HAMILTON VS. JEFFERSON
THE 1ST BANK OF THE UNITED STATES (1791-1811)

Lesson by
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Subject
Economic and Financial History of America and the United States

Academic Level
Secondary/Collegiate

Bloom Level
Knowledge
Comprehension
Analysis
Evaluation

Unit
The Art of Political Finance, Volume I, Part I—Chapter 4 & 5

Lesson Number in Unit: 4

Lesson Description

This lesson will identify The First Bank of the United States as the first de jure national bank and the reasons behind the federal government charter. It will further show the proponents and opponents thereto, especially Alexander Hamilton, Thomas Jefferson and others in regard to the Constitution.

Time Required
Two 60-minute classes

Objectives

Students will be able to:

1. Identify the First Bank of the United States as the de facto second national bank and Alexander Hamilton as its founder
2. Name at least two statesmen who opposed the idea of the bank and identify reasons for opposition by Thomas Jefferson
3. Explain how the First Bank could reduce the amount of credit in the early American economy by redeeming state chartered banks' banknotes in exchange for specie
4. Identify what cities the branches of the first Bank of the United States established and why they were located in these cities
5. Compare and contrast Hamilton's vision for the country and Jefferson's vision for the country

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Concepts & Terms

Banknote
A negotiable promissory note issued by a bank and payable to the bearer on demand. The amount payable is stated on the face of the note. Banknotes are considered legal tender, and, along with coins, make up the bearer forms of all modern money.

Inflation
A rise in the general level of prices over a sustained period of time.

Bond
In finance, a bond is an instrument of indebtedness of the bond issuer to the holders. It is a debt security, under which the issuer owes the holders a debt and, depending on the terms of the bond, is obliged to pay them interest (the coupon) and/or to repay the principal at a later date, termed the maturity date; there are several types of bonds, e.g., Government Bond, Municipal Bond, Corporate Bond.

Capital
Adam Smith defines capital as "That part of a person's stock which he expects to afford him revenue is called his capital." In the context of this lesson it is money or specie.

Factors of Production
Inputs that are used for outputs; Capital, Land (Natural Resources), Labor.

Federalism and States Rights
A political concept in which a group of members are bound together by covenant (Latin: foedus, covenant) with a governing representative head. The term "federalism" is also used to describe a system of government in which sovereignty is constitutionally divided between a central governing authority and constituent political units (such as states or provinces). Federalism is a system based upon democratic rules and institutions in which the power to govern is shared between national and provincial/state governments, creating what is often called a federation.

Money Supply
In economics, the money supply or money stock, is the total amount of monetary assets available in an economy at a specific time. There are several ways to define "money," but standard measures usually include currency in circulation and demand deposits. (There are several different classifications of money stock, M1 & M2 are generally accepted to determine the velocity).

Velocity of Money
Is a ratio of the number of times one dollar is used to purchase final goods and services. It can be thought of as the rate of turnover in the money supply. It is the number of times that money moves from one entity to another.

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Materials/Equipment

Computer with internet connection, calculator, copy of First Bank of United States by Phila Fed.pdf

Procedures and Pupil Activity

Day 1

1. Motivational Techniques:

   A) Questions – Who likes owing money to someone? After answering, ensure students that they will get a better understanding of debt and the ramifications thereof.

   B) Anyone want to guess what was the American economic life like in the 1780s? (The 1780s in the United States were characterized by widespread economic disruption. The Revolutionary War had disrupted commerce and left many Americans heavily in debt. The Continental dollar had caused rampant inflation and many people were bankrupt, even destitute.) The Bank of North America was the country's first national and de facto central bank from 1781 to 1785.

   C) Political Climate

- The Constitution was authored by James Madison in 1787 and then Ratified by the States in 1788. The Bill of Rights would come later.

