

JOHN

STEELE

GORDON,

HAMILTON'S

BLESSING:

THE

EXTRAORDINARY

LIFE AND

TIMES OF

OUR NATIONAL

DEBT

O N E

The Hamiltonian Miracle



THE UNITED STATES WAS BORN IN DEBT. Wars have been fought with borrowed money at least since Rome instituted the practice of forcing its richer citizens to loan the state money in order to help fund the conflict with Carthage in the third century B.C. The American Revolution was no exception on either side. This gave the British government one of its biggest advantages in the conflict, for with its well-established national debt and its efficient tax system it could borrow easily and, as we have seen, borrow it certainly did.

But there can hardly be a poorer credit risk than a newly formed government in rebellion against a Great Power. Such governments vanish with defeat, the leaders are hanged, and their debts become uncollectible. More, the American colonies had had only rudimentary tax systems, and the new Continental Congress, established in 1775, had none at all. The Congress was able to borrow

something over \$11 million from the French government and Dutch bankers—both countries soon went to war with Britain, hoping to take advantage of the situation—mostly for arms purchases in those countries. And Congress and the states sold bonds to wealthy patriots who were willing to risk the loss of their capital for the cause. But the money raised was not nearly enough. Thus the nascent United States had no choice but to resort to every financial expediency at its disposal in order to feed, equip, and pay the state militias and the Continental army.

The main source of revenue was, in fact, the printing press. Congress issued massive amounts of so-called continentals, paper money that was backed by nothing more than a declaration that it was legal tender. By the end of the war, these issues amounted to more than \$200 million at face value. But this fiat money had quickly depreciated, as fiat money always does. Before the war ended, Congress had been forced to revalue earlier issues at only 2.5 percent of face value, and the phrase “not worth a continental” would be part of the American idiom for a century. Further, the state governments and Continental Congress used what were, in effect, forced loans, requisitioning food and supplies from citizens and paying for the goods with IOUs. These also quickly depreciated as they passed from hand to hand.

These expedients were effective enough to produce victory. But when representatives of King George III signed the Treaty of Paris, on September 3rd, 1783, and acknowledged American independence, the United States, while free, was in a state of utter fiscal chaos. The

Congress was no longer paying interest on its bonds held by its own citizens. It had defaulted on its foreign debt and was months in arrears in paying the army. Worse, the new government that had been established under the Articles of Confederation in 1781, just as the fighting was ending, lacked any powers that would allow it to cope with the problem. It did not even know how great its total obligations were.

With the new state governments fighting for their lives against what they regarded as a distant tyranny, they were not about to cede any more power than absolutely necessary to a new and still distant central government, even one of their own devising. Thus members of Congress were chosen by the state legislatures and were subject to recall at any time, sharply limiting their political independence. Indeed it made them, in effect, ambassadors, not legislators at all.

To be sure, the new government had, in theory, exclusive jurisdiction over foreign affairs, but it lacked any power over foreign commerce, always a powerful instrument of diplomacy. And while it had the power to raise an army and navy, and to coin and borrow money, it did not have the power of taxation that would allow it to fund these activities.

Instead it had to apportion the costs among the several states according to the value of each state's surveyed land and wait for the states to forward the money. Thus the federal government under the Articles of Confederation more closely resembled the present-day United Nations than it did the modern U.S. government.

And as the United Nations has learned, asking sovereign governments (which invariably have pressing fiscal needs of their own) for money doesn't work well. Some states paid up promptly, others were soon seriously in arrears, and some, notably New Jersey in 1785, simply said no. The result was that the United States not only could not pay the interest on its debts, but could not even fund its current expenditures.

As if this were not enough, the American economy underwent a severe postwar recession as it adjusted to being outside the British Empire and finding its commerce barred from many of its old trading partners, especially the British West Indies.

The consequences of a federal government impotent to carry out its assigned duties were soon obvious. Foreign governments treated the United States with contempt. Britain refused to evacuate the forts in the Great Lakes region, despite the Treaty of Paris that required it to do so. It knew that the United States had no means to force such a retreat. Spain refused to recognize American control of the vast area west of the Appalachians and south of the Ohio River. Soon it closed the Mississippi to American commerce, hoping to induce the western population to shift its shaky allegiance in exchange for access to this vital waterway. And that allegiance was shaky indeed. As early as 1784, George Washington was saying that the westerners were "on a pivot. The touch of a feather would turn them any way."

