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HAMILTON'S POLITICAL ECONOMY
AND THE NATIONAL BANK

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SOCIAL SCIENCE WORKING PAPER 933

August 1995

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Abstract

Alexander Hamilton was a major protagonist in the struggle to build a strong national government backed by the powers necessary to wield centralized power. Hamilton's political and economic writings are complementary bodies of work since they both have common ends – the development of a strong national government and the establishment of strong political-economic institutions. The complementary nature of Hamilton's political and economic writings are most apparent in his defense of the proposal to found a new national bank. This paper will examine in depth Hamilton's writings, concentrating on the bank proposal. The development of this strong and stable financial institution would play both political and economic roles in the new republic. In particular, the national bank would institutionalize citizen support for the new government and thereby ensure the longer-term stability and strength of the national government.

The force of moneyed capital, which has been displayed in Great Britain, and the height to which every species of industry has grown up under it, defy a solution, from the quantity of coin which that kingdom has ever possessed. Accordingly, it has been, coeval with its funding system, the prevailing opinion of men of business, and of the generality of the most sagacious theorists of that country, that the operation of the public funds, as capital, has contributed to the effect in question. Among ourselves, appearances, thus far, favor the same conclusion. Industry, in general, seems to have been re-animated. There are symptoms indicating an extension of our commerce. Our navigation has certainly, of late, had a considerable spring; and there appears to be, in many parts of the Union, a command of capital, which till lately, since the Revolution, at least, was unknown . . . But, though a funded debt is not, in the first instance, an absolute increase of capital, or an augmentation of real wealth; yet, by serving as a new power in the operations of industry, it has, within certain bounds, a tendency to increase the real wealth of a community, in like manner, as money, borrowed by a thrifty farmer . . . adds to his stock of real riches.¹

Alexander Hamilton

¹Alexander Hamilton, *The Works of Alexander Hamilton*. Edited by John C. Hamilton. (New York: John F. Trow, 1850. Volume 3, p. 231.) This volume will hereafter be cited as Hamilton, V. 3. The fourth volume in this series will be cited as Hamilton, V. 4.

Hamilton's Political Economy and the National Bank*

R. Michael Alvarez

Alexander Hamilton closed the *Federalist Papers* with a dire warning: "A NATION, without a NATIONAL GOVERNMENT, is in my view, an awful spectacle . . . I dread the consequences of new attempts because I know that POWERFUL INDIVIDUALS, in this and in other States, are enemies to a general national government in every possible shape."¹ In these words lies the motivations for the thoughts and deeds of Hamilton, ranging from his participation in the Constitutional Convention to his participation in the Washington Administration. Throughout this period, Hamilton was a major protagonist in the struggle to build a strong national government, backed by the powers necessary to wield centralized power. Further, in his role as Treasury Secretary, Hamilton worked under controversy first to place the new national government on a strong financial foundation and second to develop the necessary financial institutions to establish and increase the economic power of the new United States.

Hamilton's political and his economic writings are not distinct and separate bodies of work but are instead complementary. If viewed as a whole it is clear that they have common ends—the development of a strong national government and the establishment of stable and lasting political-economic institutions. This paper will trace the complementary nature of Hamilton's political and economic thought with particular reference to the national bank. To do so, we will first examine Hamilton's political thought in the *Federalist Papers* and his lengthy speech at the Federal Convention. We will turn to his economic thought, examining the national debt crisis, Hamilton's proposed solutions, and the political-economic ramifications of Hamilton's "system." There we will see the political obstacles confronting these proposals in Congress and in the Administration, specifically the constitutional controversy over Hamilton's bank proposal. Last, we will tie these threads together and discuss the themes underlying Hamilton's "political economy."

*I would like to thank John Aldrich, Robert Bates, Ruth Grant, and Sarah Hamm-Alvarez for their advice and especially for their patience.

¹Alexander Hamilton, et al. *The Federalist Papers*. (New York: New American Library, 1961), No. 85, p. 527. Hereafter cited as Hamilton, *Federalist Papers*.

1 Hamilton's Political Thought

There are three themes in Hamilton's political writings: gaining and increasing popular support for the national government, the necessity of centralized national government, and providing the national government with the powers required to carry out its stated ends. We will examine each theme.

The first theme was Hamilton's concern with developing and increasing popular support for the new national government. During his June 18, 1787 speech to the Federal Convention, Hamilton discussed the possibility of a strong and lasting national government. He stated, "To ascertain the practicability of this let us examine the principles of civil obedience."² Hamilton listed as these principles of governmental support the interest to support it, the opinion of its utility and necessity, the development of a habitual sense of obligation, the use of force, and the use of influence.³

The first principle—interest—was discussed as a tension between state and national government. Hamilton knew that the states, as more immediate forms of government to the populace, had an easier time retaining the loyalty of their citizens. As long as the existing political system remained the states would follow the recent example of New York: "(the) New York legislature made an external compliance lately to a requisition of Congress; but do they not at the same time counteract this compliance by gratifying the local objects of the states so as to defeat their concession."⁴ It was clear to Hamilton that the national government would have to obtain the direct loyalty of the people by appealing to their short-term and immediate interests in the manner of the states.

The second principle involved the development of positive opinions on the utility and necessity of the national government. It was clear to Hamilton that the centralized government would have to quickly and coherently demonstrate to the people that they needed such government. He stated that while the dissolution of the states would be a fatal blow to confederation, a similar dissolution of the confederation "would still leave the purposes of Gov't attainable to a considerable degree."⁵

The third principle, a habitual sense of obligation, favored the state governments. The latter were more immediately important to the people, and at that time the ends the people desired from the government—protection and justice—came from the states. This habitual obligation would arise only when the national government became directly relevant to the populace for a lengthy period of time, so that people would support the national government out of habit.

²Max Farrand, editor. *The Records of the Federal Convention*. (New Haven: Yale University Press, 1966). V. 1, p. 305.

³Note: in Farrand's volume of the debates at the Convention, Hamilton's speech was written down by Hamilton in the form of notes, and by Madison and Yeats in a longer fashion. When I discuss Hamilton's ideas from this speech, I am working directly off Hamilton's notes where possible and then using Madison and Yeats for accurate interpretation.

⁴Farrand, V.1, p. 295. Quotation from Yeats.