- George Washington was president from 1789 to 1797

Contrasting Views of Federal Government	
Hamilton	**Jefferson**
Concentration of Power in Central/Federal Government	Limited Central/Federal Government-Shared with States
Fear of Mob Rule	Fear of Elite or Absolute Rule
Republic by Well-Educated Elite	Democracy of Virtuous Farmers and Tradesmen
Loose/Liberal Interpretation of Constitution	Strict Interpretation of Constitution
Central Banking/National Banking	No Central Banking
Economy Based on Manufacturing & Shipping	Economy Based on Agriculture
Public Debt Favoring Creditors	Debt Favoring Debtors
Partisans: Merchants, Manufacturers, Bankers, Landowners, Lawyers, Investors	Partisans: Farmers, Tradesmen, Populace

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2. Reading Activity

The 1780s saw widespread economic disruption. The war had disrupted commerce and left the young nation, and many of its citizens, heavily in debt. Furthermore, the paper money issued by The Continental Congress to finance the war was essentially worthless because of the rampant inflation it had caused, and many people were bankrupt, even destitute. [i]

[Although the Bank of North America was instrumental in this economic strife and had failed by 1785], Robert Morris recruited a young Alexander Hamilton to serve more or less as his political puppet within the Washington administration. (Rothbard called Hamilton "Morris's youthful disciple.") In fact, the reason why Hamilton became Treasury secretary, despite having no reputation at all in the field of finance, was the recommendation by Morris to George Washington. (During the Revolutionary War, when he was an aide to Washington, Hamilton took the time to write Morris a 30-page letter proclaiming that he agreed with every one of his ideas about protectionist tariffs, corporate subsidies, and a government run bank to finance them.)[ii]

Alexander Hamilton, Treasury Secretary from 1789 to 1795, was [also] an admirer of the works of philosophers David Hume and Adam Smith. In addition, England's use of public debt interested Hamilton because this type of funding, which had helped to build England's military might and pay for its wars, accounted, at least in part, for that country's prosperity and had enabled the British to build an empire. Hamilton reasoned that an economic structure that incorporated public debt could deliver much-needed capital to that such an institution could issue paper money (also called banknotes or currency), provide a safe place to keep public funds, offer banking facilities for commercial transactions, and act as the government's fiscal agent, including collecting the government's tax revenues.[iii]

Hamilton, estimating the total public debt at $77.1 million, called for the issuance of new federal bonds to cover the debt. By assuming the obligation to pay this debt, the government firmly established its good credit. The system of debt management instituted by Hamilton worked well to consolidate the debt and permit the government to make interest payments as they came due (as well as to secure the faith and credit of the government in the new United States and abroad).[iv]

Alexander Hamilton wanted a system that incorporated public debt, thereby delivering much - needed capital to speed the growth of the new nation's financial system. The first Bank of the United States, modeled after the Bank of England, was a central part of his vision of the United States as a country of businessmen and bankers.[v]

At the time, Secretary of the State Jefferson had this opinion on the constitutionality of a National Bank – 1791

I consider the foundation of the Constitution as laid on this ground: That "all powers not delegated to the United States, by the Constitution, nor prohibited by it to the States, are reserved to the States or to the people." [XIIth amendment.] To take a single step beyond the boundaries thus specially drawn around the powers of Congress, is to take possession of a boundless field of power, no longer susceptible of any definition.

The incorporation of a bank, and the powers assumed by this bill, have not, in my opinion, been delegated to the United States, by the Constitution. [vi]

The idea of creating a national bank I do not concur in, because it seems now decided that Congress has not that power...I am an enemy to all banks discounting bills or notes for anything but coin. Necessity, as well as patriotism and confidence, will make us all eager to receive treasury notes, if founded on specific taxes. There can be no safer deposit on earth than the Treasury of the United States. The incorporation of a bank and the powers assumed [by legislation doing so] have not, in my opinion, been delegated to the United States by the Constitution. They are not among the powers specially enumerated.[vii]

The bank also clashed with his vision of the United States as a chiefly agrarian country, not one based on banking, business, and the pursuit of profit. Jefferson was also afraid that a national bank would create a financial monopoly that would undermine state chartered banks.[viii]

Jefferson also explains that the Constitutional Convention rejected the argument of implied powers of the federal government. He recalls that a proposition to authorize Congress to create corporations, such as those formed to build and run canals, was rejected by the convention. One of the reasons for rejecting the proposition was that it would allow Congress to start a bank.

