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# Alexander Hamilton, Economic Prophet

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The American Revolution and its aftermath coincided with two great transformations in the late 18th century. The political sphere witnessed a repudiation of royal rule, fired by a new respect for individual freedom, majority rule, and limited government.

As author of 51 of the 85 essays in *The Federalist Papers*, the classic gloss on the Constitution, Alexander Hamilton made many distinguished contributions in the political realm -- but so did Benjamin Franklin, John Adams, Thomas Jefferson, and James Madison. In contrast, when it came to the parallel economic upheavals of the period -- the industrial revolution, the expansion of global trade, the growth of banks and stock exchanges -- Hamilton was an American prophet without peer. No other founding father straddled both of these revolutions, and therein lay Hamilton's novelty and greatness. He was the messenger of America's economic future, setting forth a vision of an urban manufacturing society that some found enthralling, others unsettling, but that ultimately prevailed. He stood squarely on the modern side of a historical divide that separates him from the other founders, making him uniquely our spiritual kin.

Hamilton's life was the most dramatic and improbable among the founders, a tempestuous saga that would have defied the pen of the most gifted novelist. While other founders grew up on Virginia plantations or in neat New England villages, Hamilton emerged from lowly, obscure beginnings in the Caribbean. An illegitimate child born on the British island of Nevis, he spent his adolescence on St. Croix, then under Danish rule. By the time he was 13, his feckless Scottish father had deserted the family, and his mother had died of tropical fever. To survive, Hamilton toiled as a clerk in a trading house that imported both slaves and supplies for local sugar plantations, an experience that made him a lifelong abolitionist. Chafing at his abject station in life, the teenage clerk mastered the rudiments of business and later described this period as the most useful part of his education. He had to mind money, chart courses for ships, keep track of freight, and compute prices in an exotic blend of currencies. So prodigious were the talents of this slim, handsome youth with blue eyes and a fair complexion that local merchants raised a subscription fund to educate him in North America. As a student at King's College (later Columbia) in the early days of the American Revolution, he made rabble-rousing speeches, blasted the British in polemical essays, and wound up, amazingly, as George Washington's top aide for four years during the Revolution. The spectacular climb of this wunderkind culminated in his appointment as the first Treasury Secretary.

Over the past two centuries, Hamilton's reputation has waxed and waned as America has glorified or debunked businessmen. Historian Gordon S. Wood has written: "Although late-19th-century Americans honored Hamilton as the creator of American capitalism, that honor

became a liability through much of the 20th century." All the conflicting emotions stirred up by capitalism -- its bountiful efficiency, its often stark inequalities -- adhered to Hamilton's controversial reputation. As chief agent of a market economy, he had to spur acquisitive impulses and accept self-interest as the mainspring of economic action. At the same time, he was never a mindless business booster and knew that the desire for profit could shade over into noxious greed.

Hamilton didn't create America's market economy so much as foster the cultural and legal setting in which it flourished. A capitalist economy requires certain preconditions to take root. It must establish a rule of law through enforceable contracts, respect private property, create a trustworthy judiciary to arbitrate legal disputes, and offer patent protections to promote invention. The abysmal failure of the Articles of Confederation to provide this stable business climate was one of Hamilton's main incentives for espousing a new Constitution.

Alexander Hamilton meshed perfectly with his historical moment, for George Washington's first term as President was devoted largely to the economic matters in which Hamilton excelled. As Woodrow Wilson justly observed: "We think of Mr. Hamilton rather than of President Washington when we look back to the policy of the first administration." Hamilton had a fund of information and skills that nobody else could match. Because many financial matters were new to America, politicians could "propose the worst of measures with the best of intentions," as Massachusetts Congressman Fisher Ames observed at the time. Among the well-intentioned men who were woefully backward in finance, if forward-looking in politics, were Hamilton's three most savage critics of the 1790s: Jefferson, Madison, and Adams. These founders adhered to a static, archaic worldview that scorned banks, credit, and stock markets. From this perspective, Hamilton was the progressive figure of the era, and his critics the conservatives.