The Congress tried to get the states to agree to a 5 percent tariff on trade with foreign countries. But any

such change in the Articles of Confederation required the unanimous consent of all thirteen states, and this could not be obtained. Rhode Island in particular, long the center for smuggling on this side of the Atlantic, wanted no impediments whatever on its commerce. Calls for a more far-reaching reworking of the Articles were increasingly heard, including a plan for representatives of the various states to meet in Philadelphia in May 1787.

Finally Shays's Rebellion, a spasm of discontent by debt-ridden farmers in western Massachusetts in 1786, proved the catalyst for fundamental constitutional change. The rebellion was easily suppressed, but it engendered a powerful sense that the fate of the American experiment was hanging in the balance, that the situation needed to be addressed directly and immediately. This ensured that there would be sufficient attendance at the convention in Philadelphia to have a quorum. As it turned out, only Rhode Island failed to attend. And although the convention met for the purpose of making changes in the Articles, it quickly decided to write a whole new constitution instead. (Rhode Island would be the last state to ratify it.)

The document that the Founding Fathers created that summer in Philadelphia—the desperate poverty of the old government all too fresh in their minds—put remarkably few restrictions on the new government's power to tax, borrow, and spend.

The federal government is required to provide for such things as the post office and the census, which necessarily require spending, and Congress may not make army appropriations extending for more than two

years. But it was empowered to provide for "the general welfare," a term left entirely undefined. In the twentieth century it has come to be construed so broadly as to encompass even a museum dedicated to the memory of Lawrence Welk.

The new Constitution also gave Congress exclusive power over foreign and interstate commerce and the power "to lay and collect Taxes, Duties, Imposts and Excises," a very broad mandate. But it required that they be uniform throughout the United States, in order to prevent several states from ganging up on one or two rich ones, the same reason it forbade duties on the exports of any state.

To protect the interests of the less wealthy, the Constitution required that all revenue measures originate in the House of Representatives, elected by the people, rather than the Senate, whose members were to be elected by state legislators who were, in turn, overwhelmingly men from the top of society. But to protect those men of wealth, it required that "no Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census." At the Constitutional Convention, Rufus King of Massachusetts wanted to know the precise definition of *direct taxation*. James Madison reported in his notes that "no one answered." It was a silence that would have no small consequences 100 years later. Indeed, that silence echoes loudly to this day in the American tax system.

Finally, the Congress was given the power "to borrow Money on the credit of the United States," one of the very few major powers granted in the Constitution that has no

checks or balances upon it whatever. In the context of the time, this was entirely understandable. The British Parliament, necessarily the model the Founding Fathers used in creating Congress, had come into existence at the end of the thirteenth century precisely to be a check upon the extravagance of the king, and remained such a check 500 years later. Britain's richest men represented themselves in the House of Lords, while the merely affluent were represented in the Commons. The poor, having no money, weren't represented at all. So when Parliament voted to spend money, its members were, in a very real sense, voting to spend their own money. The Founding Fathers expected Congress to be no different, and, at least for a while, it wasn't.

BECAUSE THE FINANCIAL SITUATION had been the most powerful impetus to the establishment of the new government, the most important of the new executive departments was certain to be the Treasury. It soon had forty employees to the State Department's mere five. And its tasks were as clear as they were monumental. The department would have to devise a system of taxation to fund the new government. A monetary system would have to be developed to further the country's commerce and industry. The national debt needed to be refunded and rationalized. The Customs Service had to be organized. The public credit had to be established so that the government could borrow as necessary.

All this was to be brilliantly accomplished in the first two years of the new government. It was, almost entirely,

the work of the first secretary of the treasury, Alexander Hamilton. Among the Founding Fathers, Hamilton, because of his financial genius and despite never holding elective office, would have an impact on the future of the United States that only Washington, Madison, and Jefferson equaled.

But Hamilton was not like the other Founding Fathers. He was the only one of the major figures of the early Republic who was not born in what is now the United States. Instead he was born on the minor British West Indian island of Nevis and came to manhood on what was then the Danish island of St. Croix, now part of the U.S. Virgin Islands.

Further, he was the only Founding Father, other than the ancient and by then venerable Benjamin Franklin, who was not born into the higher levels of the local society of his native colony. Rather, in the brisk, if not altogether accurate, phrase of his political enemy John Adams, Hamilton was "the bastard brat of a Scotch pedlar."

Hamilton was certainly a bastard, but his father was not a peddler. He came, in fact, from an ancient Scottish family, being a younger son of the laird of Cambuskeith. But Hamilton's father was an utter failure as a businessman. He soon parted from his family, and Hamilton's mother was forced to open a small store to feed her two sons. Hamilton became a clerk in the trading concern of Nicholas Cruger and David Beekman at Christiansted, St. Croix, at the age of eleven or thirteen. (There is some doubt about Hamilton's birth date. Nearly contemporary documents imply it was 1755. Hamilton said it was 1757.)