So intensely were the Founders at the 1787 convention determined to disallow the possibility of government - issued inflatable paper currency — such as the worthless currency issued by the Continental Congress — that delegate John Langdon of New Hampshire spoke for many when he said that he would rather reject the whole Constitution than allow the federal government power to issue paper money.[ix]

Hamilton argued that the bank would have a natural place in the regulation of trade between the states by providing a currency, in the form of banknotes that could be used to carry on that trade. The use of the bank's notes would reduce the number of coins that had to be used to engage in interstate trade. Money is the most important thing in making commerce happen. Lots of things have been used as money, including paper banknotes. Hamilton refutes Attorney General Randolph's argument that interstate trade should be carried out exclusively with coin.

Another argument Hamilton poses is that the bank would make it easier to collect taxes by increasing the number of banknotes in circulation and the speed at which transactions take place. Could this be the "Velocity of Money" concept? (Is this a good thing?) Elicit divergent answers.

3. Math Activity

Although there are different factors of the velocity formula, for the simplicity of the concept have students calculate the velocity of money given the following examples:

The velocity of money – Example 1

A farmer and a mechanic, with just $500 between them (GDP), buy new goods and services from each other in just three transactions over the course of a year.

1. Farmer spends $200 on tractor repair from mechanic.

2. Mechanic buys $100 of corn from farmer.

3. Mechanic spends $100 on barn cats from farmer.

Use simple algebra. The formula for the velocity of money is:

V = Y/M, where V is the velocity, Y is the GDP and M is the quantity of money.

Y=400 or the amount of GDP
M=500 the amount of money in the market

V=400/500=.8

The velocity of money – Example 2

A farmer and a mechanic, with just $500 between them (GDP), exchange new goods and services from each other in just three transactions over the course of a year.

1. Farmer spends $400 on tractor repairs from mechanic.

2. Mechanic buys $300 of corn from farmer.

3. Mechanic spends $100 on barn cats from farmer.

$800 changed hands in the course of a year, even though there is only $500 in this little economy. That $800 level is possible because each dollar was spent on new goods and services.

Y=800
M=500

V=800/500=1.6

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Day 2

1. Use the equation for the velocity of money and have students determine what the velocity has been for specific years, e.g., 1929, 1932, 1946, 1955, 1964, 1975, 1983, 1990, 2000, 2001, 2006, 2008 and 2014 using data from the accompanying spreadsheet, filename Money Supply.

2. Have students enter the equation in a spreadsheet and graph the results.

3. Have students analyze the graphs in figures 1 & 2 to summarize our economy in the last 50 years and specifically since 2000.

   Students should recognize that the velocity of money (commercial transactions) or trade by looking at M1 has been increasing since 1960, increased and peaked in the late 1990s and then plummeted to a 30 year low since approximately 2008.

