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Repudiation!

The Crisis of United States Civil War Debt, 1865–1870

By Franklin Noll

It was a time of unprecedented debt, of fears of austerity and of an unsettled currency system. It was 1865.

Emerging from four years of Civil War, the United States was faced with the task of reconstructing its political and economic systems. As part of this endeavor, from 1865 to 1870, much of the country's focus was on the massive public debt created during the conflict. Congress went so far as to pass a constitutional amendment that read in part, "The validity of the public debt of the United States … shall not be questioned."

Why was it necessary for the US Congress to alter the founding document of the nation to secure the public debt from repudiation? One might expect that in this time of upheaval the crisis was a financial one: the government, facing default, strove to force politics aside to resolve the situation. As it turns out, the opposite was true. The US was in no jeopardy of default, and the Constitution was amended to force politics into the economic equation for political ends.

The Civil War debt crisis actually consisted of three interrelated crises: a repudiation crisis, a repayment crisis and a refunding crisis. At the basis of all three was the battle for political advantage in the postwar United States. The Republican and Democratic Parties took concerns over the public debt and magnified them into crises. The resolution of the debt crises came only when there was no more to be gained from using the issue of the public debt for political advantage.

Secretary of the Treasury Hugh McCulloch successfully converted the nation's short-term debt into 6%, 20-year bonds by the end of 1867, averting a potential run on the Treasury.

What Crisis?

In the years 1865 to 1870, the ability of the US to pay its wartime debt never came into question despite its enormous size. The debt accumulated by the Union was unprecedented. During the war, the debt became 41 times larger than it was in 1860. The debt's peak was reached on August 31, 1865, with an outstanding balance of $2.8 billion. Not only was size a problem, but also the structure of the debt was far from desirable. The greenbacks, counted as part of the debt, fluctuated in value and saturated the money market. Meanwhile, short-term debt made up 48% of the total. This led to concerns that the Treasury could be caught short of cash as the instruments came due.

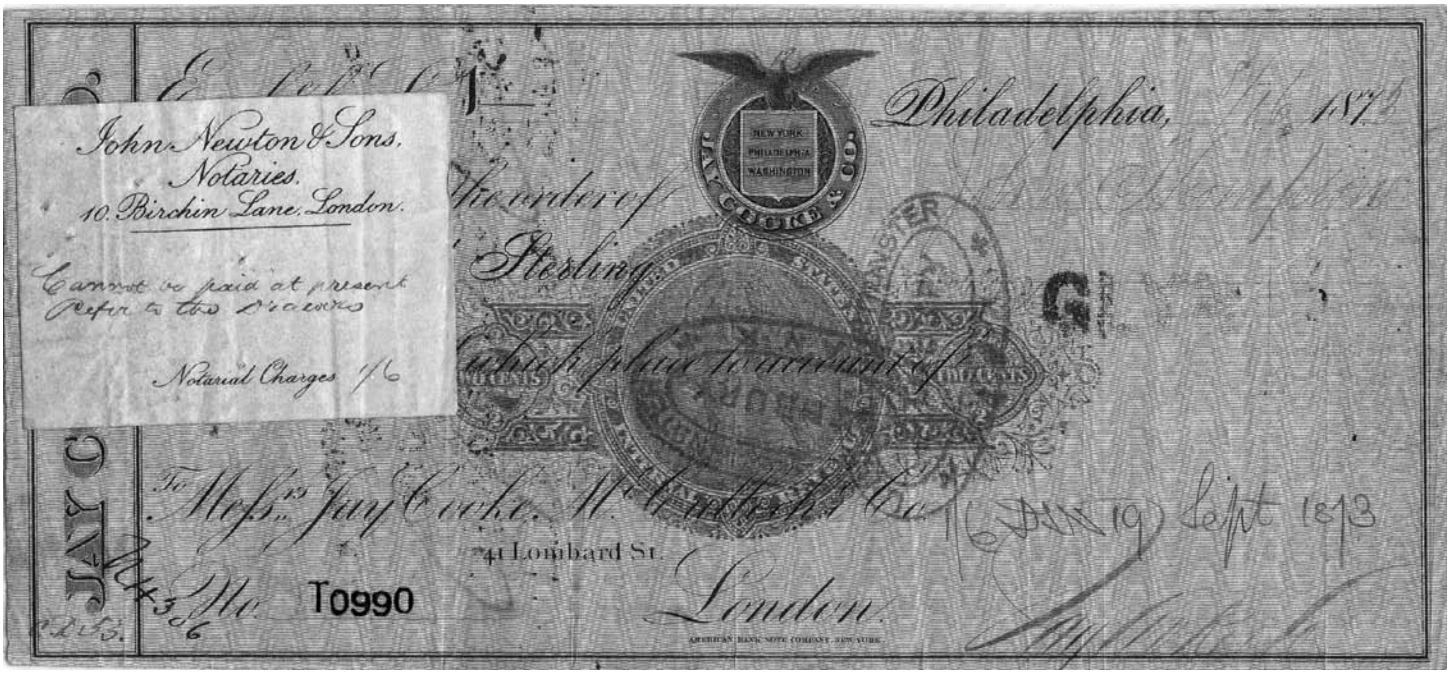
Despite these concerns, there was no panic that the country would be unable to meet its financial obligations. The US economy — at least in the North — was essentially sound, and the tax system was "Spartan."[1] The people of the North also manifested a great impatience at the thought of indebtedness, and there was little actual pressure placed on Congress for tax reform. As a result, surpluses for the postwar years ranged from $927,000 to $116 million after making debt payments.

