, NO. 1, GOVERNMENT FINANCE ON THE EVE OF THE CIVIL WAR (1952), available at <http://www.jstor.org/stable/2112903>.

million. The Founding Fathers sought to pay off the debt by imposing taxes on imports, tariffs, and tobacco and alcohol excises.

The Excise Tax of 1791 imposed a tax of 25 cents per gallon on whiskey if it was made from foreign materials and 18 cents if made from domestic supplies. This disparity in tax rates sparked anger among the people leading to the "Whiskey Rebellion" in which angry western farmers began to protest. Their anger led to the "tarring and feathering" of tax collectors. Washington quickly squashed the uprising by dispatching 13,000 militia men to suppress the rebellion and issued arrests to the perpetrators for high treason.¹⁵ The excise tax and tariffs stayed in place and continued to chip away the national debt, although these measures alone would never produce results substantial enough to eliminate it.

The War of 1812 had potential to be properly financed, but the dissolution of the First Bank in 1811 deprived the government of a major source of potential credit and loans.¹⁶ Again, the government chose to avoid direct taxation and instead authorized loans, doubled the customs duties, collected property tax, and continued excise taxes.¹⁷ Towards the end of the War of 1812, after war expenditures had produced a national debt of \$100 million, legislators made the first proposal for a federal income tax.¹⁸ This proposal for income taxation failed by a close margin. Instead, Congress adopted a high protective tariff in 1816.¹⁹

Yet again, during the Mexican-American War, the government chose not to raise internal taxes and instead chose to pay for the war by quadrupling the national debt from \$15.5 million to \$63 million between 1846 and 1849.²⁰ During this period, President Polk passed the Walker Tariff, which

¹⁵ Thomas R. Eddlem, *Before the Income Tax*, NEW AMERICAN (April 3, 2018)

<https://www.thenewamerican.com/culture/history/item/14268-before-the-income-tax>.

¹⁶ William J. Kambas, *The Development of the U.S. Banking System: From Colonial Convenience to National Necessity*, 28 RUTGERS L. REC. 4 (2004).

¹⁷ Patterson, *supra* note 14.

¹⁸ JOHN F. WITTE, *THE POLITICS AND DEVELOPMENT OF THE FEDERAL INCOME TAX* 67 (1985).

¹⁹ Steven A. Bank, *Origins of a Flat Tax*, 73 DENV. U.L. REV. 329 (1996).

²⁰ Eddlem, *supra* note 15.

produced the nation's first standardized tariff and established general schedules into which all goods could be classified and subject to defined *ad valorem* (according to value) rates. This decrease in tariffs "increased international trade so dramatically that federal tax revenue increased from \$27 million in 1846 to \$40 million in 1850."²¹ "The massive increase in tariff revenues – despite the lower rates – meant that the U.S. government began running substantial budget surpluses beginning in 1849, and paid off nearly all of the national debt."²² Unfortunately, this time of economic prosperity did not last long. The lack of diversity in sources of income for the federal government and the system of free state banking set the foundation upon which this false sense of prosperity lay.

C. IT'S ALL TOO MUCH: THE PANIC OF 1857 AND FAILURE OF PRESIDENT BUCHANAN.

The Panic of 1857 abruptly ended the prosperous times that followed the Mexican-American War. This time the economic ramifications stretched beyond the borders from Germany to Brazil. The Library of Congress considered the Panic of 1857 to be "one of the most severe economic crises in US history."²³ The event that began the panic was the failure of the New York Branch of the Ohio Life Insurance and Trust Company. This major financial force collapsed following massive embezzlement. British investors removed funds from American Banks, and this raised the question of economic soundness among the public. To make matters worse, a few months after the panic on Wall Street, the SS Central America, a ship that was carrying millions of dollars in gold specie, sailed into a hurricane and sank.²⁴ The North took most of the brunt of the damage during this crisis and had a slow recovery, while the South was less affected due to their large agrarian economy.

