

Federalism and the Problem of State Debts: The Debate Over and Lessons of the Federal Assumption of State Debts

Introduction

The tremendous national debt currently facing the United States is not a new phenomenon, and the American experiment with a national debt began during the nation's fight for independence. While the desire to be free gave American colonists the will to rebel, debt provided the financial means needed for victory. The debt, however, took on a public, national character, because it was incurred by multiple authorities in the form of state governments and the Continental Congress. A persistent want of money kept the revolutionary cause in doubt, and both the Continental Congress and the individual states issued debt in varying degrees to sustain the Revolution and achieve freedom. The resulting debt became "the price of liberty," and liberty had not come cheaply. By 1790, the Federal and state governments faced a combined debt of almost \$54 million. The newly formed federal government desperately needed a long-term plan for managing its finances, and the question of how to deal with the separate debts of the states became central to the ensuing debate.¹

Although the Constitutional Convention scrapped the impotent government created under the Articles of Confederation and replaced it with a more powerful central government, it did not erase the debts of the previous government. Article VI of the Constitution declared that, "All Debts contracted and Engagements entered into, before the Adoption of this Constitution, shall be as valid against the United States under this Constitution, as under the Confederation." Compared to the other issues debated at the

¹ Robert E. Wright, *One Nation Under Debt: Hamilton, Jefferson, and The History of What We Owe* (New York: McGraw-Hill, 2008) 41-74.

Constitutional Convention, the national debt received relatively little attention. Anti-federalists worried that the new federal government would contract additional debts while federalists promised that paying the debt would create good credit, stable money, and a sound economy. The federalist arguments easily carried the day for Americans hopeful for a prosperous future and for the soldiers and bondholders eager to recover their investment in freedom.²

Having decided to honor the debts of the previous government, America now had to devise a plan to restore the public credit and pay down the debt, and the First U.S. Congress moved quickly to repair the country's financial situation. The Constitution vested the new federal government with the power "to borrow Money on the credit of the United States," but in order to exercise that power it first had to establish itself as a worthy borrower.³ To pay off its obligations the government first needed to establish a steady revenue stream, and Congress passed the first Tariff Act on July 4, 1789. It then imposed excise taxes on carriages, liquor, salt, sugar, and other goods. Congress then passed an act creating the Department of the Treasury to manage the nation's finances, and President Washington promptly appointed Alexander Hamilton as the first Secretary of the Treasury. Just weeks later, on September 21, 1789, Congress assigned Hamilton the formidable task of drafting a plan to provide for the public credit.

After 110 days, Hamilton submitted his 140,000-word report on how to restore faith in America's credit. His report would be the first of three separate reports on the public credit, and it proposed a funded national debt and the assumption of the state debts. His subsequent reports outlined the need for a national bank and tariff and

²Wright, *One Nation*, 117-119.

³*U.S. Constitution*. Art.I, Sec.8.

subsidy programs to nurture America's budding manufacturing industry. Hamilton's series of reports represented a comprehensive plan to reshape America and increase the scope and role of national government. Hamilton saw enormous potential in America's future and sought to establish institutions and markets to facilitate economic growth.⁴

Hamilton's bill for funding and assumption, along with subsequent proposals for a national bank and mint, eventually passed into law and laid the groundwork for future economic prosperity, but not before sparking bitter debate and igniting a fierce political battle over the fundamental character of American government. The debate over assumption proved particularly acrimonious in Congress and caused a political stalemate that threatened the fragile union. How to deal with the distinct debts held by the federal and state governments brought up important questions about the nature of federalism in America and gave rise to varying forms of constitutional interpretation. Political, ideological, and economic factors informed the political actors in the assumption debate as they sought to define the contours and limits of federalism as it applied to American constitutional government.

Financing Revolution: The Price of Liberty

An understanding of the nature of the debt and how it was incurred is necessary to make sense of how people viewed and reacted to the debt and to Hamilton's proposals regarding what to do with it. In the instance of the first national debt, financial damage sustained during the Revolution was almost exclusively its source. Financing a war is always a daunting and costly task, and governments typically have three ways of

⁴Forrest McDonald, *Alexander Hamilton: A Biography*. (New York: Norton, 1982), 142, 163-165.

raising the funds: levying taxes, printing money, and issuing debt. The colonial governments and the Continental Congress used each option to varying degrees, but practical differences within the states and changing circumstances made some methods more expedient than others.