⁵Farrand, V. 1, p. 284, Madison.

The fourth principle, force, was also tipped toward the state governments: “Force by which may be understood a coercion of laws or coercion of arms. . . Congress has not the former except in a few cases.”⁶ Without either the force of laws or the force of arms, Hamilton thought the national government would be crippled from the outset. It would be impossible for the national government to enforce its decrees or act in its own interest without reliance on the state governments for coercive assistance. As the Revolutionary War demonstrated, the state governments tended to assist the national government only when it was clearly in their short-term interests to provide such assistance; when it was not in their interests, the state governments ignored or gave only slightly assistance to the national government. Without both powers of coercion Hamilton understood there was no way the national government could coerce or sanction dissenting states, enforce its decrees, or prevent the intervention of foreign nations in the relations between the states.

The last principle was influence. By influence Hamilton did not mean corruption but a subtler form of patronage—“a dispensation of those regular honors and emoulements, which produce an attachment to the Gov’t.”⁷ The central government, to gain popular support, had to maintain connections to the citizens based on those very aspects of their personal preferences which motivated them to support the state governments: ambition, self-interest, avarice.

As we have noted, each of these principles of government support was tipped in the favor of the states at the time of the Federal Convention. But could these scales be tipped toward the new national government? At the Convention, Hamilton laid out his own plan for the national government:

What is the inference from 211 these observations? That we ought to go as far in order to attain stability and permanency, as republican principles will admit. Let one branch of the Legislature hold their places for life or at least during good behavior. Let the Executive also be for life . . . On this plan we should have in the Senate a permanent will, a weighty interest, which would answer essential purposes.”⁸

This proposal—containing a virtual “elected monarch” and an obvious parallel to the British system—had little impact at the Convention, but was important in later criticisms of Hamilton.⁹ The importance of this proposed system, however, is Hamilton’s concern with building stable and permanent political institutions which would mitigate “the amazing violence and turbulence of the democratic spirit.”¹⁰ These institutions

⁶Farrand, V. 1, p. 284, Madison.

⁷Farrand, V. 1, p. 285, Madison.

⁸Farrand, V.1: 289-290, Madison.

⁹Forrest McDonald. *Alexander Hamilton: A Biography*. (New York: I.W. Norton and Company, 1974), p. 104. Hereafter cited as McDonald.

¹⁰Farrand, V. 1, p. 289, Madison.

would establish and increase popular support for the government, while attending to the short-term interests of the populace. They would be crucial in the development of habitual obligation between citizens and the central government.

The second theme in Hamilton's political thought was his exposition (*Federalist Papers*, Numbers 6-9, 11-13) on the necessity of the union. While in his earlier speeches and writings he emphasized the shape of the new government and the development of popular support, his writings during the ratification period elaborated the need for a strong central government. Hamilton centered on two distinct themes: the safeguard against dissension both within and between states and the economic benefits of union.

To highlight the means by which the Union would eliminate dissension between the States, Hamilton discussed the causes of hostility between nations: first, "are the love of power or the desire of pre-eminence and domination"; second "are the rivalships and competitions of commerce between commercial nations"; and third "are the others . . . which take their origin entirely in private passions; in the attachments, enmities, interest, hopes, and fears of leading individuals."¹¹ The historical causes of hostility between nations Hamilton translated into the probable causes of conflicts between the states. He discussed the problem of territorial disputes (especially the opening of Western lands), commercial competition, the public debt, laws concerning the violations of private contracts, and the entanglements of European politics.¹²

Hamilton's solution to this problem was summed up in this quote from the Abbe de Mably:

NEIGHBORING NATIONS are naturally ENEMIES of each other, unless their common weakness forces them to league in a CONFEDERATE REPUBLIC, and their constitution prevents the differences that neighborhood occasions, extinguishing that secret jealousy which disposes all states to aggrandize themselves at the expense of their neighbors.¹³

Why does Hamilton rely upon this quote for his solution to the problem of state dissension? If we return to the probable sources of inter-state conflict, these clearly are conflicts where states would "aggrandize themselves at the expense of their neighbors." To eliminate the incentives for states to press such claims and conflicts on other states, they must be drawn into a cooperative system. The vehicle is the union, which will eliminate "the differences that neighborhood occasions." For example, states would not be able to press individualistic demands for western lands—all such lands would be controlled by the national government. Further, the national government would establish a system of tariffs and duties, eliminating inter-state conflict over commercial matters. Thus, the

¹¹Hamilton, *Federalist Papers*, No. 6, p. 54.

¹²Hamilton, *Federalist Papers*, No. 7.

¹³Hamilton, *Federalist Papers*, No. 6, pp. 59-60.

Union would eliminate state dissension by removing the causes of individualistic conflict among the states.

How would the Union stop intra-state faction or conflict? The problem of faction, noted Hamilton, would be countered by the institutional design of the proposed government (separation of powers) and by the “enlargement of the sphere” argument, both later discussed by Madison. The problem of conflict or revolt, however, led Hamilton into a discussion of Montesquieu, who Hamilton paraphrased:

Should a popular insurrection happen in one of the confederate states, the others are able to quell it. Should abuses creep into one part, they are reformed by those that remain sound As this government is composed of small republics, it enjoys the internal happiness of each; and with respect to its external situation, it is possessed, by means of the association, of all the advantages of larger monarchies.¹⁴

The reliance on Montesquieu, while an excellent rhetorical device against those who advanced Montesquieu’s arguments as evidence that the union will not work, led Hamilton to distinguish between a confederation and a consolidation. He argued that as long as the states maintain separate and distinct organizations under the constitution, the union was actually a confederacy.

Therefore, with this confederacy of many constituent parts, a “law of large numbers” holds. With multiple, separate elements—the states—the probability that insurrection would occur simultaneously in more than one state would be minimized. The union would quell tendencies toward insurrection since “sound” states would remain which would be willing to defeat revolts to protect themselves and the “advantages” of their union.

The union, in Hamilton’s thought, was also essential for economic expansion and growth: “The importance of the Union, in a commercial light, is one of those points about which there is least room to entertain a difference of opinion.”¹⁵ The union would enhance commerce, increase government revenues, and lead to substantial scales of economy. As to the effect of the union on commerce, Hamilton was concerned with two distinct possibilities: the apprehension of the European powers about American economic growth and the problems of commerce between the states.