The Panic of 1857 officially ended when economic concerns subsided and America entered the Civil War, which began in 1861. "Between the fiscal years 1856 and 1861,

²¹ *Id.*

²² *Id.*

²³ *Today in History - August 24: The Panic of 1857*, LIBRARY OF CONGRESS (April 3, 2018) <https://www.loc.gov/item/today-in-history/august-24>.

²⁴ *Id.*

revenues declined from \$74.1 million to \$41.5 million, but expenditures were reduced scarcely at all. The cumulative deficit when the war began was approximately \$65 million.”²⁵ The Buchanan administration did nothing to help lay a strong foundation for Lincoln. In fact, when Congress met in December 1860, “the treasury was empty – bankrupt. There was no money to pay the public creditors, who were then pressing for payment. There was not money enough even to pay members of Congress.”²⁶ Consequently, Lincoln plunged headfirst into a fiscal mess.

III. WITH A LITTLE HELP FROM HIS FRIENDS: LINCOLN'S OPTIONS & CHASE'S STRUGGLES

Lincoln lived through the depressions and economic mess that were created by prior presidents and had strong views on monetary reform throughout his life. He had thought about what to do with the nation's economy long before his election. Lincoln delivered a well-known speech in 1839, attacking the Independent Treasury. He brought up strong points that even the best economists of today would raise about the Independent Treasury. Overall, Lincoln raised three major issues with the system in place. The strongest of these was that if all of this “hard money” is sitting idle then “the money is performing no nobler office than that of rusting in iron boxes”²⁷ He was on Alexander Hamilton's side when it came to national banks and was a proponent of a national unified bank. Lincoln concluded his speech by saying “that no duty is more imperative on that Government than the duty it owes the people, of furnishing them a sound and uniform currency.”²⁸

Being the savvy lawyer that he was, Lincoln made the constitutional connection that a national bank is necessary and proper because one of Congress's express powers is “to lay and

²⁵ ROBERT T. PATTERSON, *THE JOURNAL OF ECONOMIC HISTORY*, VOL. 12, NO. 1, GOVERNMENT FINANCE ON THE EVE OF THE CIVIL WAR (1952), available at <http://www.jstor.org/stable/2112903>.

²⁶ ALBERT SIDNEY BOWLES, *FINANCIAL HISTORY OF THE UNITED STATES: FROM 1774 TO 1789* 4 (1879).

²⁷ Roy P. Basler, *Abraham Lincoln, Speech on the Sub-Treasury: The Collected Works of Abraham Lincoln*, (March 13, 2018) http://www.bibliotecapleyades.net/sociopolitica/pawns_inthegame/subtreasury.htm.

²⁸ *Id.*

collect taxes; duties, imposts, and excises; to pay the debts, and provide for the common defense and general welfare of the United States.”²⁹ Therefore, “Congress is authorized to make all laws necessary and proper for carrying this power into execution and to carry it into execution, it is indispensably necessary to collect, safely keep, transfer, and disburse revenue.”³⁰ Until Lincoln came into office, his views remained the same. Lincoln was faced with a “national government that lacked even the most rudimentary financial tools.”³¹ In the secession winter of 1860-61, the United States lacked cash, a tax system, a banking system, and a functioning currency. “Everything to finance the war had to be set up from scratch.”³² The Civil War was Lincoln’s chance to finally achieve the financial unity he desired for the nation.

When Lincoln was elected, he knew achieving financial unity would be a difficult task and leaned on Salmon Portland Chase, a former Ohio Senator and governor, to be the Secretary of the Treasury. Chase had little experience with fiscal affairs but was an intelligent and distinguished lawyer, and Lincoln recognized his honorable behavior and way of thinking.³³ Chase was a ‘hard-money’ man, generally devoted to the principle of the Independent Treasury, so his views were in a seemingly drastic contrast with Lincoln’s views. The outlook Chase had on money and specie payments would contribute to the financial crisis in the beginning of 1861 and dig the North into a deeper hole.

