

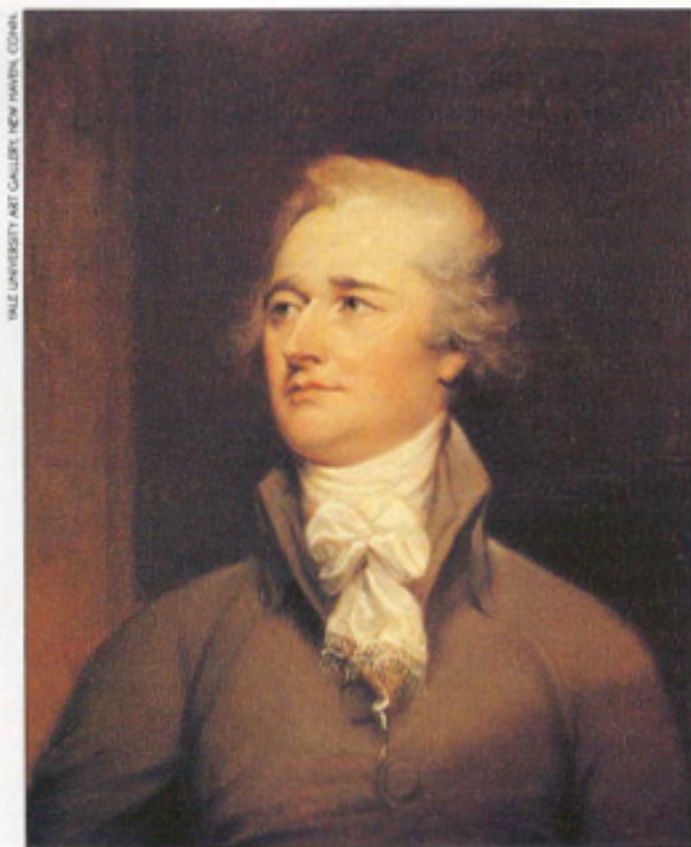
THE FOUNDING WIZARD

by John Steele Gordon

Two hundred years ago the United States was a weakling republic prostrate beneath a ruinous national debt. Then Alexander Hamilton worked the miracle of fiscal imagination that made America a healthy young economic giant. How did he do it?

One price of political greatness is to be forced to campaign even long after death. The Founding Fathers, particularly, have been constantly dragged from their graves for partisan purposes. The shades of Washington, Jefferson, Hamilton, and Madison have been invoked right up to the present by American politicians seeking to add luster to their own political agendas.

In 1923 Arthur H. Vandenberg, not yet a United States senator but already a power in Republican politics, went so far as to write an entire book called *If Hamilton Were Alive Today*. In it Vandenberg presumed to know how Alexander Hamilton would have reacted to the great questions facing the country in the post-World War I era. Deeply conservative himself, Vandenberg not surprisingly thought that Hamilton would come down on the conservative Republican side of all the issues.



Hamilton in 1792, at age thirty-seven, painted by John Trumbull.

Hamilton, he was sure, would have opposed joining the League of Nations, opposed limiting the powers of the Supreme Court (then a conservative bastion), and opposed giving unbridled

freedom to radicals, reds, and other supposed menaces to public order. Vandenberg's Hamilton would also have opposed free immigration and labor's unlimited right to strike. On the other hand, he would have favored enforcing Prohibition (although Vandenberg suspected he would have been unhappy to see it made into law in the first place).

It is, of course, easy to enlist the political support of the dead. They can't issue a denial. But Vandenberg, who had already written a hagiographic biography of Hamilton, was doing his personal hero no service. Rather, he trivialized him by dragging him into the transient issues of the day. The real Alexander Hamilton, like all truly great men, was a man for all seasons and all parties, not merely

for the conservative Republicans who are most apt to invoke his name.

Since the dawn of the Republic, whenever an American has expressed an unpopular opinion, he has had Jef-

He was not like the other Founding Fathers. He was the only one not born in what is now the United States, and he was not from the higher levels of society.

erson, above all others, to thank for the certainty that no official retribution would come of it. Equally, whenever he has made a bank deposit or bought a U.S. Treasury bond, it has been because of Hamilton that he knew the value would still be there when he needed the money back. While this may seem a lesser accomplishment than Jefferson's, without it the American economy could not have flourished so abundantly and made the overwhelming majority of us so rich. Without Hamilton, Jefferson's freedom might easily have become "just another word for nothing left to lose."

Because of his singular success in establishing the financial foundations of the American economy, along with his contributions to the Constitution itself and to the *Federalist* papers, Hamilton has a claim to the title Founding Father that few can match.