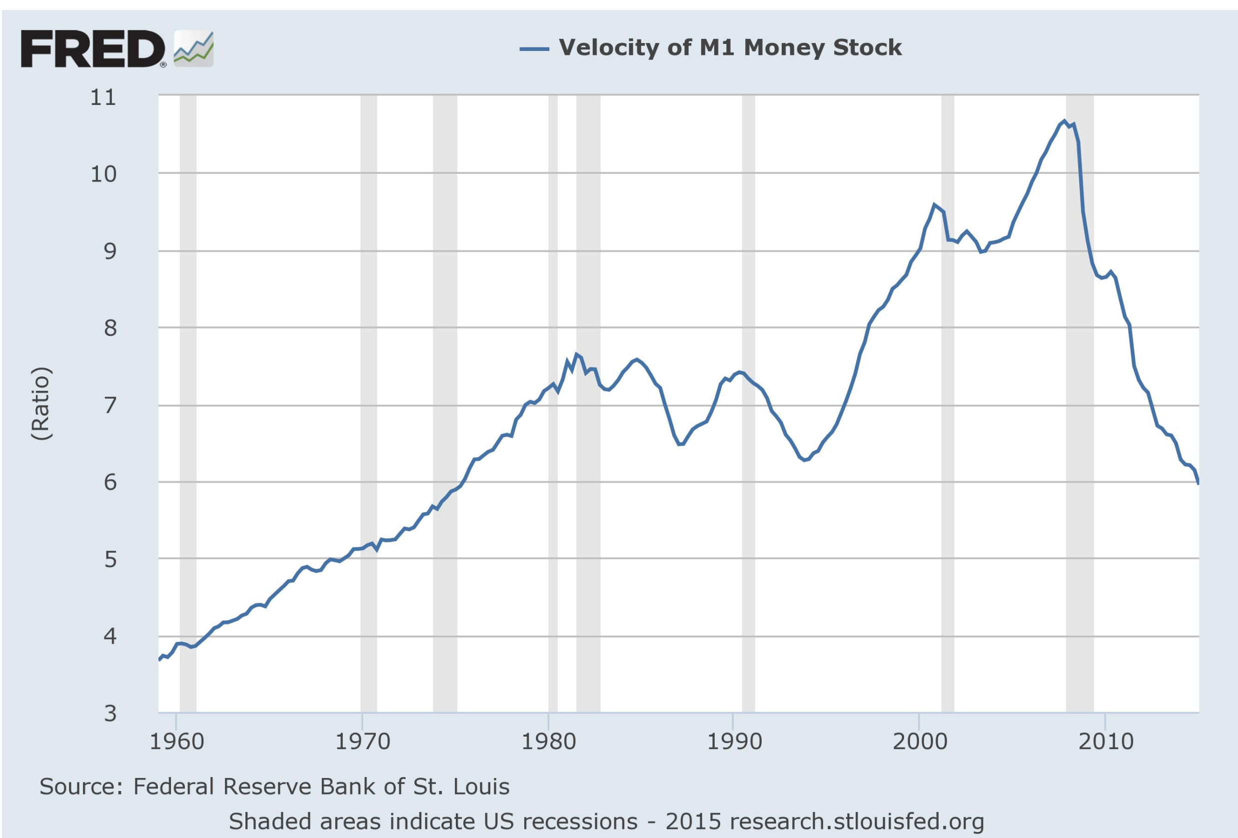

Figure 1 Velocity of Money M1 - Source St Louis Federal Reserve

Students should recognize that the velocity of M2, which may indicate savings, has been stable since 1960, increased and peaked in the late 1990s and then plummeted to a 50 year low since approximately 1998.

Both plummets indicate that exchanges/trade/commerce and savings have declined, possibly due to an economy based on loose money and the housing crisis that accounted for the great recession.