Chase wanted to secure specie for the Treasury and insisted too heavily on the terms of the Independent Treasury Act, which at that time was already repealed.³⁴ Chase negotiated loans with the state banks because borrowing abroad was out of the question. The New York, Boston, and Philadelphia banks had a large amount of specie but were making little money because the opportunities for lending had declined due to the stagnation of trade.³⁵ So, when Chase

²⁹ *Id.*

³⁰ *Id.*

³¹ *Id.*

³² *Id.*

³³ MARGARET G. MYERS, A FINANCIAL HISTORY OF THE UNITED STATES 149 (1970).

³⁴ *Id.* at 152.

³⁵ WESLEY C. MITCHELL, THE JOURNAL OF POLITICAL ECONOMY, SUSPENSION OF SPECIE PAYMENTS 307 (1899), *available at*

appealed to them for a loan, the banks were willing and able to render aid. The banks received Treasury notes on a 3-year term to maturity at a rate of 7.3% interest for advancing 50 million dollars to the treasury.³⁶ The banks were also given the option to take a second and third option on 50 million of notes on the same terms. The banks undertook the additional options and agreed to lend the government 150 million dollars in only four months.³⁷ However, Chase and the banks had different ideas of how this loan was going to work. The "banks expected that the loan to the government would be managed in the same manner as a loan to a private person; they would credit the United States with a deposit of 50 million upon their books, against which the Secretary of the Treasury could draw as he had occasion."³⁸ Chase's suspicion of banks made him insist that the loan be paid in specie into the vaults of the sub-treasury and although against their will, the banks complied.³⁹

Chase refused to deposit specie into banks, and he continued to stockpile gold in the sub-treasuries. The banks provided the first two loans in specie but were not able to continue due to the extreme drain of specie in the country. The banks suspended specie payments because they could no longer maintain the twenty-five percent reserve ratio required to protect against liabilities.⁴⁰ The remainder of the 150 million dollar loan was to be made in bank paper or in Treasury paper. Chase's first effort to secure specie for the treasury was well-intentioned, but severely imprudent, and resulted in a disturbance in public confidence, hoarding of specie by all, and deprived the whole country of the advantages of specie.⁴¹ The halt in specie outflow meant no market for federal bonds and this would be yet another disastrous blow to the initial war effort in 1861. After this blunder, Chase looked to the bankers for their advice and cooperation, leaving his 'hard-money' mentality behind. In the early months of the war, Chase worked with Jay Cooke, a successful and articulate banker from

<https://ia801700.us.archive.org/7/items/jstor-1819193/1819193.pdf>.

³⁶ *Id.* at 308.

³⁷ *Id.*

³⁸ *Id.* at 310.

³⁹ *Id.* at 311.

⁴⁰ MARGARET G. MYERS, *A FINANCIAL HISTORY OF THE UNITED STATES* 152 (1970).

⁴¹ *Id.*

Philadelphia, who would help him with the difficult task of securing bonds and financing, to avoid any more disastrous decisions.

With the Union in such a financial mess from the onset, Lincoln and the Treasury Department had only a few options to avoid the potential of extreme inflation and endless debt. The War of 1812 showed that when lacking a federal unified bank, the only ways to raise money for war were to create new money, incur debt in the form of bond issuance, and taxation.

IV. THE LONG AND WINDING ROAD: LINCOLN'S PLAN OF ACTION

With the Union in a weak economic state at the start of the Civil War and despite the rocky start due to the suspension of specie payments, Lincoln and Chase brilliantly altered the American economy. This was done through higher tariffs, progressive income tax, creation of the first Internal Revenue Service, issuance of bonds, and the development of a national currency and national banks to win the Civil War from within the Treasury Department.