The main source of funding for the Revolution, and the most popular during the early years, was the printing press. The colonial legislatures issued bills of credit, known as Continentals, which bore no interest and functioned as a medium of exchange. The bills were backed only by a declaration of legal tender and had no intrinsic value. Simply put, the bills functioned as paper currency in much the same way that dollars do today. As a fiat currency, the value of a Continental was a function of supply and demand and could depreciate in the event of excess supply, a scenario which became a painful reality for the American rebels.

Printing money in the form of bills of credit held several advantages compared to levying taxes or borrowing. First, taxes were inexpedient. The Continental Congress not only lacked the power to lay taxes, but the colonial governments and, after May 1776, state governments, who were never efficient tax collectors themselves, found tax collection complicated by the chaos of war. Furthermore, colonies and states were reluctant to levy new taxes knowing that the desire of Americans to unburden themselves from unfair taxes had been a motivating factor of the Revolution. Second, borrowing money, especially in the form of foreign loans, also proved difficult simply because rebellions are risky investments. Convincing a foreign nation to lend money to a rebellion against the greatest economic and military power in the world was no small

proposition. Any nation that loaned money to the rebellious colonies would see its investment disappear if the rebellion did not succeed.⁵

Printing money may have been advantageous early on, but the rebel government quickly lost control of its currency and resorted to borrowing. The governments printed too many bills of credit, and an oversupply of Continentals caused their value to slide. To make matters worse, neither the continental congress nor the state governments could not stop the depreciation because they lacked the funds to repurchase Continentals and take them out of circulation. Furthermore, in an act of economic warfare, the British exacerbated the already deteriorating situation by printing counterfeit bills and further contributing to the glut of Continentals. In total, the state governments and the Continental Congress, all of whom issued their own bills of credit, issued over \$400 million worth of what was essentially paper money during the Revolution, although by the end of the war they were so devalued that they sold for a fraction of their printed value.⁶

Unable to keep the printing press going, the Continental Congress and the state legislatures turned to borrowing in the form of bonds and IOUs. State governments and the Continental Congress hoped that the funds obtained from bond issuance could be used to retire some of the excess Continentals in circulation, but these hopes did not translate into reality. Loan offices initially tried issuing bonds bearing four percent interest, but had to raise interest rates to six percent to attract more subscribers, and weak bonds sales led some state governments to the more desperate practice of impressing goods in exchange for IOUs. The IOUs promised future payment, with

⁵John Steele Gordon, *Hamilton's Blessing: The Extraordinary Life and Times of Our National Debt*. (New York: Walker, 1997), 11-13.

⁶Wright, *One Nation*, 49-52.

interest, and amounted to forced loans. State governments and the Continental Congress used IOUs to requisition supplies and pay soldiers, but like the bills of credit, IOUs lost value because they were backed only by faith in the government's ability to repay them.⁷

Funding for the Revolution was carried on at both the state and the federal level, but no cohesive or coherent fiscal policy ever existed. Every state and the Continental Congress pursued distinct financial programs and issued their own bills of credit and debt certificates. The debt consisted of many forms from loans to IOUs, and the complexity and diversity of the debt made the task of reconciling it after the war all the more difficult. The experience of Revolutionary funding and the failure of the Articles of Confederation revealed the inherent problems of a system in which the national government lacked coercive power and ultimate sovereignty lay within the individual states.

Although the Constitution altered the shape of American government, it left many questions unanswered and merely provided a framework for future debate. The debt received relatively little attention in the ratifying debates compared to other weighty issues such as how to divide the legislative branch. The Constitutional Convention gave the federal government the financial means to address the debt, but it made no proscriptions as to how should be handled, and what the role of the federal government should be regarding the various debts held by state governments. Questions about the economic character of the country and the relationship between states and the federal government found new life in the debate over Hamilton's plan to address the Revolutionary debt.

⁷Ibid., 53, 57-60.

