6.6: Hamilton's Financial System

Figure 6.1: Alexander Hamilton saw America's future as a metropolitan, commercial, industrial society, in contrast to Thomas Jefferson's nation of small farmers. While both men had the ear of President Washington, Hamilton’s vision proved most appealing and enduring. John Trumbull, Portrait of Alexander Hamilton, 1806. Wikimedia.

President George Washington’s cabinet choices reflected continuing political tensions over the size and power of the federal government. The vice president was John Adams, and Washington chose Alexander Hamilton to be his secretary of the treasury. Both men wanted an active government that would promote prosperity by supporting American industry. However, Washington chose Thomas Jefferson to be his secretary of state, and Jefferson was committed to restricting federal power and preserving an economy based on agriculture. Almost from the beginning, Washington struggled to reconcile the Federalist and Republican (or Democratic-Republican) factions within his own administration.\(^\text{15}\)

Alexander Hamilton believed that self-interest was the "most powerful incentive of human actions." Self-interest drove humans to accumulate property, and that effort created commerce and industry. According to Hamilton, government had important roles to play in this process. First, the state should protect private property from theft. Second, according to
Hamilton, the state should use human “passions” and “make them subservient to the public good.” In other words, a wise government would harness its citizens’ desire for property so that both private individuals and the state would benefit.

Hamilton, like many of his contemporary statesmen, did not believe the state should ensure an equal distribution of property. Inequality was understood as “the great & fundamental distinction in Society,” and Hamilton saw no reason why this should change. Instead, Hamilton wanted to tie the economic interests of wealthy Americans, or “monied men,” to the federal government’s financial health. If the rich needed the government, then they would direct their energies to making sure it remained solvent.

Hamilton, therefore, believed that the federal government must be “a Repository of the Rights of the wealthy.” As the nation’s first secretary of the treasury, he proposed an ambitious financial plan to achieve just that.

The first part of Hamilton’s plan involved federal “assumption” of state debts, which were mostly left over from the Revolutionary War. The federal government would assume responsibility for the states’ unpaid debts, which totaled about $25 million. Second, Hamilton wanted Congress to create a bank—a Bank of the United States.

The goal of these proposals was to link federal power and the country’s economic vitality. Under the assumption proposal, the states’ creditors (people who owned state bonds or promissory notes) would turn their old notes in to the treasury and receive new federal notes of the same face value. Hamilton foresaw that these bonds would circulate like money, acting as “an engine of business, and instrument of industry and commerce.” This part of his plan, however, was controversial for two reasons.

First, many taxpayers objected to paying the full face value on old notes, which had fallen in market value. Often the current holders had purchased them from the original creditors for pennies on the dollar. To pay them at full face value, therefore, would mean rewarding speculators at taxpayer expense. Hamilton countered that government debts must be honored in full, or else citizens would lose all trust in the government. Second, many southerners objected that they had already paid their outstanding state debts, so federal assumption would mean forcing them to pay again for the debts of New Englanders. Nevertheless, President Washington and Congress both accepted Hamilton’s argument. By the end of 1794, 98 percent of the country’s domestic debt had been converted into new federal bonds.

Hamilton’s plan for a Bank of the United States, similarly, won congressional approval despite strong opposition. Thomas Jefferson and other Republicans argued that the plan was unconstitutional; the Constitution did not authorize Congress to create a bank. Hamilton, however, argued that the bank was not only constitutional but also important for the country’s prosperity. The Bank of the United States would fulfill several needs. It would act as a convenient depository for federal funds. It would print paper banknotes backed by specie (gold or silver). Its agents would also help control inflation by periodically taking state bank notes to their banks of origin and demanding specie in exchange, limiting the amount of notes the state banks printed. Furthermore, it would give wealthy people a vested interest in the federal government’s finances. The government would control just 20 percent of the bank’s stock; the other eighty percent would be owned by private investors. Thus, an “intimate connexion” between the government and wealthy men would benefit both, and this connection would promote American commerce.

In 1791, therefore, Congress approved a twenty-year charter for the Bank of the United States. The bank’s stocks, together with federal bonds, created over $70 million in new financial instruments. These spurred the formation of
securities markets, which allowed the federal government to borrow more money and underwrote the rapid spread of state-charted banks and other private business corporations in the 1790s. For Federalists, this was one of the major purposes of the federal government. For opponents who wanted a more limited role for industry, however, or who lived on the frontier and lacked access to capital, Hamilton’s system seemed to reinforce class boundaries and give the rich inordinate power over the federal government.

Hamilton’s plan, furthermore, had another highly controversial element. In order to pay what it owed on the new bonds, the federal government needed reliable sources of tax revenue. In 1791, Hamilton proposed a federal excise tax on the production, sale, and consumption of a number of goods, including whiskey.