The new Treasury Dept. was many times larger than the rest of the executive branch combined, so that Hamilton acted as de facto prime minister of the first administration in 1789. Because most revenues came from import duties, he had to fashion a customs service and build buoys, beacons, and lighthouses. He had to construct a fleet of ships to intercept smugglers -- the inception of the Coast Guard. Repeatedly, Hamilton forged the essential building blocks of government, devising our first tax and budget systems, our first central bank, and our first monetary system in a tour de force of statecraft. If George Washington was the father of the country and James Madison of the Constitution, then Alexander Hamilton was surely the father of the federal government.

## "HE KNOWS EVERYTHING"

After being sworn in as first president in April, 1789, Washington knew that the choice of Treasury Secretary would be his most far-reaching appointment. The country was virtually bankrupt, staggering under \$54 million in national debt, coupled with \$25 million in state debt. This burden threatened to sink the new republican government, indeed the whole democratic experiment. Creditors doubted the prospects of the fledgling government, and much of the outstanding debt, which had ceased to pay principal or interest, traded for as little as 15 cents on the dollar. Curiously, Washington knew little about Hamilton's financial acumen despite their wartime work. When Robert Morris, the Philadelphia financier, recommended Hamilton for the Treasury job, the new President seemed taken aback. "I always knew Colonel Hamilton to be a man of superior talents," he commented, "but never supposed that he had any knowledge of finance." "He knows everything, sir," Morris replied. "To a mind like his, nothing comes amiss."

For years, detailed financial plans had germinated in Hamilton's fertile mind, as if he were rehearsing for the Treasury job. Even during the Revolution, he had lugged about two huge, folio-sized volumes entitled Universal Dictionary of Trade and Commerce, written by political

economist Malachy Postlethwayt. In the empty pages of a military pay book, Hamilton had made extensive notes on foreign exchange, population growth, even European rivers. Like other autodidacts of his time, Hamilton aspired to universal knowledge. So when Washington offered him the Treasury post, Hamilton felt equal to the task.

The official announcement was deferred until Washington signed the bill creating the Treasury Dept. on Sept. 2, 1789. On Sept. 11, Hamilton, 34, was officially nominated for the post and confirmed by the Senate the same day. He hit the ground running: The very next day, he arranged a \$50,000 government loan from the Bank of New York, which Hamilton himself had co-founded five years earlier. And the day after that, a Sunday, he worked all day at the Treasury's new office on Broadway just south of Trinity Church and dashed off a plea to the Bank of North America in Philadelphia, soliciting another \$50,000 loan.

From the beginning, Hamilton faced relentless pressure, as wary creditors waited to see if he could miraculously resurrect American credit. And Congress was no less impatient. Only 10 days after Hamilton was confirmed, the House of Representatives asked him to prepare a comprehensive report on public credit, giving him a scant 110 days to comply. With the wind at his back, Hamilton took a giant, running leap in staking out his claim to leadership in Washington's administration. Had he stuck to dry financial matters, his celebrated Report on Public Credit -- the first of four magisterial state papers that also covered a central bank, a mint, and manufactures -- wouldn't have attained such historic renown. Instead, he presented a detailed blueprint of the government's fiscal machinery, wrapped in a broad political vision.

While other members of the revolutionary generation dreamed of an American Eden, Hamilton ransacked European history for ideas. He had inordinate admiration for Jacques Necker, the French finance minister, who had argued that government borrowing could strengthen military prowess. But it was England that shone as his true lodestar. Starting in the 1690s, Britain had set up the Bank of England, enacted an excise tax on distilled spirits, and funded its public debt -- that is, pledged specific revenues to ensure repayment. During the 18th century, Britain had vastly expanded that debt. Far from weakening the country, a well-managed debt had enabled it to build up the Royal Navy, prosecute wars around the world, and maintain a global commercial empire. At the same time, government bonds galvanized the economy, as creditors used them as collateral for loans. Although he imitated British methods, Hamilton wanted to promote American prosperity and self-sufficiency, making the country less reliant on British capital.