With the exception of the United Kingdom and its unique unwritten constitution, the United States today has the oldest continuously constituted government on earth. It is hard for Americans even to imagine the situation that confronted the country on April 30, 1789, as George Washington was inaugurated as the nation's first President.

But in that April, as the new government came together in New York's City Hall, there was only the barest outline of how to proceed, provided by the seven thousand words of the Constitution that had been hammered out two years earlier. There was an enormous amount of work to be done. The new government had to prove itself and engender loyalty among its citizens, who overwhelmingly still regarded themselves as citizens of the individual states. The executive departments, virtually unmentioned in the Constitution, had to be created and their du-

ties allocated.

Equally important, the country's disastrous financial situation had to be addressed at once. As current events in the Soviet Union confirm, bankruptcy is often the mother of serious political reform. And it was the financial chaos caused by the expenses of the American Revolution, together with the incapacity of the government under the Articles of Confederation to deal with its debts or even to fund its current expenses, that finally impelled the creation of a strong federal government.

It is hard for us to imagine, but in 1789 the United States was little more, economically, than a very large banana republic. As early as 1779 the Continental Congress had issued fully two hundred million dollars in Continental currency to pay for the Revolution. This fiat money, along with that issued by the state governments, depreciated rapidly. In March 1780 Congress itself repudiated this debt, revaluing it to one-fortieth of its old value. Much of this paper remained in private hands, some held by speculators who hoped that it would one day be redeemed at more than they had paid for it. Meanwhile, "not worth a Continental" had become a stock phrase in this country.

In addition to the near-worthless currency, the United States had a large debt. It owed the French government and Dutch bankers \$11,710,378. To its own citizens, the government owed \$42,414,085. (In proportion to the government's revenues, that's equivalent to a foreign debt of \$2.4 trillion and a domestic debt of \$8.7 trillion today; the total national debt nowadays is roughly \$3.0 trillion.) The interest on both debts was far in arrears.

Because the financial situation had been the most powerful impetus to the establishment of the new government, the most important of the new departments was certain to be the Treasury. It would soon have forty employees, to the State Department's mere five. The

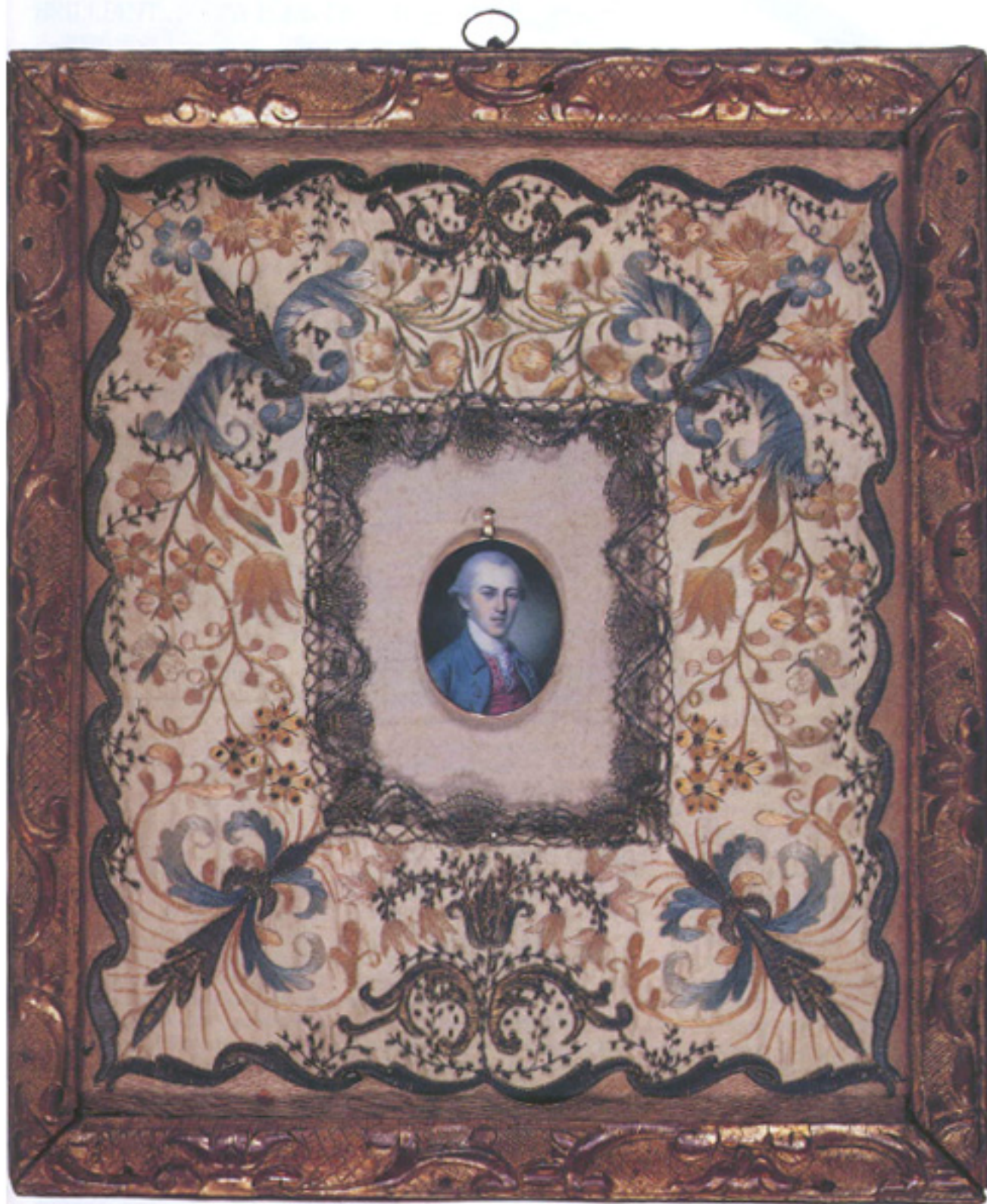
department would have to devise a system of taxation to fund the new government. A monetary and banking system would have to be developed to further the country's commerce and industry. The national debt needed to be re-funded and rationalized. A customs service had to be organized and tariffs collected. 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 young first Secretary of the Treasury.

