


# THE GREAT DEBATE

## *Hamilton, Jefferson and the Fight over Assumption*

*By Robert Sloan*

In the early days of our republic the economic foundation of the country was in disarray. The debt of the federal government was vast, as was that of the states, each of which had its own currency, not to mention debt and tariff laws. Some states were creditworthy, some were not, and most paid the soldiers who had helped win the Revolutionary War merely in IOUs.

In 1790, in order to steady the economy, Treasury Secretary Alexander Hamilton consolidated these IOUs, and other state debt, under the federal government. The move was called "assumption," and Hamilton planned to pay for it by introducing a debt scheme funded by new taxes and the use of western land as collateral. Before Hamilton's plan was enacted, skillful investors and speculators — some very close to Hamilton — began purchasing these depressed instruments from soldiers and other debt holders, creating the widespread appearance of arbitrage. The states' debt and IOUs were trading at very large discounts to par, some as low as 15 cents on the dollar.

A vast fortune might be made if investors could locate state creditors and purchase their claims at a discount. Senator Robert Morris, considered by some to be the wealthiest man in America, sent agents scurrying to the western region of his home state, Pennsylvania, to buy up cheap paper from unsuspecting citizens. Congressman James Wadsworth sent two ships to South Carolina for the same purpose. The result was that before assumption took place, or even before many people knew about Hamilton's plan, a significant number of soldiers and other holders of state debt had unloaded it at a steep discount to New York speculators. Better to receive some money, the soldiers and debt holders thought, than none at all. To the debt holders, the speculators seemed to be gambling that the federal government would step in and assume this debt.

Actually, for many of these speculators it wasn't much of a gamble. They knew the new government was about to approve assumption, and the speculators — which included political leaders — took advantage of their inside knowledge that the federal government would guarantee the repayment of that debt.

This issue over assumption set the stage for a more than 200-year ideological split of how the country's financial interests should be run. The battle determined how southern and, later, western interests would look upon their eastern brethren.

Assumption created a two-fold quandary: should speculators profit from the arbitrage opportunity that the government presented to it? Or should the original soldiers be compensated for their losses? Hamilton decided that for the greater good, the speculators should be allowed to profit. The establishment of the good credit standing of the United States was more important than the vexing issue of who should profit. The government should stand behind the transferability of bonds, no matter if the purchase occurred recently, as it had with some speculators, or much earlier, as it was with many who had faith in the new government from its earliest days.

Hamilton believed in a strong executive branch. He understood that the creation of a single unit of account upon which a national currency could be established, the right to taxation and the right to issue debt would not only unify the country, but it would also give the federal government the centralized power it needed to function. But that meant there would be a very hard choice — as the philosopher Thomas Hobbes argued — about how to assure that contracts would become the underpinning of a society. Contracts had to be honored, and the buyers and sellers had to accept the consequences of their actions. The protection of property rights was at the heart of any future economic structure.

Even when reports showed that many speculators were buying up cheap state debt that would become valuable under assumption, Hamilton held his nose. He maintained that the original holders got liquidity when they wanted it, and that was compensation enough, even though their military service made them more patriotic than the speculators. At stake now was a new kind

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of patriotism: Hamilton thought that speculators should be rewarded for showing faith in the financing structure of the new country.

Hamilton stole the moral high ground from opponents and established the legal and moral basis for securities trading in America: the notion that securities are freely transferable and that buyers assume all rights to profits or losses in transactions. The knowledge that government could not interfere retroactively with a financial transaction was so vital…as to outweigh any short-term expediency. To establish the concept of the "security of transfer," Hamilton was willing, if necessary, to reward mercenary scoundrels and penalize patriotic citizens.

Hamilton realized that the use of federal money to solidify the central government's ability to function was an important issue in the creation of the country. He "…knew that bondholders would feel a stake in preserving any government that owed them money. If the federal government, not the states, owed the money, creditors would shift their main allegiance to the central government."

On the issue of assumption, Hamilton understood that if Congress approved his plan, it would give the federal government and not the states the ability to centralize taxation, unify import tariffs and create credit for the new republic. But these centralized powers also alerted the opposition, in this case the landed interests near the Potomac. Those northern Virginian farmers had long been land rich, cash poor, and incessantly in debt to their British creditors. As Jefferson said, the Virginia planter was a "species of property annexed to certain mercantile houses in London."