So bright and energetic was the young Hamilton—for his tainted birth had instilled a ferocious ambition to get ahead—that by the time he was in his midteens he was managing the concern.

Nicholas Cruger belonged to an old and powerful New York mercantile family, and he early recognized the talent of his young clerk. When he returned to New York in 1771 because of ill health, he left Hamilton in charge. Soon he helped his young employee come to New York to further his education including the study of law. Hamilton, still in his teens, left St. Croix in October 1772, never to see the West Indies again.

With the rapidly deteriorating relations between Great Britain and its American colonies, Hamilton threw in his lot with his new country. His immense talents and his capacity for work soon secured him an important role in the Revolution—as Washington's aide-de-camp—and its aftermath. When Washington became president under the new Constitution, on April 30th, 1789, he asked Robert Morris, known as "the financier of the Revolution" because of his success at finding money and supplies for the Continental army, to become secretary of the treasury. But Morris, intent on making money, turned him down.*

He recommended Hamilton instead. Morris and Hamilton had been in correspondence for several years about the country's fiscal crisis and how to solve it, and Hamilton, still in his early twenties, had greatly impressed

* It was a bad decision. Within a decade Robert Morris would be in debtor's prison.

the elder man. As early as 1781, as the Revolution still continued, Hamilton had written Morris regarding the establishment of a proper national debt on the British model. "A national debt, if it is not excessive, will be to us a national blessing," he wrote. "It will be a powerful cement to our union. It will also create a necessity for keeping up taxation to a degree which, without being oppressive, will be a spur to industry."

Washington was happy to appoint his old comrade in arms, and Hamilton, now in his early thirties, gladly gave up a lucrative law practice in New York to accept.

Hamilton's background would always set him apart and give him an outlook on life and politics the other Founding Fathers did not share. It also made him uniquely qualified to establish the financial basis of the new United States. Far more than Jefferson, Washington, Adams, and Madison, Hamilton was a nationalist. Perhaps because he had grown up viewing the colonies on the continent only from afar, his loyalty to the United States as a whole was unalloyed by any loyalty to a particular state, not even New York where he spent his adult life.

Also, Hamilton was by far the most urban and the most commercial-minded of the men who made the country. He had grown up, almost literally, in a counting house and lived most of his life in what had already long been the most cosmopolitan and commercial-minded city in the country. In 1784 he had founded a bank that continues to this day, the Bank of New York, and would found a newspaper that also lives, the *New York Post*.

Washington, Jefferson, Madison, and even Adams were far more tied to the land than was Hamilton. Jefferson, especially, longed to see the United States as a country filled with self-sufficient yeoman farmers who shunned urban life. Hamilton, at home in the city and deeply learned in both the theory and practice of finance, saw far more clearly than Jefferson how the winds of economic change were blowing in the late eighteenth century.

Hamilton was always to be, to some extent, a social outsider. Today we tend to think of the American Revolution as having brought "democracy" to the thirteen colonies. In fact it brought no such thing. The eighteenth century was an age of aristocracy, and the American colonies were no exceptions. Each colony had its oligarchy of rich, established families who dominated the economic and, under the control of a royal governor, political affairs of that colony. To give just one instance of how pervasive was the sense of social hierarchy: Students enrolled at Harvard at this time were listed not according to the alphabetical order of their surnames but according to the social standing of their families in the community.

With the removal of royal control, these oligarchies inherited a near monopoly of political power in each colony. Although the population of the United States in 1787-88 was almost 4 million, only 160,000—4 percent of the whole—voted for delegates to the state conventions to ratify the new Constitution, the most important political event of their lives. Even when only adult white males are considered, fewer than 25 percent voted. It was not for lack of interest. Rather it was that the right to vote was

limited to those who owned substantial property, in other words, the oligarchs. That was precisely why the writers of the Constitution were so confident that Congress would be instinctively frugal.

The oligarchies, it need hardly be said, abused this monopoly of political power; monopolies, whether private or governmental, are always abused by those who hold them. The oligarchs often manipulated the legislatures to advance their own interests, such as suspending foreclosures for debt during the depressed economic conditions of the 1780s.* And taxes tended to be laid more heavily on those without the vote such as small farmers and laborers. It was the latter that had led to Shays's Rebellion in Massachusetts.

Although Hamilton married the daughter of Philip Schuyler, one of the richest members of New York's "Knickerbocker Aristocracy," he never fully belonged to it himself. While he could be charming, especially with women, he was too driven, too ambitious for fame and glory, too unable to suffer fools gladly, to be completely accepted by the men. They recognized his brilliance, utilized his intellectual and financial skills, but they never forgot where Hamilton came from or the conditions of his birth.