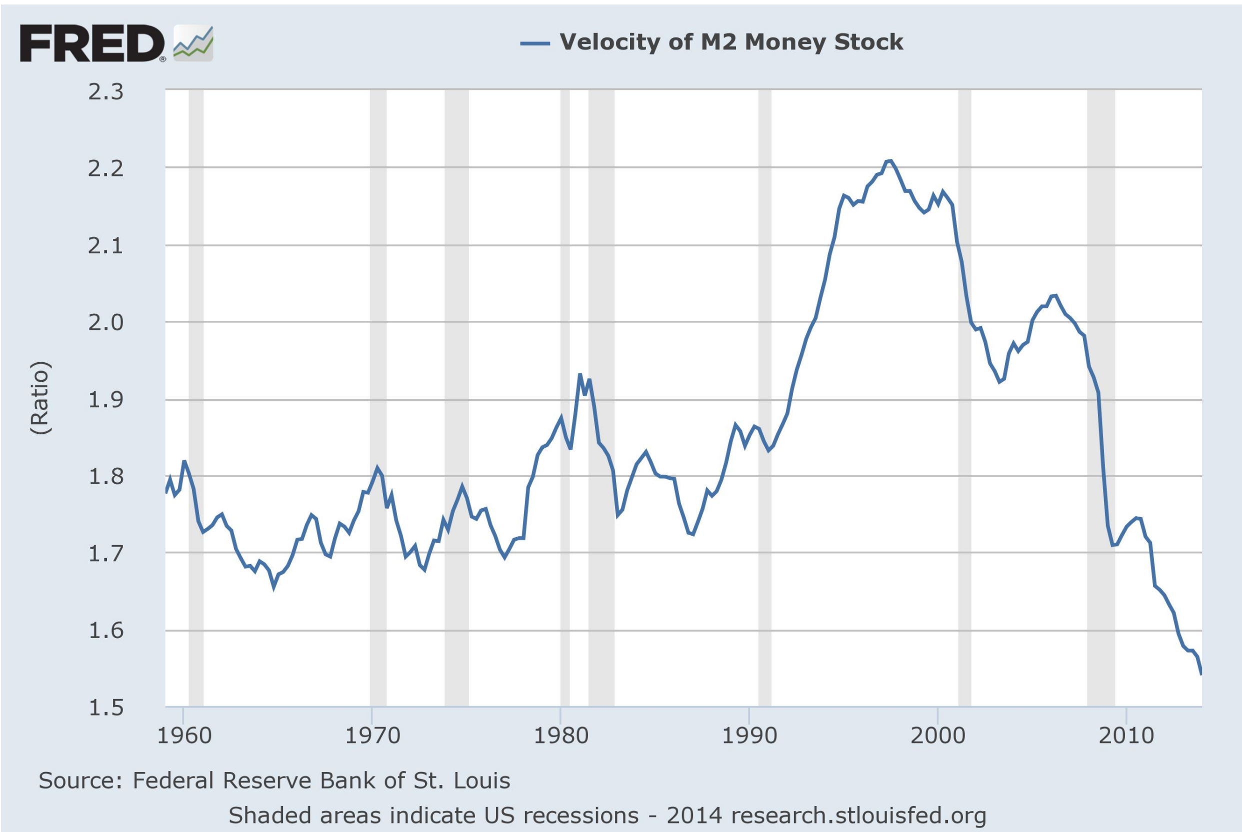

Figure 2 Velocity of Money M2 - Source St Louis Federal Reserve

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Hamilton proposed the formation of a national bank to supplement the activities of The Treasury in the fashion of the Bank of England. Both would act as the fiscal agent for the government, facilitate commercial transactions, both were prohibited from trading in commodities, and were required to obtain legislative approval before making loans to the government. Under Hamilton's plan, the bank would have a maximum ratio of loans to specie, whereas the Bank of England had no such requirement and the U.S. government would own 20 percent of the bank, whereas the Bank of England was privately owned.[x]

Despite the opposition from Jefferson and [House Member James] Madison, President Washington signed the Bank Act of 1791 into law, thereby creating the first Bank of the United States. The Bank opened in 1791 with a total capital of $10 million.[xi]

President Washington's acceptance of Hamilton's view of the bank's constitutionality set an important precedent for an expansive interpretation of the federal government's powers under the Constitution.[xii]

Later Washington would say this: "*No pecuniary consideration is more urgent, than the regular redemption and discharge of the public debt: on none can delay be more injurious, or an economy of time more valuable." Message to the House of Representatives, December 3, 1793*

Branches would be established in Boston, Baltimore, Charleston, New Orleans, New York, Norfolk, Savannah, and Washington, D.C. Why these cities? *The branches were established in these cities because they were all port cities and were the largest cities in the United States at the time.*

Many state banks envied the Bank of the United States: It received all of the government's deposits and therefore could make more loans. Although state banks issued their own banknotes when making loans, these banks did not have the size or geographic scope of the First Bank.