Alexander 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. He was born on the 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 local society. 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 he was an utter failure as a businessman. He abandoned 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 birthdate.



Hamilton probably presented this miniature of himself, done by Charles Wilson Peale in 1780, to his wife, Elizabeth Schuyler.

At home in the city and learned in finance, he saw far more clearly than Jefferson how the winds of economic change were blowing in the late 1700s.

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 his mid-teens 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 entire

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. His loyalty to America as a whole was unalloyed by any loyalty to a particular state.

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 that dominated its economic and (under a royal governor) political affairs.

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 and 1788 was almost 4,000,000, 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, less than 25 percent voted. It was not for lack of interest. It was simply that the right to vote was limited to those who owned substantial property, in other words, the oligarchs.

The oligarchies often manipulated the legislatures to advance their own interests, such as suspending foreclosures for debt during the economically depressed 1780s. And taxes tended to be laid more heavily on those without the vote, such as small farmers and laborers. Oppressive taxes had led to Shays' Rebellion in Massachusetts in 1786 and 1787, which in turn was a powerful stimulant to calling the Constitutional Convention. It is no accident that that convention placed into the document it wrote a clause forbidding the states to impair the obligation of contracts.

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 bril-



A classical bust of Hamilton adorns a two-dollar bank note from the 1840s or 1850s.

charge. Soon he helped his young employee come to New York to further his education. Hamilton, still in his teens, left St. Croix in October 1772, never to see the West Indies again.

As relations between Great Britain and its American colonies rapidly deteriorated, Hamilton threw in his lot with his new country. His immense talents and his capacity for work soon gave him a leading role in the Revolution and its aftermath. When Washington became President under the new Constitution, he asked Robert Morris, the financier of the Revolution, to become Secretary of the Treasury, but Morris, intent on making money, turned him down. He recommended Hamilton instead. Washington was happy to appoint his former aide-de-camp, and Hamilton, in his early thirties, gladly gave up a lucrative law practice in New York to accept.

Hamilton was also 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 was already the most cosmopolitan and business-minded city in the country. He had founded the first American bank, the Bank of New York. Washington, Jefferson, Madison, and even Adams were far more tied to the land than was Hamilton. Jefferson, especially, longed to see America a country filled with self-sufficient yeoman farmers who shunned urban life. Hamilton, at home in the city and deeply learned in finance, saw far more clearly than Jefferson how the winds of economic change were blowing in the late eighteenth century.

He was always to be, to some extent, a social outsider. Today we tend to think of the American Revolution as

He believed, unashamedly, that people were driven by self-interest. Control how they pursue their interests and you can make their efforts benefit society.

liance and utilized his skills, but they never forgot where Hamilton came from or the conditions of his birth.

