First Report on the Public Credit (1790)

ALEXANDER HAMILTON

Wars are expensive, and governments that indulge in them almost always have to borrow money in order to run them. Governments that are engaged in a war of independence face the additional burden of trying to borrow money when their future existence—and future ability to repay those debts—might seem especially questionable. In the course of the American Revolution, both the continental government and the thirteen state governments were able to borrow from both their citizens and from overseas lenders (especially in France and the Netherlands), and debt financing was essential to securing the independence of the United States. But the Articles of Confederation created a national state that was not really worthy of the name, as it had little power to regulate trade or levy taxes that might enable it to begin to repay its outstanding debts. And they were massive debts: from his research in the late 1780s, Alexander Hamilton concluded that the national government owed \$40 million in bonds held by its citizens and \$12 million held overseas, while the individual states owed \$25 million. In many cases, interest payments were in default and not being paid, adding to the total burden with the power of compound interest. The combined debt of \$77 million was almost half the size of the GDP, or gross domestic product—the sum value of all goods and services produced by all economic activity in the United States, which in 1790 came to \$190 million. And in a primarily agricultural economy in which most farmers produced little above subsistence, the capacity of an economy to absorb massive debt payments was inherently small.

One main impetus for the Constitutional Convention was the desire to create a strong federal government that could bring order to financial chaos, create a stable currency, and tax effectively in order to promote national objectives like a strong defense, infrastructure improvements, and a coherent trade policy. The Constitution as written and ratified gave the federal government the power to tax, to create debt, and to redeem debt. But how would it use that power? When Alexander Hamilton became the first secretary of the Treasury in 1789, he wrote this report, which addressed the problem of the national debt. Many economic thinkers—then and now—saw debt as a negative, especially for a national state, an impediment to growth and a source of weakness. Yet in his first Report on the Public Credit, Hamilton advocated the creation of a strong federal state that was—seemingly paradoxically—deeply indebted.

To understand the quandaries Hamilton faced, but also the opportunities that he perceived, one needs to understand the history of the debts incurred during the war. Most were issued in the form of bonds, for which the initial creditor gave value in the form of coins or goods to the revolutionary government. Those bonds, like most bonds, could be sold to other people, who would then hold the claim for repayment. But by the mid-1780s, the market value of bonds issued by the wartime Continental Congress and state legislatures had plunged, because most people did not believe that they would ever be paid back. This plunge in value created several dynamics. First of all, original bondholders who paid full value but then sold their paper at cents on the dollar had lost money on their investment, and many were already in dire straits because of other disruptions in the post-revolutionary economy—disrupted foreign trade, falling crop prices, and so on. Thus those who had sacrificed for the revolution were suffering, even though their financial support had helped to achieve independence.

Yet at the same time, those who bought the bonds at cents on the dollar would receive a massive speculative windfall if the debts were redeemed at full value. For this reason, many of the pamphlet writers and newspaper editors and politicians who wrote about the debt problem in the 1780s suggested that any debt-redemption plan had to "discriminate" between original holders (who were good) and "speculators," who were bad. Finally, one more effect of the plunge in confidence that the United States would pay its debts was the failure of anything like a financial market to develop in the 1780s. Without reliable debt in which people could invest, banks could not open for business, meaning that entrepreneurs could not secure loans, meaning in turn that the entire economy limped along on life-support. And at the same time, the federal government also couldn't borrow at anything less than a ruinously high rate of interest, whether at home or abroad. This limited its ability—even in peacetime—to carry out any of the functions with which the Constitutional Convention had sought to task it: national defense, enhancing economic stability, and so on.

Many in the United States suggested that the government needed to repay only the federal debt, and leave the states to pay off their own commitments. Others suggested that all the debt should be "repudiated"—that the new federal government should refuse to pay old debts and ask creditors to start over, as it were. Many repudiators actually wanted the U.S. government to operate with a purely balanced budget, in which outlays never exceeded intakes. But drawing on his study of the British system of government-issued debt which that empire had used to fund its wars, colonial expansions, and rise to superpower status in the 1700s, Hamilton argued for a revolutionary and sweeping plan that seemed to expand U.S. debt and reward speculators. This plan, he argued, would create a thriving economy with a stable currency, ready availability of loans for those who wanted to create or expand entrepreneurial activities, and a strong federal government that could borrow at low cost, and would bind the wealthiest people in the United States to support and invest in the new nation.