The European powers, thought Hamilton, had the incentive to intervene in the development of an American union in order to foment divisions between the states, or between the states and the national government: “this would answer the threefold purpose of preventing our interference in their navigation, of monopolizing the profits of our trade,

¹⁴Hamilton, *Federalist Papers*, No. 9, p. 75.

¹⁵Hamilton, *Federalist Papers*, No. 11, p. 84.

and of clipping the wings by which we might soar to a dangerous greatness.”¹⁶ A firm union, however, would fight these European designs by forcing them to bid for access to American markets and thus putting the European powers into conflict with each other; this competition would also open European markets to American goods. Further, the strong central government would be able to establish a strong navy which no individual state could construct independently. This navy would protect American commerce and open new markets for trade. By these means, the union would allow American commerce to expand and grow, thus advancing the American economy and international position.

The union would also expand the commercial exchange between the states:

An unrestrained intercourse between the States themselves will advance the trade of each by an interchange of their respective productions, not only for the supply of reciprocal wants at home, but for exportation to foreign markets. The veins of commerce in every part will be replenished and will acquire additional motion and vigor from a free circulation of the commodities of every part. Commercial enterprise will have much greater scope from the diversity in the productions of different States.¹⁷

Thus in both these ways, the union of political interests will promote the union of commercial interests.¹⁸

Moreover, the firm union would also promote increased governmental revenues. First, with the increase in commerce, both domestic and foreign, there would be an increase in both capital in the nation to be taxed and quantity of money in circulation with which these taxes can be paid. But, as Hamilton knew (especially after Shay’s Rebellion), the people of the country would resist direct taxation; in the foreseeable future the government must therefore rely on the collection of duties and tariffs. Hamilton showed, however: “It is therefore evident. that one national government would be able at much less expense to extend the duties on imports beyond comparison, further than would be practicable to the States separately, or to any partial confederacies.”¹⁹

Last, the union would entail substantial economies of scale, and would thus result in substantial savings to the various states. There would be only one national civil list to support; the protection of commerce and the detection of illegal trading would be subject to an economy of scale; also, the development of military forces would be easier and cheaper by one national government than separate efforts by the various states.

The third theme of Hamilton’s political thought was his emphasis on the powers necessary to institute and maintain a strong republic. The first step in discerning what

¹⁶Hamilton, *Federalist Papers*, No. 11, p. 85.

¹⁷Hamilton, *Federalist Papers*, No. 11, p. 89.

¹⁸Hamilton, *Federalist Papers*, No. 11, p. 90.

¹⁹Hamilton, *Federalist Papers*, No. 12, p. 95.

powers the national government would need was deciding which objects the national government was designed to pursue:

If the circumstances of our country are such as to demand a compound instead of a simple, a confederate instead of a sole, government, the essential point which will remain to be adjusted will be to discriminate the OBJECTS, as far as it can be done, which shall appertain to the different provinces or departments of power; allowing to each the most ample authority for fulfilling the objects committed to its charge.²⁰

Therefore the national government should have requisite powers to fulfill the fundamental ends for which it would be organized. In Hamilton's words, "the *means* ought to be proportional to the *end*; the persons from whose agency the attainment of any end is expected ought to possess the *means* by which it is to be attained."²¹

What were the fundamental ends? Hamilton listed common defense, public peace, regulation of international and inter-state commerce, and foreign policy. Of these, Hamilton devoted most of *Federalist No. 23* to discussing common defense. His conclusion concerning common defense was that the national government needed unlimited means to fulfill the role of national defense due to the uncertainty which Hamilton surrounded such affairs. Yet Hamilton did not stop with only national defense: while he built the argument for the means-end relationship on the least controversial aspect of centralized government power, he firmly believed that requisite powers (the means) should be extended to the national government for each explicitly-stated end.

In *Federalist No. 23*, Hamilton extended the means-end relationship to internal and external threats and the promotion of commerce. But he initially neglected to discuss revenue collection, since this was a controversial topic. Under the Articles of Confederation, the Congress had minimal means by which to raise revenues. They had to make requisitions against the states, which the states were bound to fulfill; yet during the course of the Revolution these requisitions had often gone ignored. It was clear to Hamilton that this was a necessary end of the new union:

A complete power, therefore, to procure a regular and adequate supply of revenue, as far as the resources of the community will permit, may be regarded as an indispensable ingredient in every constitution. From a deficiency in this particular, one of two evils must ensue: either the people must be subjected to continual plunder . . . or the government must sink into a fatal atrophy.²²

²⁰Hamilton, *Federalist Papers*, No. 23, p. 155.

²¹Hamilton, *Federalist Papers*, No. 23, p. 153.

²²Hamilton, *Federalist Papers*, No. 30, p. 188.

Thus to avoid atrophy or plunder, the union must possess independent revenue-collection abilities.

It is not surprising that Hamilton also extended his means-end relationship to the question of revenue collections, given the undesirable results a lack of such powers could entail. He bluntly stated that “the federal government must of necessity be invested with an unqualified power of taxation in the ordinary modes.”²³ By this Hamilton meant that the union must be granted unlimited powers to tax—both indirect and direct taxation. Unlimited revenue collection powers were required to insure future revenues for unknown future contingencies, especially those associated with national defense and wars.²⁴ Unlimited access to all taxation instruments was required to reduce the likelihood that any potential taxable activity would not be taxed so highly as to eliminate it or reduce it to an inefficient or undesirable existence. For if the national government were limited only to one instrument of taxation, like taxes on manufactures, the revenue requirements of the union could require taxing the fledgling manufacturing base of the republic out of existence or into an inefficient competitive existence.

The problem with the unlimited extension of revenue collection powers, however, was the revenue requirements of each state. As Hamilton pointed out, the only source of revenue the union would acquire from the states was the power to tax imports. On all other potential sources of revenue the states retained their sovereign taxation powers. Hamilton did not believe that overlapping powers of taxation would be a burden on the people or the commerce of the new republic: “in a short course of time the wants of the States will naturally reduce themselves within a very narrow compass; and in the interim, the United States will in all probability find it convenient to abstain wholly from those objects to which the particular States would be inclined to resort.”²⁵

To summarize this discussion, we have seen Hamilton’s political thought as comprising three themes: the principles necessary to build support for a national government; the reasons for a national government; and the necessary powers with which the national government should be endowed. These three strands, then are woven into the fabric which expressed Hamilton’s vision of the national government: a strong, centralized government with the needed powers and popular support to propel the nation to achieve the greatness which Hamilton knew was possible.