Hamilton has often been accused of seeking to establish an aristocratic form of government in this country. This is due partly to an inevitable contrast with Jefferson and his "democratic" political allies and partly to Hamilton's often-stated fear of "the mob." But it is not accurate. To be sure, he had envisioned a government wherein Washington would serve as a

were driven by self-interest. If Jefferson found the roots of his political philosophy in Rousseau and Voltaire, Hamilton found his in Adam Smith. Control the channels in which people may pursue their interests, thought Hamilton, and you can direct their efforts in ways that are positive for society. As Forrest McDonald, one of the best of Hamilton's modern biographers, explains: "The rules determine the nature and outcome of the game. That was the heart of Hamiltonianism.

States that would rationalize the national debt, adequately fund the current expenses of the government, and provide a financial and regulatory framework in which the American economy could prosper and grow.

Hamilton's first major proposal was to refund the debt incurred by the old national government, and indeed, there was not much choice, since the new Constitution commanded that the federal government assume the debts of the old Confederation. The argument was over who should benefit from this refunding. Much of the debt had been issued to pay for requisitions from farmers and merchants. In the inflation caused by the war and the fiscal weakness of the Confederation, the bonds had depreciated greatly in value. Much of the debt had fallen into the hands of wealthy merchants in Boston and elsewhere who had bought it up at far below par (some for as little as 10 percent of its face value).

On January 14, 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 became public knowledge in New York City immediately, 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 to 25 percent of par to about 40 to 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 bonds at par and then sold them 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



Hamilton appears opposite a statue of Liberty on a five-dollar bill from the early 1860s.

sort of uncrowned monarch and Hamilton would be his chief minister. (And Hamilton's political opponents were keenly aware that Sir Robert Walpole, half a century earlier, had transformed his office in the British government, that of first lord of the treasury, into the entirely new office of prime minister.) But for all his personal ambition, Hamilton in fact was a man of the extreme center, to use Stewart Alsop's marvelous phrase. He fully recognized how dangerous too much power in the hands of any one group could be. "Give all power to the many," Hamilton thought, and "they will oppress the few. Give all power to the few, they will oppress the many. Both therefore ought to have power, that each may defend itself against the other."

Here was the essence of Hamilton's political and economic philosophy. He believed, unashamedly, that people

It was a concept as essential to the art of free government as Ockham's Razor was to the philosophy of logic."

Hamilton planned to use this philosophy to accomplish his goals of putting the country on a sound financial footing and binding its citizens to it. He would succeed so well that Hamilton, and very nearly Hamilton alone, laid the foundations upon which arose in the next hundred years the rich and powerful national economy we today take so much for granted.

Over the next five years Hamilton would prepare and transmit to Congress a first and second "Report on the Public Credit," a "Report on a National Bank," and a "Report on Manufactures," embodying in great detail his plans to establish a financial system for the United

One of the greatest weaknesses in the American economy was a lack of capital. Hamilton insisted on a well-funded national debt to overcome this.

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 an 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,

weighty objections to this plan.

The first was one of simple practicality. Identifying the original bondholders would have been a nightmare, in many cases entirely impossible. Fraud would have been rampant.

The second objection was one of justice. If an original bondholder had sold his bonds, "are we to disown the act of the party himself?" asked Boudinot. "Are we to say, we will not be bound by your transfer, we will not treat with your representative, but insist on reset-

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 eager to establish the ability of the United States government to borrow when necessary. He was also anxious to establish a well-funded and secure national debt.

The concept of a national debt is not an ancient one. Until the end of the seventeenth century, debts were incurred by sovereigns personally, and money was borrowed from bankers on an ad hoc basis. Only with the creation of the Bank of England did government debt, paying a regular rate of interest and transferable in a free market, come into being. No other major country followed the British example for quite a while, a fact that in no small way contributed to Britain's rise to the status of a great power in the eighteenth century. Britain's ability to marshal its wealth for military and economic purposes effectively allowed it to play the pivotal role in European politics throughout the century.

By 1790 the British national debt amounted to the then-staggering sum of £272 million. But despite this huge debt—indeed, in many ways because of it—the British economy was the richest, per capita, and the most productive in the world. Yet 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."

But Hamilton grasped it fully. One of the greatest problems of the American economy at the time was a lack of liquid capital, which is to say, capital available for investment. Hamilton



An 1862 two-dollar bill features the stern profile of the father of federal banking.

and Georgia. My soul rises indignant."

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. . . . [I agree] with [the] gentlemen, 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, as congressman from 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. There were two

tlement with you alone?"

Further, to have accepted Madison's scheme would have greatly impaired any future free market in United States 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 government 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 an intellectual, was not. Hamilton, in his report, had been adamant. "[Madison's plan] renders

In the 1780s the United States had been a financial basket case. By 1794 it had an outstanding credit rating, and European capital was building our economy.

wanted to create a well-funded national debt in order to create a larger and more flexible money supply. Banks holding government bonds 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.