As a side note, The Mint Act of 1792 established the Mint of the United States. The Mint, in its first decades, only coined gold and silver in response to deposits of that metal by citizens, returning the bullion to the depositor in the form of coins. Either gold or silver could be presented for conversion into currency, as both metals were a legal tender.[xiii]

In the course of business, the First Bank could accumulate the notes of the state banks and hold them in its vault. When it wanted to slow the growth of money and credit, it would present the notes for collection in gold or silver, thereby reducing state banks' reserves and putting the brakes on state banks' ability to circulate new banknotes. To speed up the growth of money and credit, the First Bank would hold on to state banks' notes, thereby increasing state banks' reserves and allowing those banks to issue more banknotes through their loan making process. (The Power Jefferson was afraid of).[xiv]

In 1809, for example, its specie/banknote ratio was about 40 percent (compared to a modern average reserve/deposit ratio of about 12 percent).[xv]

The country's third president to be, who could see an ever increasing debt, with no chance of ever paying it back, had this to say:

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"I wish it were possible to obtain a single amendment to our Constitution - taking from the federal government their power of borrowing."
Thomas Jefferson, 1798

1. Have students write a short essay on whether it's better or worse that a private bank control monetary policy or congress? Why? Hold this as their first edition. Ask this same question throughout the course and compare editions with the final edition as a requisite to a final exam.

Other quotes by Jefferson:

"If the American people ever allow private banks to control the issue of their currency, first by inflation, then by deflation, the banks…will deprive the people of all property until their children wake-up homeless on the continent their fathers conquered…. The issuing power should be taken from the banks and restored to the people, to whom it properly belongs." – Thomas Jefferson in the debate over the Re-charter of the Bank Bill (1809)

"I believe that banking institutions are more dangerous to our liberties than standing armies." –Thomas Jefferson

Closure

Essentially, by accepting the charter for the First Bank of the United States, Congress forfeited its power to manage the money system.

Jeffersonian Democrats, who didn't trust banks, overturned this progress. Jefferson's Secretary of the Treasury, Albert Gallatin, was a chief critic of Hamilton's methods of debt management, and made it his priority to reduce public debt. This worked for a time, reducing the public debt to $45.2 million by 1811, but was derailed by Jefferson's "Louisiana Purchase."[xvi]

Many people still believed that the First Bank was unconstitutional. The number of state banks had increased substantially by 1811. Those state banks feared competition from the Bank of the United States. The bill to re-charter the first Bank of the United States was defeated by one vote in the House of Representatives. The vote in the Senate was tied, and the tie was broken when Vice President George Clinton voted against the bill.

Was it a coincidence that five months later Britain had attacked America and started the war of 1812?

Group Discussion

Does our country resemble a Jeffersonian System or a Hamiltonian System? Support your answer.

Recommended Reading

"The First Bank of the United States: A Chapter in the History of Central Banking," Federal Reserve Bank of Philadelphia, 2009

Websites

http://research.stlouisfed.org/fred2/

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[i] http://philadelphiafed.org/publications/economic-education/first-bank.pdf page 1
[ii] DiLorenzo, Thomas J. "The Corrupt Origins of Central Banking." Mises Institute. N.p., 5 Nov. 2008. Web. 14 Jan. 2016.
[iii] http://philadelphiafed.org/publications/economic-education/first-bank.pdf page 1
[iv] http://www.treasurydirect.gov/govt/reports/pd/histdebt/histdebt_18cent.htm
[v] http://philadelphiafed.org/publications/economic-education/first-bank.pdf
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[viii] http://www.philadelphiafed.org/education/teachers/lesson-plans/first-bank.pdf
[ix] *THE NEW AMERICAN • FEBRUARY 4, 2008, page 38*
[x] http://www.philadelphiafed.org/education/teachers/lesson-plans/first-bank.pdf
[xi] http://www.publicdebt.treas.gov/history/1700.htm
[xii] http://www.philadelphiafed.org/education/teachers/lesson-plans/first-bank.pdf
[xiii] https://en.wikipedia.org/wiki/Coinage_Act_of_1873
[xiv] http://philadelphiafed.org/publications/economic-education/first-bank.pdf page 9
[xv] "The First Bank of the United States (1791-1811)." Ed. George M. Welling. University of Groningen, Aug. 2012. Web. 19 Mar. 2016.
[xvi] http://www.treasurydirect.gov/govt/reports/pd/histdebt/histdebt_18cent.htm