The Revolution of 1913
Guest: Tom DiLorenzo
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WOODS: As 2013 slips away, so do our opportunities to reflect on the centenary of three hideous institutions: the Federal Reserve system, the income tax, and the direct election of senators, all of which we date back to the momentous year 1913.

You gave a talk at the Mises Institute one year on what you called the Revolution of 1913, and I thought that would make a good topic. As here we are in November 2013, we can look back on a hundred years of glorious revolution and talk about what the consequences have been. So let's go one at a time.

I think the one that would be most obvious for people—for a lot of people it's not so obvious what the Federal Reserve does or why the direct election of senators really matters—but the income tax, more or less, everybody feels the pinch of that. So let's start there. Where did that come from? Why was there pressure to have an income tax? Weren't people happy being relatively lightly taxed?

DILORENZO: The first federal income tax was during the War to Prevent Southern independence, as I call it, during the Lincoln administration. Then that was ended in 1872. But I think it gave the statists sort of a taste of what could be. They kind of liked having this big, giant pot of money. Even though the war was over in 1865, still, for another six or seven years, they had all that income tax revenue to play with and to buy votes with.

Periodically, I think there were dozens of attempts to resurrect the income tax. We almost did get it during the Grover Cleveland years in the 1880s, but then we finally got it in 1913, the fateful year.

One of the important contributing factors was that the high protectionist tariffs that were the policy of the Republican Party from the Lincoln administration all the way up until 1913 really disproportionally harmed farmers more than anybody. Everybody had to pay higher prices for things that these tariff taxes are imposed on. But at the same time, what a tariff does, which is basically a sales tax on imports, is it impoverishes our trading partners.

So if people from England cannot sell things in America, then they do not have the dollars with which to buy things from Americans. And what were they buying from Americans? Mostly food, mostly agricultural products. So farmers are always hit twice by protectionism—once when they have to pay the same high prices for clothing and things that we all have to pay higher prices for, and again when their business dries up, their farm business overseas.

In the late nineteenth century, their overseas business in the southern states was about 60 to 70 percent of their whole business, and so the farm bloc, the farmers in this country, became an important voting bloc for income tax because they were promised, "We will take the pressure off you. We will reduce the tariff rate, if you, the farmers, organize support for an income tax." Which they did. We were still very much more an agricultural economy than we are today, so there were a lot of votes and a lot of money involved in the farm vote.

Then, of course, they baited and switched them right after we got the income tax. The Fordney-McCumber Tariff came in, several years later, and increased the tariff rate back up from around 20 percent or 22 percent to I think it was 39 percent. Then by 1930, we had the Smoot-Hawley Tariff, which is almost 60 percent on average. So we ended up with extremely high income tax rates after World War I, and a high tariff rate again.

WOODS: Well, in a way, not that I would support any tax, but, I almost feel like saying they got what they deserved. In supporting the income tax, they weren't supporting a tax that they themselves ever expected to be paying. They imagined that some other schmuck who was richer than they were was going to be fleeced, and they'd be off the hook. So, in a certain poetic justice kind of sense, they got what they deserved, but nobody deserves a tax, I suppose.

But what is it about the income tax that makes it any worse than any other kind of tax? Aren't all taxes oppressive? Is there something uniquely bad about the income tax?

DILORENZO: Well, it punishes work, for one thing. It's a tax on work effort and saving and investing, for one thing. And then also, the income tax, since it's so pervasive on everybody who earns income, it gives the government so much money.

I have a whole chapter on the Revolution of 1913 in my book *Hamilton's Curse*, and I quoted some of the Old Right authors who were writing at the time. Felix Morley, for example.

They made the point that, during the Lincoln administration, even though he had a sort of a primitive income tax, and they had conscription, the government still did not have enough money really to enforce conscription very well. But once they got the federal income tax in 1913, and the draft for World War I, well then you could enforce conscription. You had the means to hire thousands, or tens of thousands, of conscription police to go and hunt down people who might try to avoid it. That's one of the insidious things about the income tax.

Also, it led to a tremendous centralization of power in Washington, D.C. The original constitution of America did not give any tax power to the federal government at all, income or anything else. The states raised all the tax money. The income tax did exactly the opposite. It was sort of one of the final nails in the coffin of limited, decentralized government in the Jeffersonian tradition, because it gave the government all that money. Combine that with the Fed, and that's how they financed the entry into World War I.

WOODS: So the consequences of the income tax, then, are not hard, I think, for the average person to get. But I think it is harder for people to understand why the Seventeenth Amendment, which involved the direct election of senators, should matter to us.

So first of all, how did senators used to be elected? And what difference does it make that they changed the manner of electing senators with the Seventeenth Amendment?

DILORENZO: Under the original Constitution, United States senators were appointed by state legislatures. The purpose of that was so that the people back home, whom they were supposed to represent, would have at least some sort of control over their behavior. The founders understood the danger of a senator going to the nation's capital, and then being influenced by lobbyists, rather than by the people back home. This is long before the word "lobbyist" even existed.

