War, the National Debt, Taxes, and the Creation of Money - National War Tax Resistance Coordinating Committee

17-22 minutes

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by Jay Sordean

War tax resisters are well aware of the relationship of taxes to war. Understanding the economics behind taxes and war can be simple or complex, depending upon the degree of analysis. The GDP/GNP; percentages of U.S. federal discretionary funds spent on military purposes; the history of national debt linked to funding wars; the creation and use of central banks; the history of the corporate and personal income taxes; tariffs, and other taxes are all components of the more complex analysis of how taxes are related to war. A couple of books I have been reading recently that shed some light on these and other issues are *Secrets of the Temple: How the Federal Reserve Runs the Country* by William Greider, *Hamilton's Blessing: The Extraordinary Life and Times of Our National Debt* by John Steele Gordon, and *The Creature from Jekyll Island: A Second Look at the Federal Reserve*, by G. Edward Griffin.

The comments in this article are based on information from these three books.

Government Spending, War, and the Debt

In the United States, the government spends money either in deficit or surplus. In recent times it has been deficit, whereas in the beginning almost 100 years of its existence the government was in surplus unless waging war, or in the throes of war, or for the years thereafter when it had debt to pay off. Debts also increased during times of economic crisis or when government decided to spend more for social (economic growth promotion) programs in addition to even greater spending on the military and taxing for economic engineering.

"The United States was born in debt. Wars have been fought with borrowed money at least since Rome instituted the practice." (Hamilton's). It is also wisely stated that "while individual battles may be decided by tactics, firepower, courage, and — of course — luck, victory goes to the side better able to turn the national wealth to military purposes… (and) that usually means the ability to borrow. (Hamilton's). In both peace and war, governments usually have only three ways to pay their bills: they can print, they can tax, and they can borrow. Central banks help carry out those roles. On the other hand, during the Civil War, both sides soon resorted to the quickest way for a sovereign state to obtain money: the printing press. And it was the inability of the South to collect or borrow enough money to sustain its efforts that ultimately was a significant factor in its loss.

The three main purposes to a central bank are 1) acting as a depository and distribution system for government funds, 2) as a source of loans to the government, and 3) regulating the money supply by controlling printing. The original banking system was based on a system where bank notes would be redeemable in gold and silver on demand and acceptable by the federal government in payment of taxes. The central bank, under Alexander Hamilton's concepts, was under private versus public direction — under the guidance of individual interest and not under public policy. Hamilton did not think politicians could be trusted with the power to print money; and to make sure the private owners of the bank didn't pursue private interests at public expense, he wanted the central bank's charter to require that its notes be redeemable in specie (i.e., gold or silver).

Historically, there have been several contentious, fundamental issues related to banking and money. Jefferson had a deep or visceral hatred of banks; both he and Andrew Jackson believed in dispersing power away from those at the top of society and toward the ordinary people. They also believed that paper money was a fraud. They said that specie was the way to control money. On the other hand, it is also said that no country on the gold standard can fight a great war for very long. There are people today who identify with this hatred of banks, and the fact that the Constitution nowhere specifically authorizes establishment of a central bank has led to a line of reasoning that is called “strict construction.” Thus, this issue of a specie (gold or silver) backing for money and distrust of fiat money has always been a contentious debate among the learned.

The use of a central bank has been contentious as well in some circles. In the U.S., the central bank is “the government’s principal mechanism for collecting internal revenue and its only one for raising loans” (Hamilton’s). Thus, sentiment for or against war can have a strong influence on the success of a central bank in raising funds for the war effort. For example, during the War of 1812 the sentiment against the war was strongest in those port cities (namely, Philadelphia, New York, and Boston) whose richest citizens were best able to loan money to the government. Interestingly, it can also be said that “one of the natural principles of taxation… is that the people willingly pay very high taxes during wartime.” (Hamilton’s)

How is money created?

Since the beginning, banks issued their own notes and loans based on federal loans / notes (bonds, etc.) — as well as sometimes the gold on deposit — which the banks held in their vaults. Now we have something called dollars.

What is Money?

Just what is that “green” paper we carry around and use to buy goods and services, take for payment for our labor, and may even use to pay taxes with? It seems important to realize, given that war tax resisters pay taxes with various forms of paper — including “cash,” that no one usually thinks about exactly what this green paper is. So, what is the title on this paper? “Federal Reserve Note.” Exactly what does Federal Reserve Note (FRN) mean? Let’s look at its meaning by breaking down the words and defining them.

What is a “note?”

A note is a promise to pay and it indicates that a debt exists. For example, in the past, a bank note indicated that you had deposited gold in the bank and thus they owed you that gold when you brought in the note to exchange.

What does “Federal Reserve” mean?

In order to understand the words one must realize that “Federal Reserve” refers to the Federal Reserve Bank and Federal Reserve system.