2 Hamilton’s Economic Thought

Yet immediately after the Constitution was ratified and the first Congress prepared to meet, Hamilton’s political vision seemed illusory. For Hamilton, the new Treasury Secretary, faced the forbidding task of reconstructing the war-torn national economy and establishing the national government’s role in the current and future national economy.

²³Hamilton, *Federalist Papers*, No. 31, p. 195.

²⁴Hamilton, *Federalist Papers*, No. 34, pp. 208-209.

²⁵Hamilton, *Federalist Papers*, No. 34, pp. 206-207.

To examine these two tasks, and how they meshed with Hamilton's political thought, we must turn to the political- economic crisis facing the new Union and the set of economic proposals Hamilton sent to Congress. We will concentrate on Hamilton's bank proposal since it stands at a crucial intersection in Hamilton's political and economic thought.

The roots of this economic crisis lay in the Revolutionary War, and extend back into the colonial era. During the colonial and Confederation periods, both the states and the small national government faced serious difficulties in raising revenues since pre- Revolutionary America possessed little liquid wealth. When war broke out in 1775, a means to finance the war effort by both the national and state governments was needed, given the lack of liquid wealth. Both state and national governments turned to two alternatives, printing paper money and loans. The Continental Congress, however, pledged the faith of the thirteen colonies to its (money's) redemption. Each colony was made responsible for the withdrawal of a certain share or quota of the total emission."²⁶ By war's end the Congress had printed a face value of over \$200 million, an amount of paper currency roughly equal to the real price advances during the war which would have absorbed the currency without inflation or devaluation.²⁷

The problem was that the states had also printed roughly the same amount of paper money. This doubled the amount of currency in circulation, and the real value of the Continental currency rapidly fell. By 1779 this currency traded officially at a ratio of one 1775 dollar to forty 1779 dollars and unofficially at a rate of one 1775 dollar to ninety eight 1779 dollars in the New York security markets. Thus both the national government and the state governments (who originally were to have paid off the Continental Congress's debt) had printed their way into an inflationary spiral.

Compounding the currency problem was the debt problem. The 17 Continental Congress had also issued loan certificates during the war, mostly at six percent interest. Given inflation and devaluation, the interest on these certificates could not be met so the Continental Congress issued interest certificates, "indents", which Congress then allowed the states to use as pledges against their annual requisitions to the war effort. Yet a few states—New York and Pennsylvania for instance—allowed their citizens to pay their state taxes with these certificates making these states large creditors of the national government since they held roughly one- third of all loan certificates. Also, the foreign debt totalled nearly \$11 million at war's end, which cost Congress roughly a million dollars each year in interest and capital payments. The payments on the foreign debt, agreed upon in Congress as the top post-war priority, ate up all of the national government's revenues from their sole existing tax, the 1789 tariff.

This economic crisis posed both short- and long-term economic problems for the new union. The virtual worthlessness of the various state and national currencies combined with a post-war flood of European imports to create a serious economic depression:

²⁶E. James Ferguson. *The Power of the Purse*. (Chapel Hill: The University of North Carolina Press, 1961), p. 76. Hereafter cited as Ferguson.

²⁷Ferguson, p. 26.

The hard times of the 1780's were indeed a depression, for prices became severely depressed. Beginning in mid-1784, wholesale commodity prices at Charleston, Philadelphia, and New York started to fall, and—with the exception of an upsurge at Charleston in 1796—followed a downward trend until 1788 or mid-1789.²⁸

Thus in the short-run, the new nation faced a worthless currency system, a severely depressed economy, and virtually no economic growth.

Another short-run economic problem was speculation in the debt.

It is reasonably certain that by 1787 or 1788 the greater part of the debt not already redeemed by the states was in the possession of secondary holders of varying magnitude. It was the property of former army officers, shopkeepers, lawyers, and other professional men, prosperous landowners, merchants who traded in securities as an adjunct to commerce, (and) merchants who became security brokers.²⁹

Above, we saw that in a few short years the values of the Continental currency had skyrocketed. There were booming security markets located in New York and Philadelphia which witnessed massive increases in the quantity of securities sold and prices of securities in the post-war years. The fact that wealthy men traded in government securities and profited from these skyrocketing capital markets added to the downward spiral of the national economy and sparked popular controversy. On the economic side, these booming capital markets deepened the depression by fueling price increases and by adding to inflationary expectations. On the political side, pressures to stop speculation escalated on the lawmakers, since many felt that these “speculators” were profiting unfairly on securities the original holders—those who had invested in the patriotic cause of the Revolution—had sold merely to survive.

Beyond the immediate political pressures that the issue of speculation in securities provoked, there also were two more general political problems which facing Hamilton. First, the economic debts of the national government threatened to widen the sectional split in the nation. On one hand, there was the problem of debt documentation in the states which held portions of the national debt: “Every state 19 in the union had difficulty arranging its accounts and supporting claims with documents, but the financial records of Virginia, North Carolina, and, apparently, Georgia were so fragmentary and confused as to defy organization.”³⁰ On the other hand, the public debt was unequally distributed among the states: New York, Pennsylvania, and Maryland held a third of the principal

²⁸Curtis D. Nettles. *The Emergence of a National Economy, 1775-1815*. (New York: Holt, Rinehart and Winston, 1962), p. 62. Hereafter cited as Nettles.

²⁹Ferguson, p. 255.

³⁰Ferguson, p. 215.

of the debt, while New England and the South held virtually none of the debt. Therefore the interests of the states were split over the public debt; any steps taken to eliminate the debt would face serious sectional opposition.

The other political issue was how would the national government actually pay the debt. It was clear by the beginning of the first Washington administration that direct taxes would not work. Shay's Rebellion in 1786 was motivated by the heavy taxes Massachusetts had imposed on its citizens to fund its extensive war debt: "The cause of this insurrection was the oppression under which the citizens groaned, from the imposition of taxes to satisfy the public creditors."³¹ Since direct taxes were not an option, other less "oppressive" means to fund the public debt would have to be formulated.