So, given the popular will for repaying the debt, the means to do so and the actual reduction of the debt almost annually, where was the crisis over the debt? In light of these facts, it seems there was no financial or economic crisis. Perhaps the crisis was one of confidence. Perhaps the question during the postwar years was not whether the debt *could* be paid, but whether it *should* be repaid — and, if so, how? Should it be paid in full? Who would bear the cost, and who would benefit? What happened to the public debt was an issue of profound importance to almost everyone dwelling in the North, not only because of the popular dread of indebtedness, but also because the debt itself was sacred.

The Sacred Debt

The economic magnitude of the public debt after the war was unprecedented, and so was the place it held in the popular psyche. The Civil War debt held a huge political charge in postwar America. This stemmed from the popular distribution of the debt and the way in which it was marketed.

Probably not since the Revolutionary War had so much of the public debt been held by the general public rather than financial institutions. The widespread distribution of US debt instruments resulted mainly from the Treasury's new dependence on popular support for its issues. Secretary of the Treasury Salmon P. Chase's financial inexperience led to numerous missteps in financing the war that earned him the distrust and hatred of the bankers and financiers of the major US markets. As a way to escape this situation, Chase turned to the idea of a popular loan, selling hundreds of millions of dollars worth.



Collection of the Museum of American Finance

Check drawn on Jay Cooke's bank. Cooke acted as an agent for the US Treasury and sold millions of dollars' worth of government bonds to small, novice investors.

Most of these sales were conducted by the banker Jay Cooke as an agent for the Treasury. He focused on the small, novice investor. To win over these largely middle class buyers, his company advertised widely, laying out the financial benefit and patriotic significance of purchasing government bonds. Through these sales drives, the wartime debt became inextricably entwined with the patriotism and moral purpose of the Civil War. "Most … viewed the sanctity of the national debt as a moral legacy of the war second only to emancipation itself."[2]

However, there were fears that the need to pay the debt would lead to an austerity program that would increase taxes and throw people out of work. Following this train of thought, usually championed by the Democratic Party, the public debt was portrayed as a threat to the nation, particularly the lower classes. Taxation to pay for the debt, it was argued, would lead to an increasingly permanent and powerful class that derived its riches from government bonds, known as the "bondocracy."

Thus, at the end of the Civil War, the stage was set. There was a debt of unprecedented size and complexity, with much of it quickly coming due for payment. Much of this debt was held by a large number of middle class northern voters, many of them novice investors who saw the debt as a sacred legacy and feared for its safety. Yet, there were many from the lower classes who did not hold bonds and felt crushed by the heavy, regressive tax system used to pay the debt. These fears were expressed and exploited by the political parties of the postwar period in their struggle for power.