From his Report's opening pages, Hamilton reminded readers that America's massive debt was the "price of liberty" inherited from the Revolution, which had been largely financed by borrowing. He argued that governments had to honor their debts because contracts formed the basis of public and private morality. If ably managed, the debt would not only permit America to borrow at affordable interest rates but also act as a tonic to the economy. The secret was to fund it properly by setting aside revenues at regular intervals to service interest and pay down principal.

How exactly the debt should be handled was an inflammatory issue. During the Revolution, many affluent citizens had invested in government paper, and many veterans had been paid with IOUs that plummeted in price after they were demobilized. In many cases, these upright patriots, either needing cash or convinced they would never be repaid, had sold their certificates to speculators for a pittance. Under the stimulus of his funding scheme, with government repayment guaranteed (albeit at lower interest rates), Hamilton expected these bonds to soar from depressed levels and regain their full face value.

This pleasing prospect, however, presented a political quandary. If the bonds appreciated, should speculators pocket the windfall? Or should

the money go to the original holders -- many of them brave soldiers -- who had sold their depreciated government paper years earlier? Hamilton knew the answer to this riddle would define the future character of American capital markets. Doubtless taking a deep breath, he wrote that "after the most mature reflection" about whether to reward original holders, he had decided against this approach as "ruinous to public credit." Among other things, such "discrimination" in favor of former debt holders was simply unworkable. The government would have to track them down, ascertain their sale prices, and trace all intermediate investors who had held the debt before it was bought by current owners -- an administrative nightmare, only made worse by missing paperwork.

In taking this stand against "discrimination," Hamilton established the legal and moral basis for securities trading in America: the notion that securities are freely transferable and that buyers should assume the right of profit or loss from their transactions. The principle that government couldn't interfere retroactively with a financial trade was so vital, Hamilton thought, as to outweigh short-term expediency, even if this meant a one-time windfall for speculators. It was a courageous stand but one that endowed Hamilton with an almost satanic aura among his critics.

As his Report progressed, Hamilton tiptoed through a field seeded thickly with deadly political traps. The next explosive issue was that some debt was owed by the 13 states, some by the federal government. Hamilton decided to consolidate all the debt into a single form: federal debt. Such an "assumption" of state debt by the federal government was perhaps the most momentous political decision ever taken by Hamilton. The plan had the advantage of efficiency, since there would be one overarching scheme for settling debt, instead of many small, competing ones. But it also embodied a much deeper political logic. If the federal government assumed state debt, it would be easier to retain a lock on major revenue sources, especially import duties. The plan also meant that creditors, eager to be repaid, would shift allegiance from the states to the federal government. Thus, the assumption plan was a masterful step by Hamilton to weld the states into a unified nation and tilt the power balance toward the central government.

In the Report's final section, Hamilton enunciated his famous view that a well-funded debt could be a "national blessing" that would safeguard American prosperity. Even here, at the outset, however, Hamilton fretted that this statement would be misconstrued as a call for a perpetual public debt rather than a transitory measure. And that is exactly what happened. For the rest of his life, he expressed dismay at what he saw as a deliberate distortion of his views. His opponents, he claimed, neglected a critical passage of his Report in which he wrote that he "ardently wishes to see it incorporated as a fundamental maxim in the system of public credit of the United States that the creation of debt should always be accompanied with the means of extinguishment." This was "the true secret for rendering public credit immortal." To ensure that the debt was eventually retired, Hamilton planned to institute a tax on domestically distilled wine and liquor and raise a large foreign loan. He also proposed a sinking fund, financed by post office revenues, that would be pledged to pay off the debt. In other words, he wanted government deficits to be temporary, moderate, and self-liquidating.

## SHATTERED CONSENSUS

Even as Hamilton compiled his magnum opus, the prices of government securities streaked skyward in anticipation of its publication, the psychological effect being even more pronounced than Hamilton had expected. When Congress convened, wealthy dealers in securities swarmed around Federal Hall on Wall Street, buttonholing members and trying to ferret out the details of Hamilton's program. Speculators could reap huge profits if they divined his intentions correctly, and at New York dinner parties they hung on his every word for telltale clues. Many rich merchants posted agents to backwoods Southern areas to scoop up depreciated state debt that would become more valuable

if the federal government assumed repayment.