For example, when Andrew Jackson confronted the Bank of the United States—and he eventually defunded the Bank of the United States, which was a precursor of the Fed—there were seven senators, who were appointed by their legislatures, who went to Washington under the promise that they would support Andrew Jackson, and oppose the Bank of the United States. But then once they got to Washington, they were easily bribed and bought off by the Bank of the United States. They were all recalled by their legislators back home and fired. There was none of this waiting for five and half years until the next senatorial election, or anything like that. They were fired—forced to resign, is actually what happened. And that was the idea. That's why it was important to have senators appointed by the state legislatures.

It wasn't a perfect system, of course. All politics is corrupt. But when we adopted the Seventeenth Amendment in 1913, that led to the direct election of senators. That created the system we have now where they can go and raise money—the senator from Kansas can go to China and raise money from Chinese businessmen to finance his reelection campaign, or anywhere on the planet, for that matter. That's exactly what the Founding Fathers feared, and that's exactly what has happened.

WOODS: But let's take a concrete example, like your state of Maryland, where you live. Would it really make much of a difference if the legislators of Maryland chose the senators, as opposed to the voters in Maryland at large? I mean, wouldn't they be equally crummy?

DILORENZO: Equally crummy. Yeah. Well, Tom, I think the main argument that the Founders made was that it would be convenient for the legislators to simply fire a senator on the spot. "You reneged on your promise to support Andrew Jackson. You're out of here. We're going to send somebody else." Whereas, if you have to rely on direct elections, you know, we have the election laws. You have to wait for five years for the next election, and in that time, the misbehaving senator could raise tons of money from all his lobbyist special-interest supporters to defeat the thing and keep his job. I don't know if the Founders ever made that particular argument, but I think that's the sort of thing they had in mind.

WOODS: Do you think the Seventeenth Amendment was introduced because the elites in the United States were deeply concerned that democracy was being thwarted under the old system?

DILORENZO: Yeah, that was the basic argument. The god of democracy needed to be supported. And there was a crusade that lasted for decades to do this. From my reading of the history, there were attempts to have direct election of senators for many decades prior to 1913. Of course, this was the Progressive Era. Under the Progressive Era, democracy became a god, with a small "g," and that sort of held the day, and that's how we got it.

WOODS: Well, the third of these ingredients is maybe the most important, because it's the least understood, and the least talked about, and that's the Federal Reserve System.

When I was in school, we didn't learn anything about the Federal Reserve System. It wasn't even mentioned. Of course, in an economics course, even in college, you'll learn about it, but only in a technical sense: Here's how it works. Here's what it does. Here's why we need it. Never a really dispassionate overview or analysis.

So when the Fed was created in 1913—here I am trying to find some evidence that our overlords are just looking out for what's good for us—is there any evidence that there was any attempt on the part of policymakers or bankers to try to foster the common good by giving us a stable currency that would be overseen by a central bank, and so on?

DILORENZO: No. You know that's another one of the curses of the Progressive Era, this idea that government regulation is in the public interest.

The founding generation, of course, would be horrified that this is sort of a widely accepted idea, that government acts in the public interest. We went from James Madison's warning that men are not angels—that's why we needed a constitution, because angels would never be in charge of government—to this idea that, "Yeah, men are angels, if they're in politics, and so they serve the public interests."

I guess if you repeat that enough in the schools and in the culture, you get a majority of the people to believe in that line, you can get away with all these things. But, you know, there's a long history of research in economics on what's called the capture theory of regulation, and it's an understanding that regulatory agencies that were created in the early twentieth century with very few—if any—exceptions, are all basically either lobbied for by big business interests in the first place, or, if they weren't lobbied for very much, they were eventually captured by big business and worked for big business. But somehow the Fed seems to have escaped that. Even the famous Chicago School of economics never seriously looked into that idea of the Fed being a special interest.

You know, I sponsored a lecture at my university a couple of nights ago by a man who has been in the banking business for forty years. He's the CEO of a major banking corporation in America,

one of the top ten financial institutions, and he said of the Fed—somebody from the audience asked him, "Why do we have the Fed?"—and he said the Fed was created to bail out the New York banks. He said that's why the New York Fed is still, for some reason, the most important, most powerful of all the Fed banks, of all the divisions of the Fed.

Look at what happened after the great recession of 2007. The first thing they did was pour hundreds of billions of dollars back into the New York banks. And that's always been the story. They call the Fed the lender of last resort, but it's sort of the bailout Santa Claus of last resort for mostly the Wall Street New York banks.

Even when the Fed goes about its daily operations, open market purchases, it has established this really cozy relationship with mostly New York investment bankers like Goldman-Sachs, who market the government's bonds, and who make billions of dollars doing this. So that's sort of the racket. The New Yorkers, they get the money first, and when the Fed creates price inflation, by the time you and I see any of this expansion of the money supply, the prices we have to pay for everything have all gone up, and all we do is pay more for gas and clothing and groceries. The New York investment banking community—they are the ones who really profit the most from the whole thing.

