HAMILTON AND THE FEDERALIST FINANCIAL REVOLUTION, 1789–1795

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American memory credits Alexander Hamilton mostly with bringing order and respectability to the finances of the new federal government during his tenure as the nation's first secretary of the treasury from 1789 to 1795. For that signal accomplishment, his portrait appears on the face of the ten-dollar bill. The other side of that Federal Reserve note has an engraving of the Treasury Department building in Washington, D.C., with an unrecognizable statue of Hamilton on its front steps. When Robert Rubin retired as treasury secretary in 1999, President Clinton remarked from those same steps that Rubin had been the greatest occupant of the office since Alexander Hamilton.

In truth, Hamilton as treasury secretary did much more than stabilize the finances of the government. When he took up his duties in 1789, the United States had none of the elements of a modern financial system. When he left office in 1795, it had all of them. Hamilton planned and executed what economic and financial historians later would call a "financial revolution." It is a term they use to describe the creation, during a relatively brief period of history, of a modern financial system.

Why should that interest us? One reason is that in today's world of hundreds of independent nations, modern economists are finding persuasive evidence that countries with stronger financial systems tend to perform better and grow faster than those with weaker systems. We economic historians agree, but see the modern findings as hardly novel. We regard financial revolutions as historically important for two reasons. First, financial revolutions are rare events in history. Second, when they do occur, the economies of the affected countries tend thereafter to do uncommonly well compared to other countries. The United States is just one example. Here are a few others.

FINANCIAL REVOLUTIONS IN HISTORY

During the Middle Ages and the Renaissance, Italian city-states were Europe's financial innovators, and their economies became the richest on earth. Among other things, the early Italians invented modern banking. The word "bank" derives from the Italian "banco," the small table or bench on which the banker kept his accounts of deposits and loans.

In early modern Europe, the tiny Dutch Republic had a financial revolution. The ability of the Dutch to borrow from their own people and others helped the republic to secured its independence from Spain, a much larger country. That and other financial innovations then led the Dutch economy into its Golden Age in the mid-seventeenth century, characterized by historian Simon Schama as "the embarrassment of riches." It was hardly an accident that publicly traded companies, another product of the Dutch financial revolution, were the first to explore and colonize in the 1610s and 1620s what later became New York.

Envious of Dutch economic and political success, England in its Glorious Revolution of 1688, invited the Dutch leader, William of Orange, to become King William III of England. William brought state-of-the-art Dutch financial practices with him. England added to them, notably by founding the Bank of England, and in the next decades had its own financial revolution. Subsequently, it experienced the first industrial revolution, became the workshop of the world in the nineteenth century, and established a great empire upon which the sun never set.

The French under John Law tried to have a financial revolution to match Britain's. But it fell apart in the 1720 collapse of Law's Mississippi Bubble, and France lagged behind Britain, financially and economically, for more than a century.[1] Not all attempts to have a financial revolution succeed. That is why the successful cases such as the United States are as noteworthy as they are rare.

HAMILTON AND THE LESSONS OF FINANCIAL HISTORY

Hamilton knew this financial history, and absorbed the lessons it taught about the relationship of modern financial systems to national power and economic prosperity. Months before the Yorktown campaign in 1781, while serving as General Washington's aide-de-camp, Hamilton wrote a letter of advice to Robert Morris, who had just become the U.S. superintendent of finance. "'Tis by introducing order into our finances—by restoring public credit—not by gaining battles," Hamilton wrote, "that we are finally to gain our object." Banks, he went on (at a time when America had no banks), were

> *the happiest engines that ever were invented for advancing trade. Venice, Genoa, Hamburg, Holland, and England are examples of their utility. They owe their riches, commerce and the figure they have made . . . to this source. Great Britain is indebted for the immense efforts she has been able to make in so many illustrious and successful wars essentially to that vast fabric of credit raised on this foundation. 'Tis by this alone she now menaces our independence.*[2]

At the time, the War of Independence had dragged on for six long years. Congress had no power to tax; it could only requisition money from the states, which often did not comply. Money borrowed could not be repaid, making further borrowing problematic to impossible. Continental paper currency had become worthless, and the soldiers in the Continental Army were poorly supplied and ill equipped.