The high interest charged by the British banks led many—including Jefferson—to make a stark choice: purchase slaves to service the debt by producing tobacco and other cash crops, or sell their land. Jefferson, like many, remained in steep debt to the British until his death in 1826.

The issue of assumption was the first step in centralizing power, which many Americans, especially Jefferson, feared. Jefferson was the counterargument to Hamilton's Federalist bent. Jefferson saw the aggregation and centralization of the government as something that could lead to monarchy and betray the ideals of the Revolution. There were great paradoxes when it came to the views of both men. Jefferson was against the notion of federal government, as he feared the expansion of executive power, and at the same time was pro free trade, yet anti-speculation. Hamilton saw the benefits of the Bank of England model where a good credit standing could be used to make a country more powerful. Hamilton wanted to centralize the methods for revenue collection. He was mercantilist in trade, but was very pro financial speculation. These polemic views set forth how we would feel about the concentration of financial power and how financial power and government power would become intertwined in fundamental constitutional issues that would define the limits of states' rights and expand federal authority.

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So as Hamilton used the Bank of England as a model to create the First Bank of the United States, his enemies did not trust a British system that they perceived worked with the monarchy at the expense of the English legislature. Many of Hamilton's enemies also owed money to England, a foreign power that had significant influence over their personal lives. As a result, when Hamilton proposed that speculators keep the gains from the IOUs and state debt, which they could redeem at a healthy profit in the new, better credit of the republic, there was a natural negative reaction to the move. So, at the formation of the nation's credit standing, Hamilton made sure that contracts were honored and that the resulting uproar did not result in a redistribution of wealth from the new owner of US debt back to the original holder of the IOUs.

We can argue whether the financial tools that Hamilton employed to fund assumption were understood in the House and Senate, but his strategy undeniably had two important results: it split the financial and political capitals of the country, and—just as significantly—it split the interests of the country into banks versus borrowers.

### A Capital Compromise: New York Is Money, Washington Politics

As far as dinner parties go, one hosted by Thomas Jefferson on June 20, 1790 in New York may have been the most momentous and resonant in American history. After having seen his assumption bill rejected a handful of times in Congress, Hamilton realized that in order to pass the legislation, he would need to assuage Southern fears that New York was going to become a pro-British haven where politicians and bankers intermingled. He needed to appeal to fretful southerners, particularly to Jefferson. Here was the perfect opportunity. Jefferson invited Hamilton and James Madison over to discuss a compromise of sorts that would reward land holders near the Potomac: let New York be the commercial capital, while making Philadelphia the nation's temporary—and Washington the permanent—political capital.

In a grand compromise, the three men decided that commerce would be centered in New York, but laws would be passed in Philadelphia (with a commitment to move to the Potomac eventually). Now the fear of having Anglophile speculators near the seat of government—a threat to the very nature of the country's independence—could be put to rest, or so it seemed.

Hamilton held out extraordinarily high expectations for the men he believed should steward the new republic's economy—men of wealth, but altruistic enough to value the nation's financial growth over their own. All too often, however, Hamilton's friends fell far short of his expectations, abusing their proximity to him in order to leverage their own investments. As a result, many Hamiltonians became the object of manhunts or lynch mobs, and eventually found themselves in debtors' prisons (Assistant Treasury Secretary Williams Duer lived out his final days in one). Thus commenced the longstanding, uneasy and often distrustful symbiotic relationship between Main Street and Wall Street that exists to this day.

Hamilton wasn't content merely with having his bank in New York. Relying on the necessary and proper clause in the Constitution, he envisaged a bank with powers that could influence and centralize the government, even if the founding fathers had not expressly consented to that power. The bank was capitalized through the sale of stock, and the shares soared. Cognizant that many speculators were more than game, Hamilton enabled investors to buy a call option. With a $25 deposit, investors were able to buy shares at par and pay off the balance over an 18-month period.

In 1791, while visiting Manhattan to celebrate the capitalization of the new bank, Jefferson observed countless examples of so-called rabble lugging bags of silver and gold to the city to buy scrip. There was such fervor for the paper that bank clerks were run over when the subscription began ("scrip" and "scrippomania" were terms for "subscription"). Their value skyrocketed and only plateaued when banks refused to extend additional credit to some of the most aggressive speculators. Thus one of the century's most exuberant lexicon entries of the period, "scrippomania," was coined.