The Repudiation Crisis

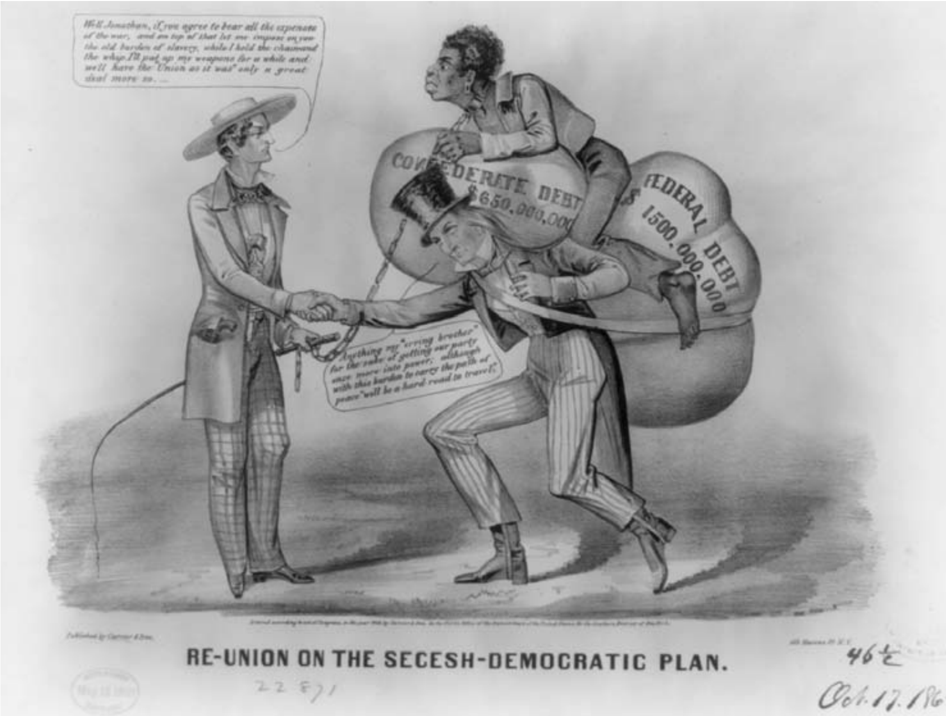
The repudiation crisis was the fear that a politically resurgent South, represented by the Democratic Party, would force the government to repudiate the Union debt or force the repayment of the Confederate debt. Efforts to secure the repudiation of the latter began during the Civil War, but without success. After the war, President Andrew Johnson made it clear to a number of southern governors that they had to repudiate the Confederate debt as a condition to readmission to the US, but they balked at the idea, leaving matters unsettled.

There was also anxiety over the security of the nation's public debt. Representative Henry Winter Davis wrote, "None of the white population of the Southern States is interested in paying the public debt…. If the whites [Democrats] be restored to political power, their representatives are interested in repudiating that public debt."[3] The financial markets were nervous to the point that *The New York Times* had to repeatedly assure readers that the public debt was in no danger.

In May 1866, all the fears of repudiation were brought together into clause four of the Fourteenth Amendment. It provided for the security of the public debt of the United States and repudiated the debt of the former Confederate States of America. However, section four was also widely seen as a political move to bolster the chances of passage of the entire amendment that included civil rights for former slaves and other controversial elements.

The *New York Herald* summed things up, saying: "Herein lies the secret of the astounding popular strength of [the 14th Amendment's debt clause] … No man who has a fifty dollar government bond salted down would trust its redemption to [a Southern, Democratic Congressman]."[4] Indeed, the threat of repudiation was seen as a vital political weapon by the Republican Party, which began to identify the Democrats with repudiation of the public debt.