VERY NEARLY Congress's first act was to set about devising a federal tax system. On July 4, 1789, it passed the

* That is why the members of the Constitutional Convention placed into the document a clause forbidding the states to impair the obligation of contracts.

first Tariff Act, largely written by Hamilton, and henceforth import duties would usually provide the bulk of the federal government's revenues until the First World War (although the proceeds from the sale of public land in the West, not a tax at all, increasingly contributed to the government's revenues as the frontier pushed westward).

But, at first, tariffs were not enough. To gain more revenue, Congress passed excise taxes on carriages, distilled spirits, sugar, salt, and other items. Excise taxes are internal taxes on specific goods or on the privilege of doing business, and the tax on carriages was clearly a tax on the rich (only the rich, after all, could afford carriages) but a very modest one. Virginia quickly sued, claiming that the tax on carriages was a direct tax and thus had to be apportioned among the states according to population (in other words, according to the number of people, not carriages). Hamilton, at the request of the attorney general, argued the case for the federal government before the Supreme Court. The Court agreed with Hamilton that the carriage tax was an excise. This, as it happens, was the first time the Court addressed the constitutionality of an act of Congress.

The tax on liquor might seem to be the first of the "sin taxes," but the idea of alcohol as "demon rum" was, in fact, largely a nineteenth-century concept. Instead, liquor, sugar, and salt were taxed simply because they were three of the relatively few commodities then manufactured on an industrial scale and thus amenable to efficient tax collection.

The federal government quickly ran into a serious

problem with the so-called whiskey tax. In most areas of the country, liquor distillers were too few in number to effectively protest the new tax, and, in any event, they could easily pass it along to their customers in higher prices. But the small farmers in western areas were blocked from eastern markets by the Appalachian Mountains. They had to convert their grain to whiskey before it was in a valuable enough form to bear the cost of transportation across the mountains. A 25 percent excise tax was a heavy economic burden for them, and they flared into rebellion in 1794, the first direct challenge to the authority of the new federal government. The rebellion was quickly and easily suppressed, and the two rebels who were convicted of treason were pardoned by President Washington. But the point was made that the new federal government could, and would, enforce its writ.

A revenue stream in place, Hamilton quickly turned to refunding the debt incurred in the Revolution and by the old national government. Indeed there was not much choice for the new Constitution commanded that the federal government assume the debts of the Confederation. The argument was over who should benefit from this refunding. Much of the debt, in the form of bonds, requisition IOUs, and continentals had fallen into the hands of wealthy merchants in the major cities, who had acquired it at far below par (its nominal face value), some for as little as 10 percent of that face value.

On January 14th, 1790, Hamilton submitted his first "Report on the Public Credit," which called for redeeming the old national debt on generous terms and issuing

new bonds to pay for it, backed by the revenue from the tariff. The plan immediately became public knowledge in New York City—then the nation's temporary capital—but news of it spread only slowly, via horseback and sailing vessel, to the rest of the country. New York speculators moved at once to take advantage of the situation. They bought as many of the old bonds as they could, raising the price from 20–25 percent of par to about 40–45 percent.

There was an immediate outcry that these speculators should not be allowed to profit at the expense of those who had patriotically taken the old government's paper at par and then sold it for much less in despair or from necessity. James Jackson, a member of the House of Representatives from the sparsely settled frontier state of Georgia, was horrified by the avaricious city folk. "Since this report has been read in this house," he said in Congress, "a spirit of havoc, speculation, and ruin, has arisen, and been cherished by people who had access to the information the report contained, . . . Three vessels, sir, have sailed within a fortnight from this port [New York], freighted for speculation; they are intended to purchase up the State and other securities in the hands of the uninformed, though honest citizens of North Carolina, South Carolina, and Georgia. My soul rises indignant at the avaricious and immoral turpitude which so vile a conduct displays."

Elias Boudinot of New Jersey, wealthy and heavily involved in speculation himself, demurred. "I should be sorry," he said in reply, "if, on this occasion, the House should decide that speculations in the funds are violations

of either the moral or political law. A government hardly exists in which such speculation is disallowed; . . . [I agree] that the spirit of speculation had now risen to an alarming height; but the only way to prevent its future effect, is to give the public funds a degree of stability as soon as possible." This, undoubtedly, was Hamilton's view as well.

James Madison, in the House of Representatives for Virginia, led the attempt to undercut the speculators. He proposed that the current holders of the old bonds be paid only the present market value and that the original bondholders be paid the difference between market value and face value. There were two weighty objections to this plan.