Just like other examples in American history: the Civil Aeronautics Board was a cartel operation that benefitted the airline industry for fifty years; the Interstate Commerce Commission benefitted the trucking industry by enforcing a cartel for the trucking industry; and the Fed is a cartel enforcement mechanism for an element of the banking industry.

WOODS: Now, if that's the case, though, how does government itself benefit from this? Government doesn't usually just shower benefits on people. It wants something in return. What's it getting?

DILORENZO: It gets an expansion of the money supply. It's every politician's dream to have a legal counterfeiting operation that only he can operate. You and I can't do it. We can go to prison for it. But the politicians have a legal counterfeiting operation that they can use to buy votes. It's illegal, of course, to walk up to a voter on the street and say, "Here's fifty dollars. Vote for me tomorrow." Although that happens. But it is legal for people to say, "Here's a $50,000-a-year job with the government. Vote for me and get all your relatives to vote for me, financed by the Fed, by the way." And so it's a way of offering the people something for nothing, and that really is the business of politics in a democracy, isn't it?

WOODS: But, again, I'll try to be the opposite of the cynic here just to play devil's advocate. Don't we need an institution like the Fed to give us—well, I'm trying to say this without laughing—to give us economic stability?

DILORENZO: Well, the answer's no. The monetary columnist George Selgin is an Austrian School economist who has a very good speech that's on the web on YouTube. He's given it on

several occasions, and he also has several academic journal articles. I think one of them is in *The Journal of Money and Banking.* And it's on a hundred years of failure of the Fed.

He looks in a very scholarly way at the promises that the supporters of the Fed make, that it produces price stability, economic stability in general, low numbers of unemployment. And he found that on every score, the opposite is true. After the Fed we had worse business cycles.

On the price stability front, we do have some statistics on prices that go back several hundred years. There's a publication called Historical Statistics of the United States that economic researchers use, and it shows that the price levels, the CPI if you will, was basically the same in 1913 as it was in 1789, the year the Constitution was ratified. But since then, since 1913, it's gone up by more than twenty times, so it's really sort of a ridiculous joke to talk about the Fed as conducive to price stability.

And even Professor Christina Romer from UC Berkley, who was an Obama administration economist—one of the things she is known for, her academic research, is showing that the Fed actually made business cycles more unstable, compared to the monetary system that existed from the end of the Civil War until we got the Fed.

WOODS: So, we put together the Sixteenth Amendment, the Seventeenth Amendment, and the Federal Reserve, and the result is much more centralized government with far greater powers. Well, is there any scenario that you can envision that involves the reversal of any of this?

DILORENZO: Well, you know the Fed and the income tax give the federal government so much power with so much money, and the Seventeenth Amendment is just one of the many tools Congress uses to make it almost impossible to unseat an incumbent. That and gerrymandering are the main reasons why we have this situation. For the past 50 years, the average reelection rate is 80 and 90 percent at minimum in the Senate, and even higher in the House of Representatives. And so, that's not likely to happen, which is why for many years I've been saying the only real hope is secession.

The only real hope is peaceful secession, which is the way in which the Soviet republics escaped the clutches of the Soviet Union. And if that could never happen in the United States, then I really don't see any way out of it, apart from an utter collapse of the dollar, and of the economy, and then fundamental change in the chaos of all that. But peaceful secession would be a much preferred scenario, in my view.

WOODS: Tom, before I let you go, I want to jump back for just one second into the income tax, and ask you: if you could get rid of the income tax and replace it with a national sales tax, do you think there are any advantages to that? Is it less oppressive? Is it less economically damaging? Or is this just like rearranging deck chairs on the Titanic?

DILORENZO: No, it's rearranging deck chairs on the deck of the Titanic. A so-called national sales tax ends up being a tax on income also, and so there's really very, very little difference.

You know, when Ron Paul was running for president the first time he said this a lot. The second time I didn't hear him say it as much. But he said he was in favor of eliminating the income tax and replacing it with nothing. And if you did that, the amount of money the government would have would be about what it had in 1997. Which is true. I remember looking up the statistics myself, and that was exactly correct.

Of course, government was already grossly bloated, and the big majority of what it was doing was grossly unconstitutional in 1997. That would be the preferred scenario. Get rid of the income tax and replace it with nothing, because this idea of revenue neutrality—whenever a politician in Washington mentions tax reform, they always bring up this word "revenue neutrality," so that if you or I lose our job, or we get a pay cut, we do it, we just bite the bullet, and we do that. But not under any circumstances, never should government ever take in a penny less, is the idea of the Washington establishment. If people believe in that, then we really are doomed, because every dollar the government spends impoverishes us by a dollar.

WOODS: Well, Tom DiLorenzo, again I'm grateful for your time, but even more so for your books, which have had a great influence on me and on many Americans. There are so many kids who have read *The Real Lincoln* and more need to read books like *Hamilton's Curse*, which basically tells the whole history of the U.S., except with the so-called heroes as the villains, and vice versa. That's my kind of history. Thanks so much again, Tom, for being here today.