Hamilton's plan had three main components. The first was assumption. The federal government would assume the states' debts. To some this seemed unfair, because while certain states had been paying their bond interest in the 1780s, others had been irresponsible by not taxing their citizens to pay their debts. But Hamilton wasn't concerned with that issue. The second component was redemption. The federal government would repay all bonds at full face value—whether or not they were still in the hands of the original purchaser. Although James Madison, for instance, supported paying current holders the amount that they had paid to purchase the bond, and paying original holders the difference between that price and the face value of the security in question, Hamilton rejected that plan. And thirdly, having promised to take on the burden of paying back the full $77 million in outstanding debt—far more than it could pay in any short time frame—the federal government, Hamilton proposed, would reissue the debt in the form of fifteen or twenty-year bonds. In many cases they would bear slightly less interest than the original bonds, but Hamilton believed—correctly, as it turned out—that the holders of the securities would be happy to accept a lower yield from the bond in return for the greater security created by the promises of assumption and redemption.

Here's the historical outcome of the first Report on the Public Credit: Hamilton's proposals were ultimately accepted by Congress and became federal policy. The government committed itself to paying off the bonds over time, using excise taxes and revenues from import tariffs. For the first ten years, interest payments comprised about forty percent of all federal expenditures. The high costs limited America's ability to build a military that would deter European bullies from harassing American trade, and fiscal pressure also helped push the federal government into some unwise decisions—like imposing the excise tax that led to the so-called

Whiskey Rebellion of 1796. And yet, as Hamilton predicted, economic growth soon shrank the relative size of the federal debt. In Boston, New York, and Philadelphia in particular, thriving markets in government securities developed, and banks began to appear. Borrowing costs for the government shrank, ironically enabling Hamilton's political rival Jefferson to become one of the most successful empire-building American presidents of all time. By 1803, U.S. credit on European markets was so good that Jefferson could borrow nearly $80 million to finance the Louisiana Purchase, in which the United States bought from France nearly 828,000 square miles of land in the heart of the North American continent. The First Report on the Public Credit was a key component in establishing a federal state that could do big things, and the creation of a massive federal debt helped create a dynamic capitalist economy in the United States.

As you read the text, pay attention to how Hamilton argues for each of his plan's elements—How does he anticipate and knock down the arguments of those who complain that assumption and redemption reward speculators? What does he claim will be the benefits for the nation as a whole?—and think about how similar arguments reappear in more recent debates about national debts, the role of the financial economy in capitalism more broadly, and the ways in which government policies can enhance or detract from the economic power of particular groups in a capitalist society.

Treasury Department, January 9, 1790.

[To the Speaker of the House of Representatives]

[. . .] Exigencies are to be expected to occur, in the affairs of nations, in which there will be a necessity for borrowing; [. . .] loans in times of public danger, especially from foreign war, are found an indispensable resource, even to the wealthiest of them; And [. . .] in a country which, like this, is possessed of [. . .] little monied capital, the necessity for that resource, must, in such emergencies, be proportionably urgent. And as, on the one hand, the necessity for borrowing in particular emergencies cannot be doubted, so on the other, it is equally evident, that to be able to borrow upon *good terms*, it is essential that the credit of a nation should be well established. For, when the credit of a country is in any degree questionable, it never fails to give an extravagant premium, in one shape or another, upon all the loans it has occasion to make. [. . .]

If the maintenance of public credit, then, be truly so important, the next enquiry which suggests itself is, by what means it is to be effected? The ready answer to which question is, by good faith, by a punctual performance of contracts. States, like individuals, who observe their engagements, are respected and trusted: while the reverse is the fate of those, who pursue an opposite conduct. [. . .]