Hamilton saw that the way out of the mess required financial reform, which he reasoned would only be possible with fundamental political reform, that is, a new constitution. Pending that, he recommended several financial reforms to Morris and other national leaders. They included sound public finances (tax revenues to pay public expenses including the army, as well as interest on old public debts, which would make it possible to borrow more), a stable currency, a banking system, a central bank he already called the "Bank of the United States," securities markets, and corporations.

The financial reforms Hamilton recommended to Morris and others in 1780 and 1781 happened to embody the key components of all modern financial systems. At the time only the English and the Dutch had them. The Americans, Hamilton deduced, needed to institute them if they wanted to secure and maintain their independence, and if they wanted to have a strong government and a prosperous, growing economy.

Nearly a decade later, in 1789, the fundamental political reform—the adoption of the Constitution—had been accomplished. Indeed, Hamilton had been one of its spearheads in proposing the Philadelphia convention, serving as a New York delegate to it, and then explaining and defending it as principal author of the *Federalist Papers*. The Constitution's supporters began to call themselves Federalists. Soon they would form a political party of that name, with Hamilton as one of its leaders.

THE FEDERALIST FINANCIAL REVOLUTION

Although the United States had a new constitution in 1789, almost nothing had been done in the area of financial reform. What Hamilton and the Federalists accomplished over the next five years can perhaps best be grasped by comparing the status of each key component of a modern financial system in 1789, when Hamilton took office, and in 1795, when he left office.[3]

Public Finance and Debt Management. When the First Congress convened in the spring of 1789, the United States government was essentially bankrupt. It had large debts on which interest had not been paid for years, and no revenues to pay them. Congress then implemented a power conferred by the Constitution by enacting modest duties on imports to the United States and tonnage taxes on the ships entering U.S. ports. That was in July 1789, even before Congress created the Treasury Department, which would have to collect these taxes. In September, when Congress did create the Treasury Department, President Washington named Hamilton to head it. Since the Treasury was empty, Hamilton immediately arranged loans from two of the country's three banks to pay government expenses. Anticipating tax revenues, Congress requested Hamilton to prepare a plan to pay the country's debt obligations. Hamilton presented his plan in January 1790. After much debate, and side deals that moved the national capital from New York to Philadelphia and then to the Potomac, Congress adopted Hamilton's plan in the summer of 1790.

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Fast forward to 1795. In that year, federal revenues were $6.1 million. That amount was more than sufficient to pay interest of $3.2 million on a total national debt of $80 million. Hamilton had restructured most of the country's domestic debts of nearly $70 million into three new securities issues that first appeared late in 1790. This is the origin of the Treasury bond market, which today is the largest in the world of any single issuer. Foreign debts of some $12 million, mostly resulting from France's loans to the United States during the War of Independence, were separately serviced in Europe with new loans Hamilton arranged with Dutch bankers. The public credit of the United States was firmly established.

Money. In 1789, there was no U.S. dollar. A variety of state-issued paper currencies not convertible to hard money (except at discounted market prices) and foreign coins comprised the U.S. money stock. Some of the paper currencies were denominated in dollars, and others in pounds of varying values in relation to one another. The U.S. dollar came into being in 1791, when Congress adopted the recommendations of Hamilton's Mint Report submitted that year. The report

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defined the dollar in terms of weights of both gold and silver, as was usually the case among the leading nations of Europe.

Fast forward to 1795. The new dollar had become the unit of account for the United States. The U.S. Mint was beginning to make silver and gold coins denominated in dollars. Upon this "hard" monetary base, new banking institutions erected a much larger superstructure of credit, with bank notes and deposits made convertible into the monetary base.

A Banking System and a Central Bank. In 1789, there was no banking system. There were three banks, one each in Philadelphia (opened in 1782), New York (1784), and Boston (1784). They were local operations.

Fast forward to 1795. There were twenty state-chartered banking corporations, plus a federally chartered Bank of the United States (BUS) with its home office in Philadelphia, then the seat of the federal government, and four branches in New York, Boston, Baltimore, and Charleston. On Hamilton's recommendation, Congress created the BUS in 1791. The advent of the BUS stimulated the states into chartering more banks. A decade later, the BUS had four more branches (in Washington, D.C., Norfolk, Savannah, and New Orleans), and the states had chartered fifty-one more banks. Thus by 1805, Americans could borrow from eighty banks, including the BUS branches.

Securities Markets. In 1789, there were no securities markets to speak of, although transactions in deeply discounted U.S. and state securities sometimes took place. Some of these transactions were based on speculation that the new federal government might finally decide to service the country's debts.