Two things about the country's reaction to speculation became apparent from this period. First, it became clear that borrowers would tolerate continued speculation as long as they had access to credit. However, once credit tightened or disappeared altogether, speculators would be blamed. It would become the bane of the farmer to sell his products in unpredictable markets controlled by bankers, whose hands had never worked the land, thereby exacerbating an already deep-seated distrust of banks and paper in all its forms. As John Adams said:

> The stock-jobbers will become the praetorian head of the government, at once its tool and its tyrant, bribed by its largesse and overawing it by clamours and combinations.

Siding with agrarian ideal, Jefferson, Adams and Madison believed that making money from money was useless. "An aristocracy of bank paper is as bad as the nobility of France or England," Jefferson said. "Every bank in America is an enormous tax upon the people for the profit of individuals," he remarked, dismissing bankers as swindlers and thieves, and the banking system itself as an "infinity of successive felonious larcenies."

But to Hamilton, it wasn't larceny at all. By modeling the First Bank of the United States after the Bank of England and joining "public authority and faith with private credit," Hamilton's central bank had the ability to unite the country. The new sovereign nation could not exist, he believed, unless a government could raise money, tax, take deposits and create credit. However, two major developments did not help dispel the notion of an urban financial elite. Nor did it pacify the concerns of weary, finger-wagging agrarians.

The first was Hamilton's *Report on the Mint* in 1792. In deciding to use a ratio of gold and silver as the medium for coins in the new American currency, Hamilton was doing what he thought was best at the time—inflating a deflated economy by expanding the money supply. He then attempted

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to set a federal standard by fixing the value of the dollar in each state—tying its value to the number of grams of silver and gold in each coin.

Hamilton's position of "bimetallism" was met with suspicion by Adams, Jefferson and Madison, who believed that the ratio of silver to gold in each dollar would tend to shrink such that the money supply would always favor the lender. It was, to them, a very insidious secret handshake intended to benefit eastern financial interests.

The second factor reinforcing to many the presence of an urban financial elite was Hamilton's insistence that the country allow the creation of limited liability corporations. Jefferson also saw this concept as a mechanism for private gains. He hated the idea that a corporate entity could be used for the aggregation of financial power. He favored private partnerships that had unlimited liability. He wanted litigation exposure for companies whose sole design was to make money. The threat of losing everything was a governor to greed.

By the end of the 18th century, two very different viewpoints on speculation had been demarcated, and a battle waged between a class that lived off its land and a risk-taking class intoxicated by the paper wealth of a concentrated banking system. This latter group—championed by Hamilton—was so at odds with the country's agrarian ideals that it reinforced Jefferson's fear that New York was inhabited by nothing more than a bunch of English-sympathizing stock jobbers who dressed like, spoke like, and wished to be the English he so detested. Put another way, the notion that it was un-American to play in the financial game is nearly as old as the country itself. The battle among the founding fathers foreshadowed how economic blame would be distributed for the next 230 years. FH

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**Sources**

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# TRIVIA QUIZ

## *How much do you know about financial history?*

1. In what city was the first U.S. stock exchange founded?
2. Whose Presidential campaign in 1896 mainly dealt with the issue of free coinage of silver?
3. In the wake of the 1907 panic on Wall Street, with stock prices dropping, whose company had controlling interest of the single banking trust established to prevent a financial collapse?
4. What was the first nation to adopt a decimal coin system?
5. In what year were women employed as adjusters at the U.S. Mint for the first time?
6. The phrase "In God We Trust" was authorized for all U.S. coins by what act?
7. Legal tender of foreign coins in the U.S. was removed in what year?
8. Which government agency enforced the Prohibition after 1920?
9. Who was the first female director of the U.S. Mint?
10. In what year did the distribution of $500, $1,000, $5,000 and $10,000 denominations stop?

1. Philadelphia
2. William Jennings Bryan
3. J.P. Morgan
4. The United States
5. 1795
6. The Coinage Act
7. 1857
8. The Internal Revenue Service
9. Nellie Taylor Ross
10. 1969