Now let’s put it all together, “Federal Reserve” and “Note.” So a FRN is a promise by the Federal Reserve Bank to pay you (the bearer of the FRN) money if you turn in an FRN. “But isn’t a FRN ‘money’ already?” you might ask. Well, nobody said this topic was simple. The definition of “money”, according to Black’s Law Dictionary is “the medium of exchange authorized or adopted by a government as part of its currency [coins and currency are money].” Other relevant definitions under money are “paper money” and “fiat money.” Paper money is “paper documents that circulate as currency; bills drawn by a government against its own credit.” Fiat money is “paper currency not backed by gold or silver.” Thus, FRNs are both fiat money and paper money. And because the FRNs are not backed by gold or silver, there is theoretically no limit as to the amount of them that could be produced and circulated in the economy. As they say, they are backed by the “full faith and credit of the U.S. government” and not by gold or silver or some other precious metal or commodity. And as resisters know, the FRNs can be used to pay taxes, putting them also in the category of “lawful money,” “money that is legal tender for the payments of debts.” “When governments issue fiat money, they always declare it to be legal tender under pain of fine or imprisonment. The only way a government can exchange its worthless paper money for tangible goods and services is to give its citizens no choice.” (Creature) Legal tender simply means that there is a law requiring everyone to accept the currency in commerce.

The Federal Reserve

What is the Federal Reserve? It is a central bank and a private banking cartel. Its books are not open to the public, nor does it pay taxes on any interest it makes. How it works and its history are explained in a variety of books, like the ones mentioned in the first paragraph.

According to *Hamilton’s Blessing*, at the beginning of the United States of America, Alexander Hamilton promoted the idea of having a central bank. Hamilton observed that governments had a history of printing more money than they could support. This was also the case of colonial governments. Thus he suggested, and it was decided after considerable debate by the young Congress, that a central bank be chartered and that it be a private bank. Thus, in 1791 the first central bank, called the Bank of the United States, was chartered for 20 years. However, the current Federal Reserve (Banks & System) began in 1913 and has persisted since.

National Debt and Its Relationship to War

WTRs know that the national debt is largely due to war. This is not just idle speculation or propaganda on the part of war tax resisters. Various books on economics and the national debt have documented this phenomenon very solidly. In *Hamilton’s Blessing* there is a description of the national debt of the United States and how it has been created, managed, and controlled in various ways, including a very relevant history of the Federal Reserve (bank(s) and system) controlling the monetary policy in the United States. It was the debt from the Revolutionary war that prompted the creation of the Bank of the United States in the first place. A primary purpose of that bank was to help retire the national debt due to the war. The bank was created to raise the revenues needed to retire the war debt and to help finance the federal government’s future need for credit.

During the Revolutionary war, the confederation of states, and the colonial states or commonwealths themselves, paid for weapons and soldiers to fight. They didn’t have enough gold or silvers in their coffers, so they had to borrow money. This put the colonial governments in debt to investors and creditors. At the same time, the weapon makers made money on the sales. The creditors (buyers of debt paper, ie. IOUs) are paid interest on their loans by the people who pay off the government’s debt by their labor. In short, taxpayers pay off the debt while those who purchase debt paper (they invest in the government’s promise to pay) and sell weapons make a lot of money off war. This is the way it has always been in the history of war making. The “spoils of war” and plundering are also ways that assets are acquired by governments to pay off or avoid greater debt.

It is interesting to note that by even as early as 1801 Europeans held $33 million worth of United States notes. Foreign investment in the United States has always been important for its survival and prosperity. At any rate, the first Bank of the United States lost its charter in 1811. The Second Bank of the United States was chartered on April 10, 1816 and its charter expired in 1836. Between 1836 and 1913 there was no central bank.

The Income Tax is Born

The Bureau of Internal Revenue was created in 1862 under Lincoln. It was the “ancestor” of the IRS. The income tax originated in 1862 to fund the Civil War. This wartime income tax was allowed to expire in 1872. At the time of the Civil War, the income tax was 3% on income between $600 — $10,000 and 5% above $10,000. The United States was the first country to tax its nationals living abroad and it remains to this day virtually the only one to do so. The War Department of Lincoln was using so much money that another way of raising revenue was created — the war bond drive. It was very successful (and set the tone for the same type of campaigns in future wars). On the other hand, the South did not have the capital resources available to the North. The North had northern banks to help bankroll the war effort while the South had only about 40% of the North’s ability to borrow. Needless to say, the South didn’t prevail.

By 1866, the first year of peace following the Civil War, the national debt stood at more than 42 times what it had been in 1860. War sure can be expensive! But, by the turn of the century the Civil War had been largely paid for. While the people were willing to endure very high taxes during the war, peacetime was another matter altogether (Hamilton's; p 81) and income taxes, as well as the excise taxes in the North were being challenged.