Fast forward to 1795. By then, New York, Boston, and Philadelphia hosted active securities markets with regular price quotations in newspapers. These markets traded the three federal debt issues Hamilton had introduced late in 1790 to fund old U.S. debts. Some $63 million (par value) of these domestic securities were outstanding. Also regularly traded and quoted were equity shares of the BUS, capitalized at ten million dollars. Local securities — stocks of state banks, insurance companies, and transportation enterprises, and some state government securities — rounded out the lists. Philadelphia and New York boasted stock exchanges, created in 1790 and 1792 to handle the mushrooming trade in securities. These were brokers' clubs meeting in coffee houses. In New York's case, the exchange club established by the famous Buttonwood Agreement of 1792 did grow into *the* New York Stock Exchange, since a number of the signers in 1792 were also charter members of the modern stock exchange with formal rules and regulations established a quarter century later.

Corporations. In 1789, there were few corporations of any kind in the United States. In the entire colonial era, only seven business corporations had been chartered. During the 1780s, the states together chartered an average of fewer than three per year.

Fast forward to 1795. By then, there were many more corporations. The pace of corporate chartering picked up noticeably in 1791, after Hamilton's BUS was founded as the largest of all U.S. corporations. States issued nine new charters that year. In 1792, there were thirty-one new charters. Thus, more business corporations were created in the two years 1791–92 than had been formed in all previous years of American history. During the decade of the 1790s, charters of business corporations averaged thirty per year, more than ten times the rate of the 1780s.[4] Most were non-financial corporations, but the largest ones were banks and insurance companies. From its inception, the new financial system stimulated the expansion of corporate enterprise, which in turn created demand for loans and securities to trade.

As if by magic, by 1795 the United States had in place all the key elements of a modern financial system: stable public finances and national debt management, a dollar currency convertible into hard money, a banking system, a central bank, securities markets, and a host of corporations. In 1789, it lacked every one of them. This was the Federalist financial revolution planned and led by Hamilton. Its success had many consequences, two of which were a strong federal government, with its credit established at home and in international capital markets, and a more rapidly growing economy fueled both by short- and long-term credit and by equity investment.

CONTROVERSIES OVER THE FINANCIAL REVOLUTION

Since the U.S. financial revolution succeeded, historians have tended to assume that it was accomplished easily. That was far from the case. Anti-Federalist opposition contested almost every financial measure proposed by Hamilton and the Federalists. That opposition quickly coalesced into the Republican Party led by Thomas Jefferson and James Madison. The antics of speculators and the gyrations of securities market prices, inevitable consequences of modern financial systems, served to confirm for the Republicans that the country was going down the wrong road. They tried to drive Hamilton from office by charging him with transgressing the letter or spirit of the laws. But he was able to parry the charges, and Congressional votes vindicated the treasury secretary. The later-enshrined two-party system of U.S. politics was thus largely a product of the financial revolution.

At heart, the dispute was about America's future. Jefferson and the Republicans saw Hamilton and the Federalists to be replicating eighteenth-century Great Britain, with its monarchical centralization, its

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political corruption and disenfranchisement of most people, its squalid cities and factories, its speculators and stockjobbers, its high taxes, and its imperialistic, militaristic adventurism. They preferred the future to be like the past. The United States would be a decentralized republic mainly of planters and farmers, with only a thin overlay of commerce, factories, and urban life, and with governments close to the people.

Hamilton and the Federalists, in contrast, saw some virtues in British institutions. They also had faith that the U.S. republican constitution, with its dual sovereignty of state and federal governments along with its checks and balances within governments, offered adequate protections against British vices. They wanted the American future to be different from past. Their future would have a strong, efficient republican government capable of protecting the country's interests in a hostile world. It would have a diversified, growing economy with agriculture, commerce, and manufacturing, all using modern financial organization to foster the rapid use of new and improved technologies. The Federalists wanted the future to be like what the future in fact turned out to be.

Not long after he became president, Jefferson appeared to recognize with some bitterness that he had lost the battle with Hamilton for America's future. In 1802, he wrote:

> *When this government was first established, it was possible to have kept it going on true principles, but the contracted, English, half-lettered ideas of Hamilton, destroyed that hope in the bud. We can pay off his debt in 15 years: but we can never get rid of his financial system.*[5]

Ironically, a year later, in 1803, Jefferson would use Hamilton's financial system to accomplish the greatest feat of his presidency: he had the United States issue $11.25 million of fresh Treasury bonds and send them to Bonaparte's government in France in payment for the Louisiana Territory. The Louisiana Purchase doubled the size of the country. Fifteen years earlier, before the Federalist financial revolution, such a transaction would have been inconceivable for a then-bankrupt country.