A. CAUSE I'M THE TAXMAN: IMPLEMENTING THE FIRST INCOME TAX

Chief Justice Marshall best encapsulated the nation's sentiment toward taxation in *McCulloch v. Maryland*. He said, "the power to tax involves the power to destroy."⁴² The people in power were very wary to implement taxes, and the Nation enjoyed an almost tax-free existence prior to the War. Even Salmon P. Chase did not immediately recognize the need to recommend to Congress an adequate program of taxation at the onset of the war.⁴³

In the nineteenth and early twentieth century, the United States mainly relied on excise taxes and high tariffs as

⁴² *McCulloch v. Maryland*, 17 U.S. 316, 431 (1819).

⁴³ *Abraham Lincoln and Civil War Finance*, The Lehrman Institute (February 24, 2018), <http://www.abrahamlincolnclassroom.org/abraham-lincoln-in-depth/abraham-lincoln-and-civil-war-finance/#epw>.

its principal source of revenues.⁴⁴ This reliance was so great that by the 1850s, the federal tax system was dependent on import duties for ninety-two percent of its overall revenues.⁴⁵ The first Morrill Tariff went into effect when Lincoln entered office and the second Morrill Tariff (included in the Revenue Act of 1861) increased the import tariff in the U.S from the previously lower rates under the Buchanan administration. These small measures may have been effective in non-wartime conditions but now seemed unfit. However, when Lincoln assumed the presidency, the idea of imposing additional taxes (such as an income tax) on the citizens seemed outrageous. Chase proposed every measure possible that avoided taxes including a "combination of Treasury notes, stepped-up sales of public lands, and increased tariffs and excise taxes."⁴⁶

The import duties on food, clothing, and shelter items brought in the bulk of the tariff revenues but controversy soon developed. Due to the somewhat finite limit on an individual's ability to consume, especially due to the prices of basic commodities such as tea, coffee, and sugar, the poor spent a greater percentage of their income on such goods compared to the wealthy. Eventually, it came to light that to finance the Civil War something had to change. Not only were taxes needed to finance the war effort, they were also needed to reassure bondholders that the federal government would be able to pay off their bonds.

Lincoln needed a direct tax to reach into those pockets which formerly had a less proportionate burden to the government. So, in 1861, President Abraham Lincoln signed the Revenue Act, imposing the first federal income tax in U.S. history. This initial act imposed an income tax to be "levied, collected, and paid, upon the annual income of every person residing in the United States, whether such income is derived from any kind of property, or from any profession, trade, employment, or vocation carried on in the United States or elsewhere, or from any other source"⁴⁷ This was a flat tax rate of 3% on incomes above \$800.⁴⁸ Despite this bill permitting

⁴⁴ Pete V. Domenici, *The UnAmerican Spirit of the Federal Income Tax*, 31 HARV. J. ON LEGIS. 273, 275 (1994); Jay Starkman, *Is a Consumption Tax the Answer?*, ATLANTA J. & CONST., A15 (1995).

⁴⁵ Steven A. Bank, *Origins of a Flat Tax*, 73 DENV. U.L. REV. 329 (1996).

⁴⁶ *Id.*

⁴⁷ Revenue Act of 1861, Ch. 45, 12 Stat 292 (1861).

⁴⁸ *Id.*

the use of an income tax, it did not translate well and there was little effort to collect or assess taxes owed.

With the financial burdens of war mounting, the bill was amended with changes from a flat rate to the first progressive tax and the creation of the Commissioner of Internal Revenue, a department whose duty was to ensure the collection of taxes and levy excise taxes on a number of everyday goods and services.⁴⁹ This new bill was the Revenue Act of 1862, whose 20,000 words made it the longest to date.⁵⁰ The irony with this bill is that in 1775, “Americans had taken up arms to resist a few shillings in taxes from abroad, and now they are being asked to swallow theoretically limitless taxes for the purposes of taking up arms against each other.”⁵¹ This act made it so people with incomes of less than \$600 paid nothing; people who made more than \$600 but less than \$10,000 paid a 3% tax; and those with incomes above \$10,000 paid a 5% tax. Luxury taxes were also imposed on tobacco, whiskey, cattle stock, and other materials.⁵²