This reflection derives additional strength from the nature of the debt of the United States. It was the price of liberty. The faith of America has been repeatedly pledged for it, and with solemnities that give peculiar force to the obligation. There is indeed reason to regret that it has not hitherto been kept; that the necessities of the war, conspiring with inexperience in the subjects of finance, produced direct infractions: and that the subsequent period has been a continued scene of negative violation, or non-compliance. But a diminution of this regret arises from the reflection, that the last seven years have exhibited an earnest and uniform effort, on the part of the government of the union, to retrieve the national credit, by doing justice to the creditors of the nation; and that the embarrassments of a defective constitution, which defeated this laudable effort, have ceased.

From this evidence of a favorable disposition given by the former government, the institution of a new one, clothed with powers competent to calling forth the resources of the community, has excited correspondent expectations. A general belief accordingly prevails, that the credit of the United States will quickly be established on the firm foundation of an effectual provision for the existing debt. [. . .]

To justify and preserve their confidence; to promote the encreasing respectability of the American name; to answer the calls of justice; to restore landed property to its due value; to furnish new resources both to agriculture and commerce; to cement more closely the union of the states; to add to their security against foreign attack; to establish public order on the basis of an upright and liberal policy—These are the great and invaluable ends to be secured, by a proper and adequate provision, at the present period, for the support of public credit. [. . .]

It is a well known fact, that in countries in which the national debt is properly funded, and an object of established confidence, it answers most of the purposes of money. Transfers of stock or public debt are there equivalent to payments in specie; or in other words, stock, in the principal transactions of business, passes current as specie. The same thing would, in all probability happen here, under the like circumstances. [. . .]

First. Trade is extended by it; because there is a larger capital to carry it on, and the merchant can at the same time, afford to trade for smaller profits; as his stock, which, when unemployed, brings him in an interest from the government, serves him also as money, when he has a call for it in his commercial operations. Secondly. Agriculture and manufactures are also promoted by it: For the like reason, that more capital can be commanded to be employed in both; and because the merchant, whose enterprize in foreign trade, gives to them activity and extension, has greater means for enterprize. Thirdly. The interest of money will be lowered by it; for this is always in a ratio, to the quantity of money, and to the quickness of circulation. This circumstance will enable both the public and individuals to borrow on easier and cheaper terms.

And from the combination of these effects, additional aids will be furnished to labour, to industry, and to arts of every kind. But these good effects of a public debt are only to be looked for, when, by being well funded, it has acquired an adequate and stable value; [. . .] [whereas] one serious inconvenience of an unfunded debt is, that it contributes to the scarcity of money. [. . .]

The effect which the funding of the public debt, on right principles, would have upon landed property, is one of the circumstances attending such an arrangement, which has been least adverted to, though it deserves the most particular attention. The present depreciated state of that species of property is a serious calamity. The value of cultivated lands in most of the States, has fallen, since the revolution, from twenty-five to fifty per cent. In those furthest South, the decrease is still more considerable. [. . .] This decrease in the value of lands, ought, in a great measure, to be attributed to the scarcity of money; consequently, whatever produces an augmentation of the monied capital of the country, must have a proportional effect in raising that value. The beneficial tendency of a funded debt, in this respect, has been manifested by the most decisive experience in Great Britain. [. . .]

It is agreed on all hands, that that part of the debt which has been contracted abroad, and is denominated the foreign debt, ought to be provided for, according to the precise terms of the contracts relating to it. The discussions which can arise, therefore, will have reference essentially to the domestic part of it, or to that which has been contracted at home.

[. . .] [Let us consider] this question, whether a discrimination ought not to be made between original holders of the public securities, and present possessors, by purchase. Those who advocate a discrimination are for making a full provision for the securities of the former, at their nominal value; but contend, that the latter ought to receive no more than the cost to them, and the interest. [. . .]