Daniel Webster (1782–1852), writing in 1831, three decades after Jefferson, had a different take on Hamilton. By then the United States had an industrial sector that had grown at a rate of 5 percent a year since 1790, and was well on its way to becoming the strong state with a diversified economy that the Federalists had envisioned when Webster was a child. Said Webster,

> *The discerning eye of Washington immediately called [Hamilton] to that post, which was far the most important in the administration of the new system. He was made Secretary of the Treasury.... He smote the rock of the national resources, and abundant streams of revenue gushed forth. He touched the dead corpse of the public credit, and it sprang upon 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 conceptions of* ALEXANDER HAMILTON.[6]

In later U.S. history, there were attempts to get rid of elements of Hamilton's financial system. They always came back. Today, public credit, the dollar, the banking system, the central bank, the securities markets, and the corporate system, although none of them is without problems, remain the envy of the world. And the power and economic strength of the United States in the world are unmatched. Two centuries after Hamilton's death, Americans ought to remember him for starting them on the road to that result.

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NOTES

1. For more on the Dutch financial revolution, see Marjolein 't Hart, et al., *A Financial History of the Netherlands* (New York: Cambridge University Press, 1997), particularly Hart's chapter, "The Merits of a Financial Revolution, 1550–1700," 11–36. A recent working paper by Oscar Gelderblom and Joost Jonker, "Completing a Financial Revolution: The Finance of the Dutch East India Trade and the Rise of the Amsterdam Capital Market, 1595–1612," available at http://www.iisg.nl/~lowcountries/2004–2.pdf, dates the Dutch revolution more precisely. Simon Schama's exploration of its economic and other consequences is in his book, *The Embarrassment of Riches: An Interpretation of Dutch Culture in the Golden Age* (New York: Knopf, 1987). The now-classic work on England is P. G. M. Dickson, *The Financial Revolution in England: A Study in the Development of Public Credit, 1688–1756* (London: Macmillan, 1967). The most thorough treatment of John Law's failure to execute a financial revolution in France is Antoin E. Murphy, *John Law: Economic Theorist and Policy-Maker* (Oxford: Clarendon Press, 1997).

2. Alexander Hamilton to Robert Morris, 30 April 1781, in *Papers of Alexander Hamilton*, ed. Harold C. Syrett, (New York: Columbia University Press, 1961–87), 2: 604–35; quotes here at 606 and 618. At the end of the letter, in an oft-quoted passage, Hamilton says, "A national debt if it is not excessive will be to us a national blessing; 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….," ibid., 635.

3. This section draws on two articles of mine, "U.S. Securities Markets and the Banking System, 1790–1840," *Federal Reserve Bank of St. Louis Review* 80, no. 3 (1998): 83–98; and "Financial Systems and Economic Modernization," *Journal of Economic History* 62 (June 2002): 277–92. A jointly-authored article, Peter L. Rousseau and Richard Sylla, "Emerging Financial Markets and Early U.S. Growth," *Explorations in Economic History* (forthcoming) documents with statistical evidence the contention that financial development led to economic growth. For the details of how Hamilton conceived and implemented his financial system, see Forrest McDonald, *Alexander Hamilton: A Biography* (New York: W.W. Norton, 1979), which is perhaps the biography strongest on Hamilton's political economy, although I await Ron Chernow's work that is about to appear as this is written.

4. The data on corporate chartering in the early United States come from Joseph Stancliffe Davis, *Essays in the Earlier History of American Corporations* (Cambridge: Harvard University Press, 1917), appendices A and B.

5. Thomas Jefferson to Pierre Samuel Du Pont de Nemours, 18 January 1802, in P. L. Ford, ed., *Writings of Thomas Jefferson*, (New York: G.P. Putnam's Sons, 1892–99), 8:127.

6. Daniel Webster, *Papers of Daniel Webster: Speeches and Formal Writings 1800–1837*, ed. Charles M. Wiltse, (Hanover: University Press of New England for Dartmouth College, 1980), 1:452.