The Congressional elections of 1866 resulted in a resounding success for the Republicans, thanks, in part, to the panic they started over a possible Democratic repudiation of the debt. The Republican victory also assured the ultimate ratification of the 14th Amendment and the end to any legitimate fear of the assumption of the Confederate debt or the outright



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President of the Confederacy Jefferson Davis confronts Brother Jonathan, who stumbles under the enormous burden of a bundle marked "Confederate Debt $650,000,000" and "Federal Debt $1,500,000,000" and is further weighed down by the figure of a black man in chains. Currier & Ives cartoon published in 1862.

repudiation of the Union war debt. However, the Republican Party continued to use the fear of repudiation to combat the Democrats.

The Repayment Crisis

The repayment crisis was the battle over whether a significant part of the public debt would be paid in gold or in greenbacks. During the war, the country went off the gold standard and issued its first fiat currency, the United States note, popularly known as the greenback. By the end of the war, greenbacks were trading at a discount to gold, and some advocated paying off the public debt in the devalued currency.

Greenbacks were originally meant to be a temporary measure. The country, it was believed, would return to the gold standard immediately after the war. Working under this assumption, when writing wartime legislation authorizing loans, Congress did not always take the trouble to explicitly state in what form of currency the principal of the loan would be payable. This was the case with the Five-Twenties, which totaled $606 million, or over 27% of the public debt.

This lack of specificity came back to haunt the Treasury after the war when the repayment of the public debt became a controversial issue. On July 11, 1867, George Pendleton of Ohio, former Democratic candidate for vice president in 1864, gave a speech in which he proclaimed that it was only just that the debt be paid off using the devalued government currency the Republicans created. This position was dubbed the "Ohio Idea" by the popular press and used as a weapon by the Democratic Party in the 1868 presidential election. Republicans counterattacked by equating greenback repayment with repudiation.

With Ulysses S. Grant as its candidate, the Republican Party defeated the Democrats in the autumn elections. However, the outgoing Democratic President, Andrew Johnson, struck back in his annual message in which he called for a repudiation of the debt. Expanding upon Democratic Party rhetoric, he warned that the debt would lead to a new form of slavery wherein "The lenders [would become] the masters of the people." The solution to these injustices was to quickly pay off the debt by making interest payments not to the bondholders but to the Treasury to retire the debt. He concluded, "The lessons of the past admonish the lender that it is not well to be over anxious in exacting from the borrower rigid compliance with the letter of the bond."[5]

A week later, Grant was inaugurated as President. In his inauguration speech, he made clear that all talk of the "Ohio Idea" was over. Grant called Congress back into session, and the legislation needed to pay all bonds in gold was signed into law.

The Refunding Crisis

The refunding crisis was the pressing need to reorganize the debt's chaotic collection of high-interest securities, many of which were becoming payable. In fact, almost half of the debt would become payable by 1870. And, given all the debt that was subject to redemption by the holder on demand ($582 million or 22% of the public debt), there was a chance that the Treasury could be caught short of the funds necessary to meet the demand.

Secretary of the Treasury Hugh McCulloch believed all that could be done in terms of refunding was to consolidate maturing and short-term securities into long-run bonds at the high rates demanded by the market. By December 1867, McCulloch had successfully converted basically all of the debt payable on demand or short notice into 6%, 20-year bonds, averting a potential run on the Treasury. This achievement passed unnoticed as George Pendleton was touring the country at the time promoting the "Ohio Idea."

At the same time, Republican Senator John Sherman sought to force holders of Five-Twenties, paying 6%, to accept a 5% bond payable in gold. He thought this would be more attractive than the alternative, repayment in greenbacks. The bill passed Congress but fell victim to a veto by President Johnson.

This was not a surprise. Basically, no important legislation, especially any dealing with the public debt, would become law as the 1868 elections had appeared on the horizon. Any reordering or refunding of the debt threatened the basis of the Democratic electioneering issue of greenback repayment. So, it was in the interest of Democratic Congressmen and the Democratic President to create as much gridlock as possible in the run up to the 1868 elections.

It was only after the Republican victories in 1868 that attention could again be focused on refunding the debt at a lower rate of interest. The Democratic gridlock was broken, and the Republicans seemed in a rush to » *continued on page 39*

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permanently put the whole matter of the debt to rest. There was no more political advantage to be gained from a crisis surrounding the debt for the Republicans. In fact, with the popularity of the "Ohio Idea," the debt crisis had almost been successfully turned against them by the Democrats, causing panic in the Republican ranks. It was time for the Republicans to move on, and quickly.