The first was one of simple practicality. Identifying the original holders of much of this paper would have been a bureaucratic nightmare, in many cases entirely impossible. Fraud would have been rampant. The second objection was one of justice. If an original bond holder had sold his bonds to another, "are we to disown the act of the party himself?" asked Elias Boudinot. "Are we to say, we will not be bound by your transfer, we will not treat with your representative, but insist on resettlement with you alone?"

Further, to have accepted Madison's scheme would have greatly impaired any future free market in U.S. government securities and thus greatly restricted the ability of the new government to borrow in the future. The reason was simple. If the government of the moment could decide, on its own, to whom it owed past debts, any govern-

ment in the future would have a precedent to do the same. Politics would control the situation, and politics is always uncertain. There is nothing that markets hate more than uncertainty, and they weigh the value of stocks and bonds accordingly.

Hamilton, deeply versed in the ways of getting and spending, was well aware of this truth. Madison, a landowner and intellectual, was not. Hamilton, in his report, had been adamant. "It renders property in the funds less valuable, consequently induces lenders to demand a higher premium for what they lend, and produces every other inconvenience of a bad state of public credit."

Hamilton was anxious to establish the ability of the U.S. government to borrow when necessary. But he was also anxious to establish a well-funded and secure national debt for other reasons, for he was fully aware of the British experience with its national debt. Perhaps the greatest problem of the American economy at this time was a lack of liquid capital, which is to say, capital available for investment. Hamilton wanted to use the national debt to create a larger and more flexible money supply. Banks holding government bonds, he argued, could issue bank notes backed by them. He knew also that government bonds could serve as collateral for bank loans, multiplying the available capital, and that they would attract still more capital from Europe.

But there were still many people who failed to grasp the power of a national debt, properly funded and serviced, to bring prosperity to a national economy. John

Adams, hardly stupid, was one. "Every dollar of a bank bill that is issued beyond the quantity of gold and silver in the vaults," he wrote, "represents nothing, and is therefore a cheat upon somebody."

Hamilton's reasoning eventually prevailed over Madison's, although not without a great deal of rhetoric. Hamilton's father-in-law, Philip Schuyler, by this time a senator from New York, owned more than \$60,000 worth of government securities, a small fortune by the standards of the day. It was said that listening to the opposition speakers in the Senate made his hair stand "on end as if the Indians had fired at him." Rhetoric or no, the House passed Hamilton's funding proposals 36-13.

THE SECOND MAJOR PART of Hamilton's program was for the new federal government to assume the debts that the individual states had incurred during the Revolutionary War. Hamilton thought these debts amounted to \$25 million, although no one really knew for sure. It eventually turned out that only about \$18 million in state bonds remained in circulation.

Again, opinion was sharply divided. Those states, such as Virginia, that had redeemed most of their bonds were adamantly opposed to assumption. Needless to say, those states, like the New England ones, that had not were all in favor of it. Financial speculators, hoping for a rise to par of bonds they had bought at deep discount, also favored the federal government assuming the state debts. But land speculators were opposed. Many states allowed public lands to be purchased with state bonds at face

value, even when the bonds were selling in the open market for much less. Any rise in the price of bonds would increase the cost of land.

Madison and others argued that it was simply unfair for Virginians, who had nearly liquidated their state's bonded indebtedness, to pay all over again for the debts incurred by other states that had not. "Where, I again demand," thundered James Jackson of Georgia, "is the justice of compelling a State which has taxed her citizens for the sinking of her debt, to pay another proportion, not of her own, but the debts of other States, which have made no exertions whatever?"

Fisher Ames, a congressman from Massachusetts, argued that since the new Constitution gave all revenues from tariffs—the best and surest source of funds with which to pay the interest on the bonds—to the federal government, the federal government should now assume the debt. "Let the debts follow the funds," he demanded.

In the middle of April 1790, the House voted down Hamilton's proposal 31-29. Four more times it was voted down, each time by so narrow a margin that Hamilton had hopes of making a deal. He had to do something, for he had tied the funding of the old national debt and the assumption of the state debt into one bill. Many thought that the state debt issue was "a millstone about the neck of the whole system which must finally sink it."

Hamilton might have abandoned his effort to fund the state debts, but he had still one more reason for extinguishing as much state paper as possible and replacing it with federal bonds. The debts, of course, were largely

held by the prosperous men of business, commerce, and agriculture—the oligarchs, in other words. These men's loyalties lay mainly with their respective states and the cozy local societies in which they had grown up. Although they had largely supported the creation of the new Union, Hamilton had every reason to suppose that their support would quickly fade away if their self-interest dictated it.