In the long-term, the new republic faced an entirely different set of potential problems concerning the national debt—fostering economic growth, developing investment, building public confidence, and establishing the credibility of the new national government's role in economic development. The first long-term problem, the relationship between the economic crisis and economic growth, was straightforward. Unless the public debt was brought under control, the economic crisis would continue and perhaps worsen: as long as depression ensued, future economic growth would be less likely. The second long-term problem, investment, was tied to economic growth: as long as the crisis continued, further investment would decrease due to diminishing capital to be invested and to the heightened attractiveness of shorter-term domestic investment alternatives. Furthermore, as economic growth diminished, the pool of capital available for investment would diminish. The dynamic relationship between growth and investment were the long-term consequences of the public debt and the economic depression.

The third long-term problem concerned the credibility of, and confidence in the national government's ability to pay its debts and to positively influence economic development. As Hamilton wrote:

Every breach of the public engagements, whether from choice of necessity, is, in different degrees, hurtful to public credit . . . with every possible mitigation, credit must suffer, and numerous mischiefs ensue.³²

Before the war, it was a common practice for state legislators to set aside their contractually obligated debts when they discovered that they would not be able to pay them.³³ This sort of behavior by the new national government regarding the public debt would have deleterious effects on the national government's reputation as a creditor. As the national government repudiated its debts, those who held the repudiated debts would be hesitant to loan money to the government in the future, and would do so only at

³¹Annals, V. 11, p. 133; Ferguson, pp. 245-248.

³²Hamilton, V. 3, p. 3.

³³McDonald, p. 119. *Forrest McDonald, We The People*. (Chicago: University of Chicago Press, 1962).

extremely high interest. Therefore, the issue of the national government's credit and credibility was at stake.

Given what we know of Hamilton's political thought, and given these short- and long-term economic problems facing the new republic (which would act as restraints on the policy proposals Hamilton could advance), what political-economic solutions did the new Secretary of the Treasury to formulate? Again it is illuminating to separate his proposed solutions to the economic crisis into short- and long-term proposals. The short-term, immediate solutions—assumption of state debts, funding, and the sinking fund—were submitted by Hamilton to the House during the First Congress. Once these immediate solutions were in effect, Hamilton turned to long-term solutions which he submitted to the House during the Second Congress. This set of proposals aimed to institutionalize the foundations for a solid and lasting system of public finance: the creation of a new national bank, a mint, and a taxation system. To elucidate Hamilton's economic thought, then, we will examine Hamilton's proposals to the first two Congresses.

In January, 1790, Hamilton submitted his first report to the House, "The Report on the Public Credit." Hamilton understood that the easiest option would be to follow the course taken by many pre-war state governments—simple repudiation of all or part of the public debt. Yet Hamilton also knew the ramifications: "States, like individuals, who observe their engagements, are respected and trusted, while the reverse is the fate of those who pursue an opposite conduct."³⁴ It was clear to Hamilton that the government would have to again appeal to those who held capital in the future for further loans; if the government has built a reputation as one which repudiates its debts, capital-holders would be reluctant to lend to the government and would do so only at high interest rates. Therefore repudiation was not a viable option.

The second question Hamilton faced was whether the payment plan should distinguish between the original holders of the public debt or the subsequent purchasers. Hamilton rejected any type of discrimination between original holders and subsequent purchasers of public debt, again on contractual grounds:

The nature of the contract, in its origins, is, that the public will pay the sum expressed in the security, to the first holder or his assignee. The intent in making the security assignable, is, that the proprietor may be able to make use of his property, by selling it for as much as it may be worth in the market, and that the buyer may be safe in the purchase. Every buyer, therefore, stands exactly in the place of the seller.³⁵

Further, allowing discrimination between original holder and purchaser would eliminate the use of the various forms of public debt as a medium or exchange; such a move would have destroyed all types of legal tender then circulating throughout the nation.³⁶

³⁴Hamilton, V.3, p. 3.

³⁵Hamilton, V.3, p. 8.

³⁶Nettles, p. 112.

Hamilton also rejected the idea that the states should pay the public debt. He recommended that the national government should service not only the debt outstanding to individual creditors, but that the national government should assume the debts incurred by the states. All of these debts were contracted for one reason—"It was the price of liberty"³⁷—and he felt the national government should be responsible for financing that common goal. Also, the national government could more easily service these debts since the states had sharply varying abilities to provide for the public debts they held.

Perhaps most importantly, a centralized debt service would strengthen the national government:

If all the public creditors receive their due, from one source, distributed with an equal hand, their interest will be the same. And, having the same interests, they will unite in the support of the fiscal arrangements of the Government—as these, too, can be made with more convenience where there is no competition.³⁸

After he had shown that the national government should be responsible for the entire public debt, and that there should be no discrimination between holders (past or present), Hamilton turned his attention to the means by which the debt would be serviced. He calculated the entire public debt to total \$79 million dollars, on which the interest per year would amount to \$4.5 million dollars. The question which Hamilton faced was whether the revenues of the national government could meet this annual interest payment and pay off a certain percentage of the principal each year.³⁹ Hamilton concluded that the government could not fund the entire debt at its current interest rate since this would require an extension of direct taxes greater than the House or the people would approve. Also, he believed that if the public credit were adequately funded the future rate of interest would fall. Therefore Hamilton proposed that the government convert the present debt to a lower rate of interest by allowing creditors to exchange their current securities for newer low interest securities. The new securities would compensate their bearers for the reduced interest return in two different ways. First they guaranteed that a certain percentage of their security would be paid in full on an annual basis over an extended period of time similar to what we today call annuities). Second they allowed redemption of a portion of the security in the form of Western land. This was the most important and subtle part of Hamilton's plan, since by this method of supporting the debt, the national government could literally force the interest rate to fall and stabilize. This would eliminate the fluctuations in interest rates which fueled the drive toward speculation. In addition, this would play against the public's hatred of speculation and solidify popular support behind his plan. Note that Hamilton framed the program as an annual appropriation to slowly pay portions of the debt across time, rather than pay the entire debt in one gigantic sum.⁴⁰

³⁷Hamilton, V. 3, p. 4.

³⁸Hamilton, V. 3, p. 14.

³⁹Hamilton, V. 3, pp. 19-21.

⁴⁰McDonald, pp. 166-167.