Gold and Currency

An interesting issue came up during the Civil War regarding money. By December 1861 the northern banks stopped paying their debts with gold and the federal government had to go off the gold standard as well a few days later. The gold standard was something thought to be responsible for the great growth in world trade in the 1800s. But "the great disadvantage…is that no country on the gold standard can fight a great war for very long. Traders will always prefer the certainty of gold to the inherent uncertainty of the currency of a country at war and quickly drain the country of its gold supply." (*Hamilton's Blessing*, p.71) So, given the circumstances, Congress authorized the Treasury to issue "greenbacks," as the new paper money was called. Of course, this was fiat money because it was no longer backed by gold or silver. This is also why the FRNs are called "green."

The federal government has a budget and spends money. If it decides to spend more than it takes in, that is called deficit spending; the government thus decides to go into debt and must sell its debt paper to someone. It is the Federal Reserve-through its Open Market Desk, with its affiliated commercial banks and brokers, that markets the debt paper. The Fed takes all the government bonds which the public doesn't buy and writes a check to Congress in exchange for them…the money created for the bonds is spent by the government, and these bonds become reserves that the Fed can loan out, with 9 new dollars created from 1 dollar worth of bonds. This expansion of federal government debt increases the monetary aggregate (the M1, M2, and M3) — the amount of money in the system. This money aggregate is something the Federal Reserve controls and tries to track carefully. So, this is how that money is created; in fact, it is made out of thin air. Or perhaps it is more accurate to say that money is created out of debt-but instantly at the moment the debt is incurred. Like Monopoly money, fiat money is only worth as much as people are willing to value/trust it during the game (of commerce).

Money is Cheap

Let's say a commercial bank loans a business $100,000. That loan (a note) becomes the basis for a $100,000 entry in the savings account of the business or the writing of a check for $100,000. Either way, money has been created by the simple entry in a ledger. The creation of money is really based on bank created debt. New money is created not only by the sale of government debt paper but also by loans from commercial banks. The businesses that do this are the Federal Reserve and private commercial banks (that are chartered by the Federal Reserve). Credit is what creates an expansion of the supply of money. And the printing presses are used to print the paper money (FRNs) that publicly indicate that the money in savings or checking accounts were created by a loan. This creation of money out of thin air has the aura of something mystical: hence, the use of the word "temple" in the title of the book *Secrets of the Temple*.

Furthermore, "wars are seldom funded out of the existing treasury, nor are they even done so out of increased taxes. If governments were to levy taxes on their citizens fully adequate to finance the conflict, the amount would be so great that many of even its most ardent supporters would lose enthusiasm. By artificially increasing the money supply, however, the true cost is hidden from view." (*Creature from Jekyll Island*, pp. 160–161). For example, the total money supply from 1775 to the end of 1779 expanded by an estimated 5,000%. The paper Continentals were traded for one dollar in gold in 1775 but were worth less than a penny in 1779, thus the well known phrase "not worth a Continental." That is also called hyperinflation.

In Summary

Resisters know that the national debt has its origins in the Revolutionary War and every other war since then. At the end of each war there has been a huge surge in the national debt level due to borrowing funds to fight war and due to printing of paper money. Nowadays, it is the military industrial complex that is a big winner in wars. The government borrows money and has the Federal Reserve print (fiat) paper money (or even more accurately stated, modern money is on-off silicon switches in a computerized banking system) which is transferred into the hands of the weapons industry. The Federal Reserve also sells U.S. government debt paper. The fiat money is actually a token expression of the debt that the U.S. owes to the Federal Reserve and those who own treasury bonds, notes, and bills. The Federal Reserve Bank, its shareholders, and member banks make money on the loans / notes that they issue as a result of creating money out of thin air. The Federal Reserve Bank doesn’t pay taxes on any interest it makes on the loans. Strange world of money isn’t it?

Resisters view the telephone tax historically as associated with the funding for the Vietnam War. This is why it is a target of resistance. Interesting to note also is that the personal income tax was created by Lincoln to fund the Civil War. It was reinstated in 1913 to pay for World War I. Because it has always been used to pay for war, like the telephone tax, one might just as correctly call the personal income tax intrinsically a war tax.

This concept of the personal income tax being a war tax is above and beyond the usual thought in WTR circles that somewhere around 50% of federal discretionary funds go to war related activities and thus at least 50% of your income taxes go to those activities.

After the Civil war, the income tax was retired in 1872, only to be reinstated by the 16th constitutional amendment declared to be adopted February 3, 1913. In 1913, there was an exemption for income under $3,000 — 98% of American families were exempt. Other exemptions to income tax instituted at that time included the proceeds of life insurance policies. One year later World War I began and “government revenues and outlays moved to a new, permanently higher plane as they have after every great war in U.S. history.” (*Hamilton’s Blessing*; p. 103). The Federal Reserve, as you recall, was created in 1913 as well. It is a private banking cartel. The national government possessed the unique power to create credit and money, yet it delegated the power to a select group of private corporations that were licensed as commercial banks.

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