Hamilton's reasoning eventually prevailed over Madison's, although not without a great deal of rhetoric. Hamil-

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. So were financial speculators, hoping for a rise to par of bonds they had bought at deep discounts. But land speculators were opposed. Many states allowed public lands to be purchased with state bonds at face value. Any rise in price

positional 31 to 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 debts into one bill. Many thought that the state debt issue was, in the words of one of Hamilton's biographers, "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 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 cozy local societies. While they had largely supported the creation of the new Union, Hamilton had no reason to suppose that their support would not quickly fade away if their self-interest dictated it.

He was therefore eager to make it in the self-interest of these men to continue their support of the federal government. If they had a large share of their assets held in federal bonds, they would have powerful incentives for wishing the Union well. And 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 and nearly every other New Yorker were hoping that the city would become the permanent capital. 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 the commerce and corruption of the big cities.

Hamilton intercepted Jefferson outside President Washington's Broadway



He shares an 1864 compound-interest treasury note with an embodiment of Loyalty.

ton's father-in-law, Philip Schuyler, a senator from New York, owned more than sixty thousand dollars' worth of government securities. 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 rejected Madison's proposal 36 to 13 and approved Hamilton's.

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 twenty-five million dollars, but no one really knew for sure. It eventually turned out that only about eighteen million dollars in state bonds remained in circulation.

would increase the cost of land.

Madison and others argued that it was simply unfair for Virginia to have to pay all over again for the debts incurred by other states. "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 to the federal government all revenues from tariffs and customs—the surest source of funds with which to pay interest—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 pro-

He got Southern votes for the bond bill by making a deal: he would see that the nation's capital was moved to the muddy, fever-ridden banks of the Potomac.

mansion one day and asked for help on getting his bill through Congress. Jefferson 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 assure passage of Hamilton's bill, in return for which Hamilton would see that the capital was located on the muddy and fever-ridden banks of the Potomac River. To assure Pennsylvania's cooperation, the temporary capital was to be moved to Philadelphia for ten years.

(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 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.)

The deal was made, and the bill was passed and then signed into law by President Washington. Hamilton was right that the bonds would find acceptance in the marketplace; 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, 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. In the 1780s the United States had been a financial basket case. By 1794 it had a higher credit rating than any country in Europe, and some of its bonds were selling at 10 percent over par. Talleyrand, 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 thirty-three million dollars' worth of American securities, and European capital was helping mightily to build the American economy.

Less than two years after Hamilton's funding bill had become law, trading in stocks and bonds became so brisk in New York that brokers who specialized in them joined together and formed an organization to facilitate

for government funds and a means of transferring them from one part of the country to another (no small consideration in Hamilton's day). It is also 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. (Spanish dollars, the mone-



By 1880, the date of this note, he had been on twenty-dollar bills for eighteen years.

trading. This organization would evolve into the New York Stock Exchange, and within a hundred years it would be the largest such exchange in the world, eclipsing London.

The third major portion of Hamilton's program, after redeeming the old national debt and nationalizing the states' debts, 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.

A central bank acts as a depository

tary unit upon which the dollar was originally based, were called pieces of eight because they comprised eight reals, or bits. 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 federal bonds could serve the same purpose: "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

Hamilton saw a central bank as an instrument of efficiency, regulation, and money creation. Jefferson saw it as another giveaway to the rich and tyrannous.

thing would, in all probability, happen here, under the like circumstances."

But the bonds were necessarily 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 accomplished 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 thought that governments

capital of only two million dollars. The federal 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 14, 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

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, 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."

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 of the Constitution, 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 indispensably necessary to carry 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 coined until the 1840s—and has been a powerful force in the American political firmament ever since.

President Washington recognized the utility of a central bank, but Jefferson and Randolph's arguments had much force for him. Also, it is possible that like most Southerners he was none too anxious for a central bank, useful or not. 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



With this gold certificate, issued in 1882, Hamilton attains his highest denomination.

could not be trusted to exert self-discipline. Certainly the Continental Congress had shown none when it came to printing paper money. Hamilton thought that an independent central bank could supply not only a medium of exchange but the discipline needed to keep the 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—a position that would mean that no one else would take them either—it could supply discipline too.

Hamilton proposed a capitalization of ten million dollars, a very large sum when you consider that the three state banks in existence had a combined

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*."

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 Congress, which passed Hamilton's bill, the House of Representatives 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.