Now all Hamilton had to do was tie up a few loose ends. On the foreign debt, he proposed that another loan be taken out abroad to pay only the interest on the existing foreign loans and not the principal. He believed that future loans could pay off the principal when it came due since scarce cash should not be sent abroad to service foreign debts. Second, the state debts should be assumed immediately, but neither the interest nor the principal should be paid for at least another year. Hamilton wished to give the national government breathing room to slowly and incrementally raise direct taxes.⁴¹ Third, Hamilton proposed to increase revenues through increased duties on wines, spirits, teas, and coffees: "They are all of them in reality luxuries; the greatest part of them foreign luxuries; some of them, in the excess in which they are used, pernicious luxuries."⁴² These increased duties would net an additional \$1.7 million dollars per year which would be utilized to pay interest on the public debt. Last, Hamilton proposed to create a "sinking fund" with surplus revenues from the Post Office. A board of commissioners would be appointed to oversee this "sinking fund" and they would buy public securities in the market or buy back portions of the outstanding principal. The "sinking fund" would not independently retire a significant portion of the public debt; rather, it would buy public securities to maintain them at their face (or par) value.

The more important purpose of the sinking fund would be what, in the twentieth century, would be known as "pegging the market" or "open market operations," designed to drive the market price of securities to par and maintain it at that level. With securities stabilized at par, speculation would be ended, public credit would be established, and the public debt would be monetized.⁴³

The major aspects of the Report on Public Credit—assumption, funding, and the sinking fund—constituted most of the business before the First Congress. But in Hamilton's understanding of political economy, these measures were all short-run: the funding plan was to buy time for the government so it could slowly increase taxes and the sinking fund was to play the role of a national bank until an official bank could be founded. Therefore, after the "Report on the Public Credit" established the short-term fiscal policies of the national government, Hamilton turned to the establishment of permanent institutions of public finance.

As Congress adjourned from the first two sessions, they instructed Hamilton to prepare an additional report on a national bank and a new set of taxes. The reports which Hamilton submitted to the Second Congress detailed plans for the creation of a national bank, a mint, and a taxation system. These institutions, together with the funding system, would be mutually supporting and would stabilize the fiscal environment of the national government to reduce risk and uncertainty of investment.

⁴¹McDonald, p. 170.

⁴²Hamilton, V. 3, p. 34.

⁴³McDonald, p. 171.

Hamilton's proposal for a national bank listed the advantages of such an institution: it would increase the amount of active capital in the economy; it would be a source of short-term emergency loans to the government; and it would facilitate the payment of taxes.⁴⁴ This national bank was to be capitalized at \$10 million dollars, of which Congress would provide \$2 million (half in cash, the rest to be borrowed from the bank and incrementally paid back) and the remaining \$8 million would be offered for public subscription.

In Hamilton's mind, the establishment of this bank would almost immediately stabilize the public debt. The high interest rates on the government bonds (six percent) which provided the bank's capital assured that these bonds would be eagerly sought by investors, and the government itself would be able to support and maintain the bond prices through sinking fund purchases of bonds. The high demand for bonds would in turn build expectations concerning the bonds in particular and public credit in general. This would establish the government's reputation as a debtor.

"The Report on the National Bank," submitted by Hamilton on December 14, 1790, was modeled on the Bank of England. This enabled Hamilton to cloak this proposal in the economic and business theories of the time: "after an experience of centuries, there exists not a question about their utility in the countries in which they have been so long established. Theorists and men of business unite in the acknowledgment of it."⁴⁵ But there was one very important distinction between Hamilton's proposed bank and its English predecessor. The Bank of England was only an instrument of public finance since its capital was entirely public debt; Hamilton's bank would not deal in public debt but would instead supply a national money supply.⁴⁶

This bank, however, needed capital to meet interest payments, which meant that additional sources of revenue would have to be found. Hamilton reiterated one of the themes of his First Report where he argued for increased import duties, but added that there were limits on how high these duties could be raised before they were detrimental to business. His new proposal planned to shift the burden of duty collection from a voluntary basis to a more coercive system relying on federal officers paid on a commission-basis.

The last aspect of Hamilton's plan concerned the establishment of a mint. Most of the rationale behind the proposed mint was provided by others before Hamilton, but he considered a national mint to be an essential addition to his establishment of a stable public credit. The mint would provide the currency which the national bank would keep in circulation, and this currency would be uniquely American. Further, the mint was another aspect of the expectation and reputation-building aspects of Hamilton's plan since a stable currency based on precious metals would provide a reliable and sound medium of exchange.

Through these short- and long-term proposals, Hamilton sought to create institutions

⁴⁴Hamilton, V. 3, pp. 109-112.

⁴⁵Hamilton, V. 3, p. 107.

⁴⁶McDonald, p. 194.

which would provide a firm and lasting foundation for public credit in the United States. The short-term solutions— assumption of state debts, no discrimination among holders, and this institutionalization of the sinking fund—all were expressly designed to face the immediate economic crisis, to stabilize interest rates, to slow inflation, and to restore public confidence in the ability of the new government to operate in a credible fashion concerning the economy and the public debt. Those separate short-run actions were mutually dependent upon each other. Immediate and dramatic steps were necessary to pull the nation out of economic crisis and that was the purpose of the sinking fund and assumption plans. But Hamilton understood that “ultimately, the only way to establish public credit was in the marketplace, and the marketplace dealt in beliefs as well as facts.”⁴⁷ Therefore the establishment of public confidence in the government’s actions concerning the national debt was critical.

Till this shall be accomplished, the finances of the United States will never wear a proper countenance In nothing are appearances of greater moment that in whatever regards credit. Opinion is the soul of it; and this is effected by appearances as well as realities.⁴⁸

The establishment of a sound foundation for funding the public debt was critical in the short-term for solving the economic crisis and for institutionalizing public confidence in the government and the economy. Furthermore, public confidence was essential for the debt funding and the consequent reduction of inflation and interest rates.

The short-run institutionalization of public confidence and the public debt were insufficient for the permanent foundation Hamilton wished to construct for the economy and the national government. He -proposed long-run political-economic institutions:

the establishment of a mint, a revision of the tax system, and the creation of a national bank. Properly rigged, each would support the others and the funding system as well, and the funding system in turn would support them all. Opinion would remain the heart and the life’s blood of the whole, but opinion would now be institutionalized; and opinion, firmly institutionalized, becomes well-nigh unalterable.⁴⁹

The main element of the institutionalization of public credit and public confidence was the new national bank. Hamilton’s national bank proposal highlights the intersection between his political and economic writings, and for that reason I will turn now to a discussion of the national bank and its political-economic ramifications before discussing the general outline of Hamilton’s political economic thought.