The Secretary, after the most mature reflection on the force of this argument, is induced to reject the doctrine it contains, as equally unjust and impolitic, as highly injurious, even to the original holders of public securities; as ruinous to public credit. It is inconsistent with justice, because in the first place, it is a breach of contract; in violation of the rights of a fair purchaser. The nature of the contract in its origin, 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, has the same right with him to the identical sum expressed in the security, and having acquired that right, by fair purchase, and in conformity to the original agreement and intention of the government, his claim cannot be disputed, without manifest injustice. That he is to be considered as a fair purchaser, results from this: whatever necessity the seller may have been under, was occasioned by the government, in not making a proper provision for its debts. The buyer had no agency in it, and therefore ought not to suffer. He is not even chargeable with having taken an undue advantage. He paid what the commodity was worth in the market, and took the risks of reimbursement upon himself. He of course gave a fair equivalent, and ought to reap the benefit of his hazard; a hazard which was far from inconsiderable, and which, perhaps, turned on little less than a revolution in government. [. . .]

The impolicy of a discrimination results from two considerations; one, that it proceeds upon a principle destructive of that *quality* of the public debt, or the stock of the nation, which is essential to its capacity for answering the purposes of money—that is the *security* of *transfer;* the other, that as well on this account, as because it includes a breach of faith, it renders property in the funds less valuable; consequently induces lenders to demand a higher premium for what they lend, and produces every other inconvenience of a bad state of public credit.

It will be perceived at first sight, that the transferable quality of stock is essential to its operation as money, and that this depends on the idea of complete security to the transferree, and a firm persuasion, that no distinction can in any circumstances be made between him and the original proprietor. The precedent of an invasion of this fundamental principle, would, of course, tend to deprive the community of an advantage with which no temporary saving could bear the least comparison. [. . .]

The Secretary, concluding that a discrimination, between the different classes of creditors of the United States, cannot with propriety be made, proceeds to examine whether a difference ought to be permitted to remain between them, and another description of public creditors—Those of the states individually. The Secretary, after mature reflection on this point, entertains a full conviction, that an assumption of the debts of the particular states by the union, and a like provision for them, as for those of the union, will be a measure of sound policy and substantial justice. [. . .] [Otherwise] different plans originating in different authorities [. . .] [would lead to] interfering regulations, and thence collision and confusion. [. . .]

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 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. These circumstances combined, will ensure to the revenue laws a more ready and more satisfactory execution. If, on the contrary, there are distinct provisions, there will be distinct interests, drawing different ways. That union and concert of views, among the creditors, which in every government is of great importance to their security, and to that of public credit, will not only not exist, but will be likely to give place to mutual jealousy and opposition. [. . .]

[. . .] Neither would it be just, that one class of the public creditors should be more favored than the other. The objects for which both descriptions of the debt were contracted, are in the main the same. Indeed a great part of the particular debts of the States has arisen from assumptions by them on account of the Union. And it is most equitable, that there should be the same measure of retribution for all. [. . .]

The result of the foregoing discussions is this. That there ought to be no discrimination between the original holders of the debt, and present possessors by purchase. That it is expedient there should be an assumption of the State debts by the Union, and that the arrears of interest should be provided for on an equal footing with the principal. [. . .]

Persuaded, as the Secretary is, that the proper funding of the present debt, will render it a national blessing, yet he is so far from acceding to the position in the latitude in which it is sometimes laid down, that "public debts are public benefits," a position inviting to prodigality, and liable to dangerous abuse, that he ardently wishes to see it 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. [. . .]

Under this impression, the Secretary proposes that the net product of the Post Office, to a sum not exceeding one million of dollars, be vested in Commissioners, to consist of the Vice-President of the United States, or President of the Senate, the Speaker of the House of Representatives, the Chief Justice, Secretary of the Treasury, and Attorney General of the United States, for the time being, in trust; to be applied by them, or any three of them, to the discharge of the existing public debt, either by purchase of stock in the market, or by payments on account of the principal, as shall appear to them most adviseable, in conformity to public engagements; to continue so vested, until the whole of the debt shall be discharged.

As an additional expedient for effecting a reduction of the debt, and for other purposes which will be mentioned, the Secretary would further propose, that the same Commissioners be authorized, with the approbation of the President of the United States, to borrow, on their credit, a sum not exceeding twelve millions of dollars, to be applied—

First. To the payments of the interest and instalments of the foreign debt, to the end of the present year. [. . .]