Two years later, The Act of June 30, 1864, again increased rates, making them even more progressive. Now, incomes between \$600 to \$5,000 were taxed at 5%; between \$5,000 to \$10,000 at 7.5%; and incomes above \$10,000 at 10%.⁵³ Still, income taxes raised only \$20 million in 1864 and \$60 million in 1865, which was nowhere near enough to finance the war.⁵⁴

Even President Lincoln paid taxes like everyone else, even though he was exempt from the income tax under Article 11, Section 1 of the Constitution.⁵⁵ Despite the relative unimportance of tax revenue to finance the war, 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 Revenue Act of 1862, Ch. 119, 12 Stat. 432 (1862).

⁵⁰ *The Civil War and Greenbacks*, THE GOLD STANDARD NOW, (March 12, 2018), <http://www.thegoldstandardnow.org/the-civil-war-and-greenbacks>.

⁵¹ *Id.*

⁵² Revenue Act of 1862, Ch. 119, 12 Stat. 432 (1862).

⁵³ Internal Revenue Act of 1864, 13 Stat. 223 (1864).

⁵⁴ MARGARET G. MYERS, A FINANCIAL HISTORY OF THE UNITED STATES 160 (1970).

⁵⁵ U.S. CONST. art. XI, § 1.

B. DON'T LET ME DOWN: PATRIOTISM AND BONDS

Salmon P. Chase's massive failure with his first loan of 150 million dollars from the bankers, followed by the suspension of specie payments, did not meet the needs of the Treasury. With the Civil War dragging on longer than expected, a better system of borrowing was needed. In 1862, Chase requested and obtained the permission of Congress to issue, in addition to the legal tender notes, 500 million bonds at 6%, callable in five years and redeemable in twenty years, to be sold "at any time, at market value thereof" for coin or for treasury notes.⁵⁶ These bonds were difficult and seemingly impossible to sell at par, and Chase refused to sell them at the market value below par.⁵⁷

This is when Chase finally brought on a successful banker, Jay Cooke, for the task of selling these "five-twenty" bonds. Cooke was eager to not only help the Union, but also to secure a commission of one-half percent on the first 10 million bonds and three-eighths on the rest of the bonds, with the added benefit of boosting his banking house of Jay Cooke & Company. Cooke recognized that bankers in the United States could not take on any more government obligations and it was clear they would receive no foreign help. So, this Philadelphia banker devised the bond drive—a feature of every major war since—selling war bonds directly to the people and bypassing the banks that had bought most federal debt until then. This bond drive scheme is often thought to be one of Cooke's own inventions but in fact, historian Jane Flaherty wrote that Cooke "copied this idea from Napoleon II, who sold securities to the French public to finance the Crimean War."⁵⁸ Tapping the powerful outpouring of patriotism that was sweeping the North was the key to selling these government bonds. Cooke mobilized a sales force and financed a nationwide sales campaign marketing the bonds directly to the American people. He worked with newspapers to purchase ads and editors to

⁵⁶ *Id.* at 161.

⁵⁷ *Id.*

⁵⁸ *Abraham Lincoln and Civil War Finance*, The Lehrman Institute (February 24, 2018)

<http://www.abrahamlincolnclassroom.org/abraham-lincoln-in-depth/abraham-lincoln-and-civil-war-finance/#epw> (Citing Jane Flaherty, *The Exhausted Condition of the Treasury on the Eve of the Civil War*, *Civil War History*, Vol. 66, No. 2, June 2009, p. 273).

write lengthy articles about the virtues of buying government bonds. Bonds could be bought in denominations as small as \$50 and paid for in installments.