⁴⁷McDonald, p. 164.

⁴⁸Hamilton, V. 3, p. 31; McDonald, p. 164.

⁴⁹McDonald, p. 190.

3 The National Bank

Hamilton meant the sinking fund to be a short-run instrument with which the national government would control the public debt until a permanent national bank were established. He stated in his first "Report on the Public Credit:"

He ardently wished to see 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 he regards as the true secret for rendering public credit immortal ... the Secretary proposes that the net product of the Post Office ... be applied ... to the discharge of the existing public debt As an additional expedient for effecting a reduction of the debt, and for other purposes, which will be mentioned, the Secretary would further propose ... a National Bank.⁵⁰

The bank proposed by Hamilton would originally have only \$500,000 in capital. Its eventual capital stock would not exceed \$10 million: \$1.5 million held by the government and \$8 million held by shareholders. The shares would be sold in four hundred dollar chunks, of which the buyer would have to pay one-fourth in gold or silver coin and three-fourths in 6then, was supported in turn by sinking fund operations.

Once the capital stock of the bank was sold the price of the public debt and its rate of interest would stabilize. Investors who held portions of the public debt, attracted by the prospect of the almost certain profitability of the national bank, would rush to sell public debt to the bank in return for bank stock. This would bid the price of the public debt up, while sinking fund intervention would maintain a stable interest rate. Quickly the national bank would become the principle bearer of public debt, which would virtually eliminate speculative buying and selling of public debt in the capital markets.

While Hamilton no longer believed that the national bank could use the public debt as currency, he did see that the public debt held by the national bank would serve as a foundation for new national currency:

His original idea had been to monetize the public debt, in the doing of which a national bank would be indispensable But all such thinking became obsolete when it was decided that the new certificates of public debt would bear three different rates of interest; they obviously could not be pegged at the same price, and thus the idea of transforming them directly into money was impractical.⁵¹

⁵⁰Hamilton, V. 3, pp. 41-43.

⁵¹McDonald, pp. 192-193.

Also, these operations by the national bank would stabilize and reduce interest rates not through the coercive influence of laws, but by the national bank's manipulation of the money supply: "Banks are among the means most proper to accomplish this end; and the moderation of the rate at which their discounts are made, is a material ingredient towards it."⁵²

In the short-run, the new national bank would quickly become the major holder of the public debt. Also, the prices of the public debt would increase and the interest rates on the public debt certificates would stabilize through bank capitalization. Moreover, the possession by the bank of this majority share of public debt certificates would serve as the foundation for a new national currency system, in a nation with insufficient gold and silver reserves to back a metal-based currency system. Finally, the interest rates throughout the nation on loans and debts would be reduced and stabilized: "the natural effect of low interest is to increase trade and industry; because undertakings of every kind can be prosecuted with greater advantage."⁵³

The national bank would also serve important long-run purposes. It would increase commerce and governmental revenues. Obviously, more currency in circulation would fuel economic expansion. But, currency in circulation would also serve to further increase the productive capital stock of the nation. Hamilton noted:

His money, thus deposited or invested, is a fund upon which himself and others can borrow to a much larger amount. It is a well-established fact, that banks in good credit can circulate a far greater sum than the actual quantum of their capital in gold and silver.⁵⁴

Currency, saved in a deposit by one individual formed the basis for capital loans to other individuals, which reinvested elsewhere in the national economy, further spurred profit, savings, and investment. Only with the foundation of a national bank—with a strong and stable national currency, with low and steady interest rates, and with deposit and loan capabilities—could this profit-savings-investment dynamic be initiated.

This national bank would also facilitate the collection and expansion of government revenues. With a strong, stable, and circulating national currency, taxes could efficiently and quickly be gathered, and the national government would have a place to deposit and draw upon its revenues. But with the institution of the profit-savings-investment dynamic, and the consequent increase in commerce and industry, the tax base of the national government would expand.

Also in the long-term, the national government would have resources for future unforeseen contingencies, especially those which would require unknown governmental expenditures. The national bank would be a source of short-term loans for the national

⁵²Hamilton, V.3, p. 144.

⁵³Hamilton, V. 3, pp. 143-144.

⁵⁴Hamilton, V. 3, p. 108.

government in times of war or other sudden emergencies. This alternative would alleviate most of the pressure on the government in such situations to resort to pre-Constitutional sources of revenues—printing money, selling bonds, or taking foreign loans. Thus the national bank would help maintain national security in face of sudden contingencies.

Another long-term result of a single national bank was an increase in public support for the new national government. Hamilton noted:

If all the public creditors receive their dues from one source, distributed with an equal hand, their interest will be the same. And, having the same interest, they will unite in the support of the fiscal arrangements of the Government.⁵⁵

With the national bank buying and holding the public debt, issuing national currency, and supporting the financial foundation of the new republic, Hamilton believed that the interests of the populace would be steadily wedded to both the national bank and the national government.

With public support for the bank and government would come two other essential ties between individuals and the new republic. First, the faith of the people in the public credit would be restored and maintained through the institution of the national bank. No longer would the national government need to use economically harmful means to gather revenues in future emergencies. But if the future emergencies shifted to long-term financial needs (for example, long-drawn wars), then the populace would be assured that the operations of the national bank would avoid the type of financial crisis which existed after the end of the Revolutionary War.

Second, the government's reputation as a creditor would be enhanced. Investors and capital-holders would know that even in the face of past financial crisis the government had not repudiated its war debts, and had taken the best possible steps to pay back its creditors. This would increase individual willingness to lend money to the government in the future with low rates of interest. Thus, the institutionalization of the national bank would maintain government credibility and reputation regarding its debts.

In all these ways the national bank would in the short- and long-run serve to strengthen the role and power of the new national government. With the institutionalization of the national bank, the government would insinuate itself into the very foundation of the national economy, by providing stable interest rates, currency, and economic expectations. The government would also dramatically increase its own financial resources with more efficient revenue collection, stimulation of economic activity, and with an assured pool of capital. Last, the government would through individual self-interest begin to bind the people of the nation to the national government.