The exact contents of Hamilton's Report remained a mystery until mid-January, when the 51-page document was read aloud to the House of Representatives. The effect on the securities market was electrifying: Bonds began to change hands with a speed never before seen in America. The Chancellor of New York State, Robert R. Livingston, observed that the speculative craze "invaded all ranks of people," while Georgia Congressman James Jackson dubbed the speculators "rapacious wolves seeking whom they may devour."

As the House debated Hamilton's Report that February, he counted on the loyal backing of his former collaborator on *The Federalist Papers*, James Madison, now a congressman from Virginia. Small and rather shy, Madison usually dressed in black, had the bookish pallor of a scholar, and cut a somber figure. He had a formidable mind, extensively researched issues, and could be a tough, cunning adversary. On Feb. 11, Madison rose in the House and shocked Hamilton by assailing his funding scheme. He wanted the original holders of government securities, no matter how long ago they had sold them, to benefit from any future appreciation resulting from Hamilton's scheme. As Madison saw it, blameless patriots were being victimized.

Hamilton was flabbergasted. He had set forth all the practical problems that made "discrimination" unworkable, especially the absent documents needed to trace original holders. And Madison's proposal would have damaged the invaluable maxim that buyers of securities should reap all future profits and losses. For Hamilton, Madison's apostasy was a painful betrayal. Their rift proved more than merely personal, however, for it helped to precipitate the rise of the two-party system in America. The funding debate shattered the short-lived political consensus that had ushered in the new government. For the next five years, the political spectrum in America was defined by whether people endorsed or opposed Alexander Hamilton's audacious programs.

## JEFFERSON'S REBUKE

The cleavage in American political life only widened when the newly appointed Secretary of State arrived in New York on Mar. 21, 1790, and took up lodgings in Maiden Lane. For five years, Thomas Jefferson -- tall, lean, and freckled, with reddish hair and hazel eyes -- had served as American minister in France. The Virginia plantation owner lived with something less than republican austerity. From Paris, he shipped home 68 crates packed with costly French furniture, porcelain, and silver, as well as books, paintings, and prints. He brought back 288 bottles of French wine. To appease his craving for French food, he had the cooking of James Hemings (Sally's brother), who had studied with a Parisian chef.

In contrast to this patrician style, Jefferson cherished a vision of America as a rural retreat of Arcadian innocence. Once in New York, the courtly but suspicious Jefferson decided that the country had been corrupted in his absence and that "a preference of kingly over republican government was evidently the favorite sentiment" among well-heeled New Yorkers. The town struck him as infested with Tories and avaricious speculators in government securities -- all of them looking worshipfully toward Hamilton as their favorite.

Twelve years Jefferson's junior, Hamilton had never met him before; he had been a minor artillery captain when Jefferson composed the Declaration of Independence. By the time Jefferson arrived in New York, Hamilton had already trounced Madison in the "discrimination" debate and was hurtling ahead with the rest of his funding scheme. Jefferson feared that this program would create a fiercely loyal following for Hamilton among speculators enriched by it. He was convinced that congressmen were also dabbling in government securities and that

"even in this, the birth of our government, some members were found sordid enough to bend their duty to their interests and to look after personal rather than public good." Jefferson derided the idea that Hamilton intended to pay off the government debt. "I would wish the debt paid tomorrow," Jefferson told Washington. "He wishes it never to be paid, but always to be a thing wherewith to corrupt and manage the legislature." This rebuke flew in the face of Hamilton's express words in his Report.

Perceiving a dire threat to the American Revolution, Jefferson made common cause with Madison, now the House floor leader, as debate raged over federal "assumption" of \$25 million in state debt. On four separate occasions between February and July, the dexterous Madison thwarted attempts to enact assumption, complaining that his home state and some other Southern states had already paid off most wartime debt and would be penalized if, "after having done their duty," they were forced "to contribute to those states who have not equally done their duty." To Hamilton, it seemed that Madison was speaking for his Virginia constituents and not, as in *The Federalist*, for the national welfare.