Hamilton, therefore, was anxious to make it in the self-interest of these men to continue their support of the Union. If they had a large share of their assets held in federal bonds, they would have powerful incentives for wishing the Union well. So he was willing to throw a very large bargaining chip onto the table to save his funding and assumption scheme. The new federal government had come into existence in New York City, and Hamilton, as well as nearly every other New Yorker, was hoping that the city would become the permanent capital. Certainly the city had gone to a lot of trouble to spruce itself up, spending £18,000 in the process (these pounds were in New York currency, to be sure, not in the far more valuable sterling*).

Hamilton knew perfectly well that every state wanted the capital, and that Jefferson and Madison especially wanted the capital located in the rural South, away from what they regarded as the commerce and corruption of the cities. Hamilton intercepted Jefferson outside Presi-

* The dollar would largely replace the myriad other forms of currency in the 1790s, as the new federal government began to mint coins. Much old nomenclatural usage remained, however. An eighth of a dollar, twelve and a half cents, was known as a shilling until nearly the middle of the nineteenth century, despite the fact that the government never minted a coin of that denomination.

dent Washington's Broadway mansion one day shortly after the bill's defeat and asked for help on getting his bill through Congress. Jefferson, who had opposed the adoption of the Constitution itself, and favored the states in nearly all federal-state disputes over the distribution of power, was opposed to the bill.

Nonetheless, he offered to meet Hamilton the following night for dinner, with Madison in attendance. There a deal was made. Enough votes would be switched to ensure passage of Hamilton's bill, in return for which Hamilton would throw his support to having the new capital located on the muddy and fever-ridden banks of the Potomac. To ensure Pennsylvania's cooperation, the temporary capital was to be moved to Philadelphia for ten years.*

The deal was made, and the bill was passed and signed into law by President Washington. Hamilton was right that the bonds would find acceptance in the marketplace, and the entire issue sold out in only a few weeks. The new government, with a monopoly on customs duties and possessing the power to tax elsewhere, was simply a much better credit risk than the old government and the states had been. When it became clear that the U.S. government would be able to pay the interest due on these bonds, they quickly became sought after in Europe, just as Hamilton had hoped, especially after the outbreak of

* Historians should probably be required to swear a solemn oath never to play the game of "what if." Still, one can hardly help speculating on how profoundly different would have been the history of this country, not to mention the history of New York City, if its political capital had been located in the city that so swiftly became its financial, commercial, and cultural capital as well.

the war in which the other European powers tried to reverse the tide of the French Revolution.

THE THIRD MAJOR PORTION of Hamilton's program was the creation of a central bank, modeled after the Bank of England. Hamilton saw it as an instrument of fiscal efficiency, economic regulation, and money creation. Jefferson saw it as another giveaway to the rich and as a potential instrument of tyranny. Furthermore, Jefferson and Madison thought it was patently unconstitutional for the federal government to establish a bank, for the Constitution nowhere gives the federal government the explicit power to charter a bank or, for that matter, any other corporation.

There are three main purposes to a central bank. It acts as a depository for government funds and a means of transferring them from one part of the country to another (no small consideration in the primitive conditions of Hamilton's day). It is a source of loans to the government and to other banks, and it regulates the money supply.

The last was a great problem in the new Republic. Specie—gold and silver—was in critically short supply. Colonial coinage had been a hodgepodge of Spanish, Portuguese, and British coins, often cut into pieces in order to make small change.*

* Spanish reales, the monetary unit upon which the dollar was originally based, were called "pieces of eight" because they were often cut into eight pieces for this purpose. This is why a quarter is still known as "two bits" and why the New York Stock Exchange to this day quotes fractional prices in eighths, not tenths, of a dollar.

The lack of specie forced merchants to be creative. In the southern colonies warehouse receipts for tobacco often circulated as money. Hamilton knew that foreign bonds could serve the same purpose. In his "Report on the Public Credit" he wrote: "It is a well-known fact that in countries in which the national debt is properly funded, and an object of established confidence, it answers most of the purposes of money. Transfers of stock, or public debt, are there equivalent to payments in specie; or, in other words, stock, in the principal transactions of business, passes current as specie. The same thing would, in all probability, happen here, under the like circumstances."*

But the bonds, of course, were of very large denomination. There were a few state banks (three in 1790) to issue paper money, but these notes did not circulate on a national basis. Many business deals had to be accompanied by barter simply because there was no money to facilitate them.