⁵⁵Hamilton, V. 3, p. 154.

4 The Attack on the Bank

The first legislative phase of Hamilton's plan passed the House intact. Yet in the second session of the First Congress, there was growing opposition to Hamilton personally and to various aspects of his plan. When the House reconvened in late fall 1790, Hamilton submitted the long-term aspects of his financial plans to the House for consideration. While the least controversial proposal—the establishment of a mint—was passed into law with little opposition, the excise and bank proposals did rouse opposition. A solid bloc of southerners were arrayed against Hamilton's proposals for increased commodity taxes, but since the opposition leader, Madison, was indifferent over the excise bill, it was passed over the Southerner's objections.

The bank proposal was another story. In the House, there were several dimensions to the bank's opposition: Madison's desire to stop the "Federalist" steamroller; opposition to the bank's location in Philadelphia; and concern over Congressional creation of a quasi-private corporate institution. But mainly,

the Virginians fear(ed) that once the bank became firmly entrenched in Philadelphia, it would be almost impossible to move the capital a decade later As part of his maneuvering, (Madison) warned the Pennsylvanians that if they failed to cooperate, he would attack the bill in the House as unconstitutional Rebuffed, Madison make good his threat. In long speeches delivered in February 2 and 8, he maintained that Congress had no power to charter a corporation.⁵⁶

While the House passed the bank proposal over Madison's constitutional objection 39 to 20, President Washington became concerned that the constitutional consensus established by the ratification was in danger.

Therefore, Washington asked members of his cabinet to prepare briefs discussing Madison's argument against the bank. Randolph, the Attorney General (also a Virginian), informed Washington that in his opinion the bank bill was unconstitutional. Jefferson seconded Randolph's opinion only a few days later, along with a lengthy brief describing other laws the bank bill supposedly violated. Washington forwarded Randolph and Jefferson's briefs to Hamilton so that he could formulate a reply.

Hamilton quickly went to the heart of the issue in his "Opinion as to the Constitutionality of the Bank of the United States." He saw "the objections of the Secretary of State and Attorney-General are founded on a general denial of the authority of the United States to erect corporations."⁵⁷ But, Hamilton firmly believed "that principles of construction like those espoused by the Secretary of State and Attorney-General, would be fatal to the just and indispensable authority of the United States."⁵⁸

⁵⁶McDonald, p. 201.

⁵⁷Hamilton, V. 4, p. 105.

⁵⁸Hamilton, V. 4, p. 104.

Hamilton noted that a sovereign power can establish corporations, the only question being which corporations it has the authority to construct. In Hamilton's view, this sovereign authority to create corporations extended to all "the objects intrusted to the management of government."⁵⁹ The constitutional objection to the bank stated, however, that the power to charter a national bank was not a power expressly included among the powers granted to the national government in the Constitution; hence, the power to create banks must rest with the people or the states.

There was no doubt in Hamilton's mind that the power to establish a national bank was not expressly granted in the Constitution. But he argued, there are three types of power—express, implied, and resulting. The latter, resulting powers, Hamilton described with an example. If, the United States conquered neighboring territory, it would acquire sovereignty over the conquered territory not from the express clauses in the Constitution, but from the de facto possession of the land. "This would be rather a result, from the whole mass of the powers of the government, and from the nature of political society, than a consequence of either of the powers specially enumerated."⁶⁰

Implied powers were very similar to resulting powers. Power to establish a corporation, argued Hamilton, would be implied if that corporation were a necessary means or instrument to carry out one of the expressly-stated powers in the Constitution. Again arguing from example, Hamilton wrote:

Thus a corporation may not be erected by Congress for superintending the police of the city of Philadelphia, because they are not authorized to regulate the police of that city. But one may be erected in relation to the collection of taxes, or to the trade with foreign countries . . . because it is the province of the federal government to regulate those objects.⁶¹

Since the Constitution expressly granted the national government the power to collect taxes and duties, to pay the national debt, to provide for common defense, to borrow, coin, and regulate the value of money, and last to provide for the common welfare, Hamilton reasoned that the government had the implied power to create a national bank to achieve these expressly-granted powers.

Hamilton then extended this discussion of implied powers very broadly, beyond the establishment of the national bank: it encompassed all expressly-given powers, and hence dramatically increased the authority of the government to establish laws and institutions concerning a multitude of objects not discussed in the Constitution.

If the end be clearly comprehended within any of the specified powers, and if the measure have an obvious relation to that end, and is not forbidden by

⁵⁹Hamilton, V. 4, p. 106.

⁶⁰Hamilton, V. 4, p. 107.

⁶¹Hamilton, V. 4, p. 108.

any particular provision of the Constitution, it may safely be deemed to come within the compass of the national authority.⁶²

Washington, impressed with Hamilton's brief, signed the bank bill into law; after that stroke of a pen, Hamilton's financial plan was established. The national government would thereafter play a fundamental role in the economic development of the United States.

5 Hamilton's Political Economy

In this discussion of Hamilton's political and economic thoughts and actions, it is clear that both are interconnected in the bank proposal. The national bank, created as an institution of the national government, would play both political and economic roles. First, it would wed individual interest with the development of the new national government. Second, it would increase public confidence in the new government, and develop in the populace a feeling that the national government is useful and necessary. Third, the national bank would play critical short- and long-term economic roles promoting economic development of the nation. Furthermore, with his constitutional defense of the national bank, he established a persuasive constitutional interpretation principle—implied power— which dramatically broadened the range of activities which the national government could involve itself. Last, the national bank would serve to generally strengthen the powers of the government, especially in relation to economic policymaking.

To conclude, there are two very broad themes which occur repeatedly throughout Hamilton's writings. First, he was deeply committed to the development of a strong national government which was armed with the requisite powers to exercise its sovereignty. He firmly believed that the solution to the political and economic troubles of the pre-Constitutional states would be found in a strong, centralized government. Second, Hamilton was expressly dedicated to developing institutions within the governmental structure which were strong, stable, and permanent. These institutions would influence and mold individual opinion and interest to support the national government in the long-run. And only the institutionalization of individual support would ensure the eventual stability and strength of the central government.

⁶²Hamilton, V. 4, p. 113.

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