Since assumption was his make-or-break issue, Hamilton threw himself into the heated battle with special impetuosity. The Treasury Secretary became ubiquitous at Federal Hall, proselytizing congressmen for assumption and packing the gallery with supporters. With his whirling energy, he encountered huge resistance from congressmen fearful of a strong executive branch. On Apr. 12, the House voted down assumption, and two weeks later discontinued debate. By early June, with the plan seemingly stillborn, Hamilton began to search for a compromise that could salvage the linchpin of his program.

The issue he seized on was the divisive matter of where the national capital should be located. At the Constitutional Convention, delegates had decided to create a federal district, 10 miles square, in an unspecified location. Its siting was a monumental decision, since it would confer tremendous wealth, power, and population upon the chosen region. It would also affect the style of the federal government, which was bound to soak up some of the political atmosphere of the surrounding area. The question of the national capital also served as a proxy for the more fundamental issue of whether America should assume an urban or agrarian character. Complicating all this was the expectation that a temporary capital, likely New York or Philadelphia, would function as a makeshift seat of government while a permanent capital was readied. Notwithstanding his national bent, Hamilton hoped New York would be at least the temporary capital and his opponents dubbed the town "Hamiltonopolis."

During the spring of 1790, the simultaneous quarrels over assumption and the national capital grew so acrimonious that it seemed the union might dissolve. Of the two policies that Hamilton promoted -- assumption of state debt and New York's selection as the capital -- he regarded assumption as incomparably more important, for it would yoke the states irrevocably into a lasting union. He tried to cut deals with both Southerners and Pennsylvanians, dangling the capital before each group in exchange for assumption votes. The Pennsylvania and Virginia delegations reached a tentative understanding: Philadelphia would become temporary capital, with a site on the Potomac as the permanent capital.

It is against this backdrop of an already emerging consensus that we must evaluate the famous anecdote retailed by Jefferson about the dinner bargain that set the capital on the Potomac. According to Jefferson, the Northern states were threatening "secession and dissolution" when he ran into a ragged Hamilton outside Washington's residence. Usually, Hamilton was dapper and polished; now, to Jefferson's amazement, he was despondent and unkempt. "His look was somber, haggard, and dejected.... Even his dress uncouth and neglected." Hamilton seemed desperate.

"He walked me backwards and forwards before the President's door for half an hour," Jefferson continued. "He painted pathetically the temper into which the legislature had been wrought; the disgust of those who were called creditor states; the danger of the secession of their members and the separation of the states. He observed that the members of the administration ought to act in concert; that though this question was not of my department, yet a common duty should make it a common concern...that an appeal from me to the judgment and discretion of some of my friends might effect a change in the vote."

If assumption faltered, Hamilton hinted, he might have to resign. Jefferson blandly informed Hamilton that he "was really a stranger to the whole subject" -- Jefferson was adroit at presenting himself as a political naïf -- but he invited the Treasury Secretary to dine at his home the next day to discuss the matter.

If we are to credit Jefferson's story, the dinner held at Maiden Lane on June 20, 1790, fixed the future site of the capital. It is perhaps the most storied meal in American history, the guests including Jefferson, Madison, Hamilton, and perhaps one or two others. For more than a month, Jefferson had been bedeviled by migraine headaches, yet he presided with commendable civility. Madison restated the argument that assumption punished Virginia and other states that had duly settled their debts. But he agreed to support assumption -- or at least not to oppose it -- if something major was granted in exchange. A deal was struck that Philadelphia would be the temporary capital for 10 years, followed by a permanent shift to the Potomac. Madison also won lucrative concessions for Virginia in any final debt settlement with the federal government. In return, Hamilton agreed to exert his utmost efforts to get the Pennsylvania congressional delegation to accept the Southern capital.