Hamilton did not like the idea of the government itself issuing paper money because he felt that governments could not be trusted to exert self-discipline. Certainly the Continental Congress had shown none when it came to printing paper money, although at least it had the pretty good excuse of utter necessity. Hamilton thought that an independent central bank could supply not only a medium of exchange but the discipline needed to keep the

* It would be only after the Civil War that the word *stock* would come to mean a share of ownership, while *bond* would mean debt; in Hamilton's day the words were largely interchangeable.

money sound. If it issued notes that were redeemable in gold and silver on demand and accepted by the federal government in payment of taxes, those notes would circulate at par and relieve the desperate shortage of cash. Further, because the central bank could refuse the notes of state banks that got out of line—which would mean that no one else would take them either—it could supply discipline to those banks as well.

Hamilton proposed a capitalization of \$10 million, a very large sum when it is considered that the three state banks in existence had a combined capital of only \$2 million. The government was to subscribe 20 percent of this, but Hamilton intended the bank to be a private concern. "To attach full confidence to an institution of this nature," Hamilton wrote in his "Report on a National Bank" delivered to Congress on December 14th, 1790, "it appears to be an essential ingredient in its structure, that it shall be under a *private* not a *public* direction—under the guidance of *individual interest*, not of *public policy*; which would be supposed to be, and, in certain emergencies, under a feeble or too sanguine administration, would really be, liable to being too much influenced by *public necessity*." In other words, Hamilton did not believe that politicians could be trusted with the power to print money, whereas a privately held bank could, because its owners would go broke if they printed excessive amounts. The history of many countries, including, in his own time, France under the First Republic, would prove him right.

To make sure that the private owners of the bank did not pursue private interests at public expense, Hamilton wanted the bank's charter to require that its notes be redeemable in specie, that 20 percent of the seats on the board of directors be held by government appointees, and that the secretary of the treasury would have the right to inspect the books at any time.

There was little political discussion of the bank outside of Congress, which passed Hamilton's bill, the two houses splitting cleanly along sectional lines. Only one congressman from states north of Maryland voted against it, and only three from states south of Maryland voted for it.

Hamilton thought the bank was a *fait accompli*, but he had not reckoned on Thomas Jefferson and James Madison. Jefferson, the lover of rural virtues, had a deep, almost visceral hatred of banks, which he thought the epitome of all that was urban. "I have ever been the enemy of banks," he wrote years later to John Adams. "My zeal against those institutions was so warm and open at the establishment of the Bank of the U.S. that I was derided as a Maniac by the tribe of bank-mongers, who were seeking to filch from the public their swindling, and barren gains."*

* Anyone who doubts the influence of great men on history should consider how Jefferson's intense, even irrational hatred of banks has affected the history of the United States. The savings-and-loan crisis of the 1980s, 160 years after Jefferson's death, had its origins, in a very real sense, in Jefferson's passion. For that passion, articulated by one of the most articulate men who ever lived, greatly strengthened a fear of powerful financial institutions in his political heirs. This led to laws that favored many small (and thus weak)

Jefferson and Madison, along with their fellow Virginian Edmund Randolph, the attorney general, wrote opinions for President Washington that the bank bill was unconstitutional. Their arguments revolved around the so-called necessary and proper clause, giving Congress the power to pass laws "necessary and proper for carrying into Execution the foregoing Powers."

The Constitution nowhere specifically authorizes the federal government to establish a central bank, they argued, and therefore one could be created only if it were indispensable for carrying out the government's enumerated duties. A central bank was not *absolutely* necessary and therefore was absolutely unconstitutional. This line of reasoning is known as *strict construction*—although the phrase itself was not actually coined until 1838—and has been a powerful force in the American political firmament ever since.

President Washington recognized the utility of a central bank, but Jefferson's and Randolph's argument had much force for him. Further, he may have worried that if the bank were established in Philadelphia, the capital might never make its way to his beloved Potomac. He told Hamilton that he could not sign the bill unless Hamilton was able to overcome Jefferson's constitutional argument.

To counter Jefferson's doctrine of strict construction, Hamilton devised a counter doctrine of *implied powers*.

banks over a few large ones. Even today, when thousands of banks have merged and banking across state lines has finally become possible, the United States still has more banks than all the rest of the industrialized world put together.

He said that if the federal government was to deal successfully with its enumerated duties, it must be supreme in deciding how best to perform those duties. "Little less than a prohibitory clause," he wrote to Washington, "can destroy the strong presumptions which result from the general aspect of the government. Nothing but demonstration should exclude the idea that the power exists." Moreover, he asserted that Congress had the right to decide what means were necessary and proper. "The national government like every other," he wrote, "must judge in the first instance of the proper exercise of its powers."