These smaller investors were reached by appeals to their patriotism, and as Alexander Hamilton pointed out, owners of government bonds would have a deeper concern for the welfare of their country.⁵⁹ By the end of 1863, almost all the bonds were in the hands of individuals and with the 6% interest payable in gold, the bonds were a good hedge against inflation.⁶⁰

In all, Cooke sold bonds to about 5% of the Northern population, an astonishing figure when one considers that fewer than 1% of Americans had bank accounts at the time. The effect on Wall Street of this vast upsurge in the number of securities holders would be profound.⁶¹ By 1864, Cooke was selling war bonds so successfully that he was finally raising money about as fast as the War Department could spend it. In sum, the North raised about two-thirds of its revenue by selling bonds.⁶² Essentially the system of bonds enabled the other tactics of financing the war to be successful. The relationship between bonds and taxes is a cycle. It works because when the government issues bonds to people, the people expect to be paid back for the investment. The people feel secure with the investment because they know the government can tax later, and the government can use the tax to pay back the interest on the bonds.

Despite the success of the bond sales, if the nation was going to survive this lengthy and expensive war, a new and much greater source of income must be sought. The stability of these bonds set the foundation for the National Banking Acts.

C. FIXING A HOLE: GREENBACKS AND FEDERAL BANKS

The Union was still in desperate need of money. In 1862, the war was estimated to be costing \$1.5 million per day and “by the end of February[,] contractors were clamoring for a

⁵⁹ Myers, *supra* note 33.

⁶⁰ *Id.* at 162.

⁶¹ John Steele Gordon, *The High Cost of War*, BARRON'S (April 4, 2018) <https://www.barrons.com/articles/SB50001424052970203990104576191061207786514?tesla=y>.

⁶² JOHN STEELE GORDON, HAMILTON'S BLESSING: THE EXTRAORDINARY LIFE AND TIMES OF OUR NATIONAL DEBT 79 (1998).

payment of nearly \$27 million in outstanding requisitions.”⁶³ Lincoln knew that the Union needed money, but also recognized the need for a uniform convertible currency. The currency could not easily be counterfeited, unlike the currency of state banks, and its value must be reliable. Lincoln needed to act fast to make sure the Union would have enough money to continue fighting the war. If Lincoln failed to provide financing, the Union would fail to defend the North and the war as we know it could have had a much different ending.

Lincoln and Chase, along with some members of Congress, worked tirelessly to overtake the nation’s financial system and implement something more efficient. The main method in which a government can obtain funds via money “creation” is to resort to fiat money and cut loose from specie backing. This was done through greenbacks.

Although Lincoln and Chase were very wary of fiat money and its impact, this was a financial emergency, and the Treasury desperately needed money to pay suppliers and troops. Initially issuing \$150 million in the new fiat money, the Legal Tender Act of 1862 was passed. This act authorized the issuance of greenbacks and clarified that the notes qualified as legal tender.⁶⁴ The act stated that the new fiat money is a lawful and legal tender that can be used as payment or receivables of all debt, public and private, except interest on government bonds and customs duties.⁶⁵ So, essentially, this was now a valid form of currency on par with coin, gold, and silver. People continued to have a hard time adjusting to or validating whether this was constitutional or not. James M. McPherson wrote:

Three main factors explain the success of the Legal Tender Act: First, the underlying strength of the northern economy. Second: the fortuitous timing of the law. It went into effect during the months of Union military success in the spring of 1862, floating the greenbacks on a

⁶³ *Abraham Lincoln and Civil War Finance*, THE LEHRMAN INSTITUTE (February 24, 2018) <http://www.abrahamlincolnclassroom.org/abraham-lincoln-in-depth/abraham-lincoln-and-civil-war-finance/#epw>.

⁶⁴ Act of Feb. 25, 1862, ch. 33, §§3, 5, 12 Stat. 345, 346 (1962).