On July 10, 1790, the House approved the Residence Act, designating Philadelphia as provisional capital and the Potomac as the permanent site. A disenchanted Senator William Maclay of Pennsylvania concluded that Hamilton was now all-powerful: "His gladiators...have wasted us months in this place.... Everything, even to the naming of a committee, is prearranged by Hamilton and his group of speculators." On July 26, the House narrowly passed the assumption bill. The famous dinner deal had worked its political magic.

In retrospect, it was a splendid moment for Hamilton, Madison, and Jefferson. They had devised a statesmanlike solution that averted disintegration of the union. In this idealistic dawn of the republic, however, such compromises evoked howls of execration. Thomas FitzSimons of the Pennsylvania delegation feared "that stones would be thrown at him" in Philadelphia because he had gone along with a Potomac capital. On Manhattan streets, the Pennsylvanians endured obscene epithets shouted by pedestrians irate at losing the temporary capital, New York City having already broken ground on a new Presidential mansion.

As the foremost exponent of states' rights, Jefferson had to defend before posterity his role in a deal that dramatically strengthened the federal government. He decided to scapegoat Hamilton, later describing to Washington his own part in passing assumption as follows: "I was duped into it by the Secretary of the Treasury and made a tool for forwarding his schemes, not then sufficiently understood by me, and of all the errors of my political life this has occasioned me the deepest regret." While Jefferson had understood the plan better than he admitted, he probably hadn't seen as clearly as Hamilton that the plan poured a concrete foundation for federal power in America. The national government had captured forever the bulk of American taxing power; the states would now find it impossible to contest the federal monopoly on customs duties. In comparison, the location of the national capital seemed to Hamilton a secondary matter. It wasn't that Jefferson had been deceived by Hamilton, who had explained his views at dizzying length. It was simply that he had been outsmarted by Hamilton, who had embedded an enduring political structure in the technical design of his funding scheme.

The dinner deal was the last time that Hamilton, Jefferson, and Madison ever cooperated to advance a common agenda. Henceforth, they found themselves in increasingly open, partisan warfare.

## WISE TUTELAGE

The effects of Hamilton's funding scheme were instantaneous, wide-ranging, and, to many observers, wondrous. Daniel Webster later rhapsodized Hamilton's Report on Public Credit thus: "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." Under Hamilton's wise tutelage, the interest rates that the U.S. paid on loans plunged from 6% to 4%, as the nation went from a pariah in European credit markets to one worthy of the finest rates commanded by sovereign states. The domestic economy boomed as foreign capital flowed in to finance commerce and agriculture.

The success of the Hamiltonian system, far from assuaging critics, only alarmed them more. Repeatedly, the Treasury Secretary had to combat willful distortions of his belief that a national debt could be a national blessing. By the summer of 1793, he secretly took to the public prints to defend his programs, hiding behind assorted Roman pen names. He denied that government debt was always a good thing and held that "particular and temporary circumstances might render that advantageous at one time, which at another might be hurtful." He also charged the Jeffersonians with hypocrisy for opposing both taxes and debt: "A certain description of men are for getting out of debt, yet are against all taxes for raising money to pay it off."

As the greatest but also most controversial of Treasury Secretaries, Hamilton wasn't about to walk away quietly from office. On the eve of his departure in January, 1795, he mustered the strength for one last voluminous report on government finance and outlined an ambitious future course. Debt remained a legitimate concern, with 55% of federal expenditures being siphoned off to service it. In his parting shot to Congress, Hamilton called the bluff of opponents and laid out a program for extinguishing the public debt within 30 years. He wanted new taxes passed and old ones made permanent, and he painstakingly argued that he had striven to reduce the debt as speedily as possible.

Afterwards, Alexander Hamilton never missed a chance to sound warnings about the insidious creation of government debt. As the ghostwriter for Washington's Farewell Address in 1796, he exhorted his countrymen to avoid "the accumulation of debt, not only by shunning occasions of expense, but by vigorous exertions in time of peace to discharge the debts which unavoidable wars may have occasioned." He didn't want them to throw "upon posterity the burden which we ourselves ought to bear." Hamilton's and Washington's words have echoed down the years, and they never seem to lose their timeliness.

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