Secondly. To the payment of any deficiency which may happen in the product of the funds provided for paying the interest of the domestic debt.

Thirdly. To the effecting a change in the form of such part of the foreign debt, as bears an interest of five per cent. It is conceived that, for this purpose, a new loan, at a lower interest, may be combined with other expedients. [. . .]

The Secretary contemplates the application of this money through the medium of a national bank, for which, with the permission of the House, he will submit a plan in the course of the session.

The Secretary now proceeds, in the last place, to offer to the consideration of the House, his ideas of the steps which ought, at the present session, to be taken towards the assumption of the State debts. These are, briefly, that concurrent resolutions of the two Houses, with the approbation of the President, be entered into, declaring in substance—

That the United States do assume, and will, at the first session in the year 1791, provide, on the same terms with the present debt of the United States, for all such part of the debts of the respective States, or any of them, as shall, prior to the first day of January, in the said year, 1791, be subscribed towards a loan to the United States, upon the principles of either of the plans, which shall have been adopted by them, for obtaining a re-loan of their present debt.

Provided, that the provision to be made as aforesaid, shall be suspended, with respect to the debt of any State, which my have changed the securities of the United States for others issued by itself, until the whole of said securities shall either be re-exchanged or surrendered to the United States. [. . .]

That the amount of the debt of each State so assumed and provided for, be charged to such State in account with the United States, upon the same principles which it shall be lent to the United States.

That subscriptions be opened for receiving loans of the said debts, at the same times and places, and under the like regulation, as shall have been prescribed in relation to the debt of the United States. [. . .]

He is fully convinced, that it is of the greatest importance, that no further delay should attend the making of the requisite provision: not only because it will give a better impression of the good faith of the country, and will bring earlier relief to the creditors—both which circumstances are of great moment to public credit—but because the advantages to the community, from raising stock, as speedily as possible, to its natural value, will be incomparably greater, than any that can result from its continuance below that standard. No profit which could be derived from purchases in the market, on account of the government, to an practicable extent, would be an equivalent for the loss which would be sustained by the purchases of foreigners at a low value. Not to repeat, that governmental purchases, to be honorable, ought to be preceded by a provision. Delay, by disseminating doubt, would sink the price of stock; and as the temptation to foreign speculations, from the lowness of the price, would be too great to be neglected, millions would probably be lost to the United States.

All which is humbly submitted.
Alexander Hamilton,
Secretary of the Treasury

Questions

1. What were Hamilton's key arguments in favor of his plan for the national debt?
2. What sort of "fiscal state" was Hamilton trying to create? How would the plan of assuming and redeeming (and incurring still

State in account with the United States,
ich it shall be lent to the United States.
pened for receiving loans of the said
d places, and under the like regulation,
ed in relation to the debt of the United

hat it is of the greatest importance, that
end the making of the requisite provision:
e a better impression of the good faith of
earlier relief to the creditors—both which
moment to public credit—but because the
nity, from raising stock, as speedily as pos-
will be incomparably greater, than any that
uance below that standard. No profit which
urchases in the market, on account of the
cable extent, would be an equivalent for the
stained by the purchases of foreigners at a
, that governmental purchases, to be honor-
ded by a provision. Delay, by disseminating
rice of stock; and as the temptation to foreign
owness of the price, would be too great to be
ld probably be lost to the United States.

y submitted.
n,
sury

f his plan for the

ying to create? How
nd incurring still

more) debt set the pattern for the behavior of the federal state? What possibilities and what limits would be created?

3. What was Hamilton's goal for the broader economy in this plan?
4. Why did Hamilton insist on the assumption of state debts? What implications would this have had, and how might the political debates on this issue have played out?
5. Hamilton was insistent on the importance of circulating notes as a substitute for specie. Why did he take this view, and how might his opponents have responded to this argument?
6. How does Hamilton's message to the House of Representatives fit into current debates about the size and importance of the national debt? Do any of his arguments have relevance for modern policymakers?