AH's Plan and Opposition

On January 9, 1790, Hamilton submitted his First Report on the Public Credit to Congress. Hamilton intended for his plan to function as a comprehensive solution to the debt problem. The plan contained multiple provisions, and because each component was integral to the success of the whole program, Hamilton went to great lengths to show the logic behind each proposal, and he deftly anticipated and deconstructed possible counterarguments. Simply put, Hamilton wanted the federal government to fund the debt, assume the debts of the states, and establish a sinking fund for the eventual repayment of the debt.⁸

Hamilton's plan reflected his own values and his vision of a country united under a strong central government. In a very real sense, his economic program flowed from his personal beliefs about human nature and his perception of the colonial society he inhabited. Historian and Hamilton biographer Forest McDonald remarks that, "Hamilton's audacious mission in life was to remake American society in accordance with his own values." Hamilton valued hard-work and personal industry, and he resented the provincialism and laziness he saw in his fellow Americans, once remarking that they had the "passivity of sheep." He thought that the aristocratic, agrarian social order of eighteenth-century America handicapped progress and fostered indolence. He wanted instead to shape America into a fluid and merit-based society where money was

⁸Wright, *One Nation*, 156. Hamilton wanted to create a sinking fund by giving the federal government the option to turn the newly issued government bonds into annuities. The national government would be allowed to pay back up to 2% of the principle on the annuities every year through profits from the sale of western lands. The incorporation of a sinking fund in Hamilton's plan showed that he was committed to paying back the debt in the long-term, or that he at least wanted to make the appearance that the government was actively trying to pay down the debt. The federal exercised the annuity option on April 28, 1796.

the objective arbiter of status. If the national government could cultivate the necessary conditions for commercial activity, it could awaken America's latent potential for growth and industry. Hamilton viewed government as the engine of change, guiding America towards her destiny as an economic power. Hamilton wanted to be the great legislator of the American state, and he saw the debt as a vehicle to transform America into the prosperous nation of his grand vision. Hamilton's vision included political and economic motivations, and he wanted a strong, supreme federal government to direct economic activity in a country where money and industry, not land and pedigree, were the ultimate measures of worth.⁹

Thomas Jefferson and James Madison, whose opposition to Hamiltonian ideas would soon grow into an organized party, rejected the notion that government, or at least national government, should guide economic progress. They instead preferred that government get out of the way and allow economic development to happen on its own. They increasingly opposed Hamilton's view of America and the role of national government. If Hamiltonian thinking can be understood as a complex and coherent ideology that embraces strong central government, encourages commercial activity, and treats the Constitution as a grant of power rather than a restraint on it, then Hamilton's funding program represents the practical application of that ideology. To transform America into the industrious nation of Hamilton's vision required stable credit and liquid forms of capital for investment, both of which could be achieved by establishing the public credit.

Hamilton first had to convince his audience that establishing the public credit was both desirable and necessary. He argued that the ability to borrow money on good

⁹McDonald *Alexander Hamilton*, 3-4.

terms was integral to the future success and stability of the United States and observed that, “[e]xigencies are expected to occur in the affairs of nations, in which there will be a necessity for borrowing.” In the event of war, famine, or other public dangers, the ability to raise funds through borrowing would be indispensable.¹⁰ Hamilton had little trouble on this point, and even Thomas Jefferson recognized the need for good credit and admitted, “[t]hough much an enemy to the system of borrowing, yet I feel strongly the necessity of preserving the power to borrow. Without this, we might be overwhelmed by another nation, merely by the force of its credit.”¹¹ The only way to ensure that America would be able to borrow at favorable interest rates was to restore the shattered confidence in its ability to pay its debts.

Having established the necessity of good credit, Hamilton then had to provide a method of restoring America’s credit. Credit is based on confidence in the issuer’s ability to repay the debt. To build confidence in America’s ability to pay, Hamilton suggested funding the outstanding debts at face value. The actual value of the debt had declined greatly as the value of colonial, state, and national bonds and bills of credit had plummeted during and after the Revolution. Hamilton could have chosen to pay the debt at its depreciated value, but he insisted on funding the debt at its face value. Hamilton noted that “[s]tates, like individuals, who observe their engagements are respected and trusted.” Paying the grossly depreciated value of the debt would not

¹⁰Alexander Hamilton “First Report on the Public Credit, January 9, 1790” in *Alexander Hamilton: Writings*. (New York: Library of America, 2001), 531-532.

