

18b. Hamilton's Financial Plan

A major problem facing the first federal government was how to deal with the financial chaos created by the American Revolution. States had huge war debts. There was runaway inflation. Almost all areas of the economy looked dismal throughout the 1780s. Economic hard times were a major factor creating the sense of crisis that produced the stronger central government under the new Constitution. George Washington chose the talented Alexander Hamilton, who had served with him throughout the Revolutionary War, to take on the challenge of directing federal economic policy as the treasury secretary.

Alexander Hamilton conceived of the First Bank of the United States as a way to standardize American currency and cope with national Revolutionary War debt. The Bank still stands today on Independence National Park in Philadelphia. The first issue that Hamilton tackled as Washington's secretary of the treasury concerned the problem of public credit. Governments at all levels had taken on so much debt during the Revolution. The commitment to pay them back was not taken very seriously. By the late 1780s, the value of such public securities had plunged to a small fraction of their face value. In other words, state IOU's — the money borrowed to finance the Revolution — were viewed as nearly worthless.

Hamilton issued a bold proposal. The federal government should pay off all Confederation (state) debts at full value. Such action would dramatically enhance the legitimacy of the new central government. To raise money to pay off the debts, Hamilton would issue new securities bonds. Investors who had purchased these public securities could make enormous profits when the time came for the United States to pay off these new debts. Hamilton's vision for reshaping the American economy included a federal charter for a national financial institution. He proposed a Bank of the United States. Modeled along the lines of the Bank of England, a central bank would help make the new nation's economy dynamic through a more stable paper currency. The central bank faced significant opposition. Many feared it would fall under the influence of wealthy, urban northeasterners and speculators from overseas. In the end, with the support of George Washington, the bank was chartered with its first headquarters in Philadelphia.

The third major area of Hamilton's economic plan aimed to make American manufacturers self-sufficient. The American economy had traditionally rested upon large-scale agricultural exports to pay for the import of British manufactured goods. Hamilton rightly thought that this dependence on expensive foreign goods kept the American economy at a limited level, especially when compared to the rapid growth of early industrialization in Great Britain. Rather than accept this condition, Hamilton wanted the United States to adopt a mercantilist economic policy. This would protect American manufacturers through direct government subsidies (handouts to business) and tariffs (taxes on imported goods). This protectionist policy would help fledgling American producers to compete with inexpensive European imports.

Hamilton possessed a remarkably acute economic vision. His aggressive support for manufacturing, banks, and strong public credit all became central aspects of the modern capitalist economy that would develop in the United States in the century after his death. Nevertheless, his policies were deeply controversial in their day.

Many Americans neither like Hamilton's elitist attitude nor his commitment to a British model of economic development. His pro-British foreign policy was potentially explosive in the wake of the Revolution. Hamilton favored an even stronger central government than the Constitution had created and often linked democratic impulses with potential anarchy. Finally, because the beneficiaries of his innovative economic policies were concentrated in the northeast, they threatened to stimulate divisive geographic differences in the new nation.

Henry Clay and the American System

A plan to strengthen and unify the nation, the American System was advanced by the Whig Party and a number of leading politicians including Henry Clay, John C. Calhoun and John Quincy Adams. The System was a new form of federalism that included:

- Support for a high tariff to protect American industries and generate revenue for the federal government
- Maintenance of high public land prices to generate federal revenue
- Preservation of the Bank of the United States to stabilize the currency and rein in risky state and local banks
- Development of a system of internal improvements (such as roads and canals) which would knit the nation together and be financed by the tariff and land sales revenues.



Henry Clay

Clay argued that the West, which opposed the tariff, should support it since urban factory workers would be consumers of western foods. In Clay's view, the South (which also opposed high tariffs) should support them because of the ready market for cotton in northern mills. This last argument was the weak link. The South was never really on board with the American System and had access to plenty of markets for its cotton exports.

Clay first used the term "American System" in 1824, although he had been working for its specifics for many years previously.

Portions of the American System were enacted by Congress. The Second Bank of the United States was rechartered in 1816 for 20 years. High tariffs were maintained from the days of Hamilton until 1832. However, the national system of internal improvements was never adequately funded; the failure to do so was due in part to sectional jealousies and constitutional scruples about

such expenditures.

Despite his uneven success in gaining passage of all aspects of the American System, Henry Clay was proud of the plan. In a speech in Cincinnati in 1830, he declared:

That system has had a wonderful success. It has more than realized all the hopes of its founders. It has completely falsified all the predictions of its opponents. It has increased the wealth, and power, and population of the nation. It has diminished the price of articles of consumption and has placed them within the reach of a far greater number of our people than could have found means to command them if they had been manufactured abroad instead of at home.

Marshalling the American Economy

Lincoln appointed several efficient cabinet members responsible for leading and preparing the American economy for war. His first secretary of war, Simon Cameron, the party boss of Pennsylvania, had thrown his support to Lincoln at the Republican convention in return for a cabinet appointment. But he was a corrupt and inefficient ally, who once described an honest politician as "a man who, when he's bought, stays bought." In 1862, Lincoln replaced him with Edwin M. Stanton, who restored honesty and efficiency to the department.

At the U.S. Treasury, Lincoln named Salmon P. Chase of Ohio, a leading abolitionist who constantly criticized Lincoln for his less-than-radical stand on emancipation. Despite their differences, Chase proved to be a remarkably apt director of the nation's finances. Among his most innovative and long-lasting programs was his use of the Legal Tender Act of 1862 to issue fiat currency, called "greenbacks," which were not backed by specie (gold or silver), to help finance the war. These paper dollars carried with them no promise to pay with gold in the future. They were valued instead as "legal tender" notes, meaning that everyone was required to accept them at face value in the settlement of debts. But the majority of the Union's war expenses was financed by taxes, loans, or the sale of government bonds.

Chase supervised the first income tax (3 percent on incomes over \$800) in the nation's history as well as the national banking system, which was established by Congress and signed into law by Lincoln in 1863. This law resurrected the central banking system destroyed by Andrew Jackson in the 1830s. It authorized the chartering of national banks, which could issue bank notes as loans to customers for up to 90 percent of the value of the U.S. bonds held by each bank. This provision created an instant demand for government bonds as many private banks and state banks were forced to become national banks and bought bonds in order to issue bank notes to their borrowers. In time, these bank notes became an important form of currency in the nation, circulating with greenbacks, paper checks drawn on deposits, and gold-backed certificates as the principal medium of exchange.

Chase also worked closely with the nation's bankers, merchants, and industrialists to find ways to sell bonds to the larger public. Assisted by Philadelphia financier Jay Cook, Secretary Chase used patriotic appeals to sell war bonds in amounts as small as \$50. Cook sold over \$400 million in bonds, earning a fortune for himself in commissions. By the end of the war, the U.S. had borrowed \$2.6 billion, the first case in American history of mass financing for defense and war.

Dissent on the Home Front

Opposition to Lincoln's program and policies by Peace Democrats escalated into full-fledged counterwar measures by 1862. Most of these opponents were old-line Democrats who resented the centralizing laws and measures supported by the Republican majority in Congress. They especially opposed the national banking system, the newly passed protective tariffs, the draft, martial law, and any talk of emancipating slaves. Winning several congressional seats in 1862, Peace Democrats became more vocal and their critics began referring to them as "Copperheads." The term apparently came from the practice of some midwestern, hard-money Democrats who wore copper pennies around their necks in protest of legal tender greenbacks. Others claim that the term was a derogatory comparison of Peace Democrats to the copperhead snake.