⁶⁵ *Id.*

buoyant mood of confidence in victory. The third reason was the enactment of a comprehensive tax law on July 1, 1862, which soaked up much of the inflationary pressure produced by the greenbacks.⁶⁶

During the war, people did not object and controversy over the greenbacks did not occur until several years after the war was over. The Constitution provides in Section 10 that states are restricted from making anything “but gold and silver Coin a Tender in Payment of Debts.”⁶⁷ The key word here being “states”; in a series of cases known as the Legal Tender Cases, the Supreme Court held that the acts were a proper exercise of Congress’ authority to coin money.⁶⁸

Obviously, a national banking system and a national currency go hand in hand, and with the creation of a new uniform legal tender, Lincoln used this opportunity to also revive a system of National Banking. The National Currency Act of 1863 “chartered national banks that met certain requirements, made the notes of national banks legal tender for all public and private debts, and levied a tax of 2% on state bank notes, which rate gradually increased over time.”⁶⁹ State banks were opposed to this and “by imposing a tax on state bank notes, the federal government forced state banks to join the federal system. By 1865 national banks had 83% of all bank assets in the United States.”⁷⁰ Historian Mark S. Joy noted that “the first National Banking Act represented one of the few times that Lincoln did much political arm-twisting on legislation. Lincoln apparently intervened with key Republican Congress members who opposed the bill, and they eventually fell into line.”⁷¹

⁶⁶ Leo Stahl, *Union Financing of the American Civil War*, (April 4, 2018) <https://www.scribd.com/document/353716152/Union-Financing-of-the-American-Civil-War> (citing James M. McPherson, *Battle Cry of Freedom* 447 (1988)).

⁶⁷ U.S. CONST. art. I, § 10, cl 1.

⁶⁸ Legal Tender Cases, 79 U.S. 457 (1870).

⁶⁹ Stahl, *supra* note 66 (citing David Brion Davis, *The Boisterous Sea of Liberty: A History of America from Discovery through the Civil War*, p. 527 (2000)).

⁷⁰ *Id.*

⁷¹ *Abraham Lincoln and Civil War Finance*, THE LEHRMAN INSTITUTE (February 24, 2018)

The main goal of this act was to create a single national currency and to eradicate the problem of notes from multiple banks circulating simultaneously and eliminate the mess of the system of state banks. The National Banking Act of 1863 was superseded by the National Banking Act of 1864.⁷² The amendments established the Office of the Comptroller of the Currency (OCC), which had a duty to assess the soundness of national banks through bank examinations. In December of 1864, Lincoln reported: "Changes from State systems to the national system are rapidly taking place, and it is hoped that very soon there will be in the United States no banks of issue not authorized by Congress, and no bank-note circulation not secured by the Government."⁷³ With its success, the National Banking Act was again extended on July 13, 1866, to increase the annual federal excise tax on state banknotes from 2% to 10%, to eliminate banknotes issued by state banks.⁷⁴

Veazie Bank v. Fenno challenged the constitutionality of § 9(2) of the Law of July 13, 1866, which imposed a 10% tax on currency issued by state banks.⁷⁵ In the end, the Court held that the law was constitutional because the tax was not a direct tax; thus, not requiring apportionment. Further, the Court held that the power to create a national currency allowed the Congress to tax, even oppressively, property, including franchises.⁷⁶ Despite its imperfections, this new national banking system was an important "weapon" in fighting the civil war and putting an end to the era of wild and free banking.

<http://www.abrahamlincolnsclassroom.org/abraham-lincoln-in-depth/abraham-lincoln-and-civil-war-finance/#epw> (citing Paul Finkelman and Martin J. Hershock, *The Political Lincoln: An Encyclopedia* 46 (Mark S. Joy, "Banking and Monetary Policy").

⁷² National Banking Act of 1864, ch. 106, 13 Stat. 99 (1864).

⁷³ 1864 December 17: Lincoln's 4th Annual Message to Congress, THE CIVIL WAR AND NORTHWEST WISCONSIN (April 4, 2018)

<https://thecivilwarandnorthwestwisconsin.wordpress.com/2014/12/21/1864-december-17-lincolns-4th-annual-message-to-congress/>.