Grant's Secretary of the Treasury was George S. Boutwell. His ideas on refunding were embodied in a law passed on July 14, 1870. The act authorized the Secretary, at his discretion, to issue $500 million in 10-year bonds at 5%, $300 million in 15-year bonds at 4.5% and $1 billion in 30-year bonds at 4%. These bonds were to be paid in gold. And, though it would take years for the total refunding to be accomplished, the 1870 act closed the book on the repayment crisis and the refunding crisis.

After 1870, the public debt receded from the public's attention. It continued to be reduced, as it had for years prior. It continued to be restructured, as it had since 1866. Taxes were collected and interest payments made as they had since the end of the Civil War. Repayment and management of the public debt remained on its established, dreary, steady course. Yet there was no longer a debt crisis. Where had it gone?

The debt crisis ceased to exist because there was no longer a political need for it. The Republicans had exploited anxiety over the public debt for its full worth, whipping up potential threats to the sacred debt into panics and crises for political gain. The party then hastily smothered the fire it created when it threatened to be successfully used against them by the Democrats.

The Democrats, in turn, had played up to lower class fear and resentment by creating the "Ohio Idea" of paying off the debt in devalued currency and using it to attack the Republicans. They also delayed Republican refunding efforts by causing Congressional gridlock in the run up to the 1868 elections.

Ultimately, it was not the unprecedented dollar amount of the public debt that created a debt crisis after the Civil War, but the public debt's unprecedented symbolic importance to the American people. **$**

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Notes

1. Sharkey, Robert P. *Money, Class, and Party: An Economic Study of Civil War and Reconstruction.* Baltimore, MD: The Johns Hopkins Press, 1959. Pg. 54.
2. Foner, Eric. *Reconstruction: America's Unfinished Revolution, 1863–1877,* 1st Perennial Classics ed. New York: Harper Collins, 2002. Pg. 311.
3. Beale, Howard K. *The Critical Year: A Study of Andrew Johnson and Reconstruction,* reprint 1930 ed. New York: Frederick Ungar Publishing Co., 1958. Pgs. 333–34.
4. Beale, pg. 334.
5. McPherson, Edward. *The Political History of the United States of America during the Period of Reconstruction,* 2d ed. Washington, DC: Solomons & Chapman, 1875. Pgs. 386–88.

HOW MUCH DO YOU KNOW ABOUT FINANCIAL HISTORY?

TRIVIA QUIZ

By Bob Shabazian

1. What do super storm Sandy and the historic stock market crash of 1929 have in common?

2. What four financial institutions merged in 1949 to form the Midwest Stock Exchange?

3. Three of the five worst days in the history of the S&P 500 Index occurred on what day of the week?

4. What did the Currency Act of 1900 do?

5. President Franklin D. Roosevelt named Joseph P. Kennedy to head what government agency?

6. Karen N. Horn was the first woman to serve as president of a Federal Reserve Bank. In which district did she serve?

7. What was the first railroad to trade on the New York Stock and Exchange Board (later renamed the NYSE)?

8. When and where did organized options trading begin in the United States?

9. What publicly-traded utility company has paid a common stock dividend for more than 100 consecutive years?

10. Who was Benjamin Strong, Jr.?

1. Both occurred in the last week of October. **2.** The Chicago Stock Exchange, the Minneapolis-St. Paul Stock Exchange, the Cleveland Stock Exchange and the St. Louis Stock Exchange. **3.** Monday. **4.** It put the United States on the Gold Standard. **5.** The Securities and Exchange Commission. **6.** Cleveland. She served as president from 1982–1987. **7.** The Mohawk and Hudson. **8.** In 1973, with the opening of the Chicago Board Options Exchange (CBOE). **9.** Public Service Electric & Gas Company (PSE&G). **10.** First governor (title later changed to president) of the Federal Reserve Bank of New York.