Hamilton's complete response to Jefferson and Randolph runs nearly 15,000 words and was written under an inflexible deadline, for the Constitution required President Washington to sign or veto the bill within ten days of its passage. Hamilton thought about his response for nearly a week but seems to have written it entirely in a single night. To read it today is to see plain the extraordinary powers of thought he possessed. Even John Marshall was awed by them. "To talents of the highest order," the great chief justice wrote, "he united a patient industry, not always the companion of genius, which fitted him in a peculiar manner for the difficulties to be encountered by the man who should be placed at the head of the American finances."

Washington, his doubts quieted, signed the bill in 1791, and the bank soon came into existence. Its stock subscription was a resounding success, for investors expected it to be very profitable, which it was. It also func-

tioned as Hamilton intended and did much to further the early development of the American economy. State banks multiplied under its control—from 3 in 1790, to 29 by the turn of the century, to more than 100 a decade later.

Had Washington accepted Jefferson's argument and not Hamilton's, not only would the bank bill have been vetoed, but the development of the U.S. government would have been profoundly different. Indeed, it is hard to see how the Constitution could have long survived, at least without frequent amendment. Jefferson's doctrine of strict construction, rigorously applied, would have been a straitjacket, preventing the federal government from adapting to meet both the challenges and the opportunities that were to come in the future. Abraham Lincoln and Franklin Delano Roosevelt, for instance, would both push the Hamiltonian concept of implied powers very far in seeking to meet the immense national crises of the Civil War and the Great Depression.

Even Jefferson, once in the White House, would come to realize that strict constructionism was a doctrine that appeals mainly to those in opposition, not those who must actually exercise political power. Certainly he did not let the fact that the Constitution nowhere mentions the acquisition of territory from a foreign state stop him from snapping up the Louisiana Purchase from France when the opportunity arose.

HAMILTON'S FINANCIAL PROGRAM quickly, indeed utterly, transformed the country's financial circumstances. In the 1780s the United States had been a financial basket

case. By 1794 it had the highest credit rating in Europe, and some of its bonds were selling at 10 percent over par. Talleyrand, who later became the French foreign minister, explained why. The United States bonds, he said, were "safe and free from reverses. They have been funded in such a sound manner and the prosperity of this country is growing so rapidly that there can be no doubt of their solvency." By 1801 Europeans held \$33 million in U.S. securities, and European capital was helping mightily to build the American economy.

Less than two years after Hamilton's funding bill became law, trading in state and federal bonds had become so brisk in New York that brokers who specialized in them got together and formed an organization to facilitate trading. This organization would evolve into the New York Stock Exchange, and within a little more than 100 years it would be the largest such exchange in the world, eclipsing London's.

But Hamilton's program and its enactment had one great and entirely unanticipated consequence. It produced the first big political fight of the new federal union. It revealed deep and heretofore unsuspected cleavages in the American body politic. "When the smoke of the contest had cleared away," wrote Albert S. Bolles in his majestic *Financial History of the United States*, published a century ago, "two political parties might be seen, whose opposition, though varying much in conviction, power, and earnestness, has never ceased." It still hasn't, and the American political nation can be divided to this day largely into Jeffersonians and Hamiltonians, those who

look more closely at the trees of individual liberty and justice and those for whom the forests of a sound economy and an effective government are most important.

Jefferson never ceased to rail against Hamilton's program. His "Remarks Upon the Bank of the United States," published a few years after the bank was chartered, is a savage attack upon Hamilton. Jefferson, for instance, considered only the inevitable inequities that had resulted from Hamilton's funding scheme. "Immense sums were . . . filched from the poor and ignorant," he wrote, "and fortunes accumulated by those who had themselves been poor enough before."

Hamilton, understandably, preferred to look at the results and felt abused. "It is a curious phenomenon in political history," he wrote in reply, "that a measure which has elevated the credit of the country from a state of absolute prostration to a state of exalted preeminence, should bring upon the authors of it obloquy and reproach. It is certainly what, in the ordinary course of human affairs, they could not have anticipated."

But by then, 1797, the political pendulum was swinging toward the Jeffersonians, and they would run the country for years to come. In the fullness of time, however, as the very few who were actually harmed by Hamilton's program faded from the scene and the very many who benefited, generation after generation, remained, it came to enjoy the praise it deserves. Of Hamilton's work Daniel Webster, with typical grandiloquence, would one day say "the whole country perceived with delight, and the world saw with admiration. He smote the rock of the

national resources, and abundant streams gushed forth. He touched the dead corpse of the public credit, and it sprung to its feet. The fabled birth of Minerva from the brain of Jove was hardly more sudden or more perfect than the financial system of the United States as it burst forth from the conception of Alexander Hamilton."