⁷⁴ Law of July 13, 1866, 14 Stat. 146 (1866).

⁷⁵ *Veazie Bank v. Fenno*, 75 U.S. 533 (1869).

⁷⁶ *Id.* at 536.

V. HERE COMES THE SUN: THE END OF WAR AND FUTURE RAMIFICATIONS

The conclusion of the Civil War did not immediately end the dual monetary system, or keep the greenbacks, nor did the country want to keep the progressive income tax that was implemented. A multitude of cases were derived from the acts passed during Lincoln's administration. The Legal Tender Act was held unconstitutional in 1870 in *Hepburn v Griswold*, which, ironically, was authored by the former Secretary of the Treasury, Salmon P. Chase, who had become Chief Justice of the United States Supreme Court in 1864. It was only one year later that this decision was reversed in *Knox v. Lee and Parker v. Davis* and reaffirmed 13 years later in *Juilliard v. Greenman*.⁷⁷

These cases concluded that Congress' authorization of the use of greenbacks as the legal tender in all debts was a valid exercise of its power to coin money. Although eventually the specie backing slowly came back into play in the years to follow, it was not until Richard Nixon's administration when the U.S. officially went off the gold standard, in the wake of the Vietnam War. Lincoln's taxation act was also eventually struck down in 1895, and in *Pollock vs. Farmers' Loan and Trust Co.*, the Supreme Court held that income taxes were unconstitutional and an "unapportioned" direct tax.⁷⁸ In 1913, the Sixteenth Amendment to the Constitution was adopted, overruling *Pollock*, and Congress then levied an income tax on both corporate and individual incomes.⁷⁹ Since the adoption of the Sixteenth Amendment, the Bureau of Internal Revenue (BIR) was changed into the Internal Revenue Service. The Internal Revenue Service was given the power to enforce taxation law.

Abraham Lincoln pushed the exercise of federal power beyond anything that had been done before and shifted the relationship between state and federal government. Lincoln embraced the idea of the American experiment and used his position to give the federal government powers that, under any other circumstance, would have been opposed by the public. The Union financing was far more diversified and well thought out than the Confederacy. As stated by Historian Allan Nevins,

⁷⁷ Legal Tender Cases, 79 U.S. 457 (1870); *Juilliard v. Greenman*, 110 U.S. 421 (1884).

⁷⁸ *Pollock v. Farmers' Loan & Tr. Co.*, 157 U.S. 429 (1895).

⁷⁹ *Id.*

“the issuance of bonds, the National Banking Act, the Morrill tariff, the greenbacks issue, and such new revenue measures as the income tax acted as ‘weapons of war.’” Cooke’s success with the bond market was even revered when one Confederate official bemoaned, “The Yankees did not whip us in the field. We were whipped in the Treasury Department.”⁸⁰

Lincoln is quoted to have told the new Treasury Secretary, Hugh McCulloch, on the day he was assassinated, that “we must look to you, Mr. Secretary, for the money to pay off the soldiers” who were about to be relieved from military service.⁸¹ This was evidence that Lincoln had concerns over the financial status of the United States until the day he died.

⁸⁰ Tim Reuter, *Money Matters: Speculation, Democracy, And the Forgotten Politics of Monetary Policy*, FORBES (April 5, 2018) <https://www.forbes.com/sites/timreuter/2014/07/14/money-matters-speculation-democracy-and-the-forgotten-politics-of-monetary-policy/#5cc5d4755bb1>.

⁸¹ *Cabinet and Vice Presidents: Hugh McCulloch (1808-1895)*, Mr. Lincoln’s White House (April 5, 2018) <http://www.mrlincolnwhitehouse.org/residents-visitors/cabinet-vice-presidents/cabinet-vice-presidents-hugh-mcculloch-1808-1895/> (citing Hugh McCulloch, *Men and Measures of Half of a Century* 193).