¹¹Thomas Jefferson to the Commissioners of the Treasury, 1788, in *The Writings of Thomas Jefferson*, ed. by Andrew A. Lipscomb and Albert E. Bergh. (Washington, D.C: Jefferson Memorial Association, 1903), Volume 6, 423.

instill confidence, and to achieve the respect and trust of investors, Hamilton believed the United States had no choice but to pay its outstanding debts at full value.¹²

Hamilton did not want to simply pay off the principle on the debt, he wanted to follow the British example and fund the debt. Funding meant regularly paying interest on the debt rather than making annual appropriations to pay it off. The experience of the British, whose national debt allowed them to finance costly wars and fueled the growth of its empire, illustrated how a properly funded debt could increase the amount of available capital and lead to exceptional economic growth. Rather than levying burdensome taxes to pay the debt, Hamilton wanted to issue new bonds that, while increasing the debt, would also increase the money supply and allow the government to borrow freely and confidently. When a debt is properly funded and interest is paid promptly, government bonds will trade at par value and can easily be bought, sold, and held as collateral. The bonds therefore would function as a medium of exchange and act as “a substitute for money.” Hamilton thought the United States lacked “active wealth” and fluid capital, but he also believed that debt would solve the problem and increase the amount of capital that could be used for investment in agriculture and commercial activity.¹³

Virtually everyone agreed that some provision needed to be made for the debt, but significant opposition questioned the wisdom and benefits of funding the debt. Most opponents expressed fears that a funded debt would become perpetual. James Jackson, a House representative from Georgia, voiced this common sentiment. “Hence I contend, sir, that a funding system, in this country, will be highly dangerous to the

¹²Hamilton “First Report on the Public Credit,” in *Alexander Hamilton: Writings*, 531-532.

¹³*Ibid.*, 531-536.

welfare of the republic; it may, for a moment, raise our credit and increase the circulation, by multiplying a new species of currency; but it must, in times afterward, settle upon our posterity a burthen which they can neither bear nor relieve themselves from.” Jackson worried about the long-term implications of large national debt and feared it would lead to higher taxes and dependence on foreign creditors. Jackson sincerely wished to reestablish the public credit, but he favored heavy taxation on the current generation over a funded debt.¹⁴

Thomas Jefferson, James Madison, and others joined Jackson in their opposition to a funded debt. Jefferson, himself a lifelong debtor, had acutely experienced the hardship of debt, and thought it unjust to burden future generations with a large debt. In a letter to Madison, he expressed a view he held throughout his life that the earth belongs to the living, not the dead, and that “no generation can contract debts greater than may be paid during the course of its own existence.”¹⁵ Madison too felt uncomfortable saddling future generations with debt, and he despaired that a funded debt would concentrate wealth and thus undermine the relative equality needed in republican government. He expressed his concerns to fellow Virginian Henry Lee when he wrote, “I go on the principle that a public debt is a public curse, and in a Republican Government a greater curse than any other.”¹⁶ While Madison, Jefferson, Jackson, and others accepted the necessity of paying down the debt, they believed a funded debt would have pernicious effects on the future of the American republic.

¹⁴James Jackson. “From *Debates in the House of Representatives on the First Report on Public Credit*,” in *Liberty and Order : The First American Party Struggle*, ed. by Lance Banning. (Indianapolis: Liberty Fund, 2004.) 50-51.

¹⁵*Thomas Jefferson to James Madison, September 6, 1789*

¹⁶Madison to Henry Lee, April 13, 1790.

The fear of a large, funded debt was not new and had surfaced in anti-federalist rhetoric during the debate over ratification of the Constitution. An anti-federalist writer under the pen name Brutus, most likely Robert Yates, wrote that under the authority of the necessary and proper clause, “the Congress may mortgage any or all the revenues of the union, as a fund to loan money upon, and it is probably, in this way, they may borrow of foreign nations, a principal sum, the interest of which will be equal to the annual revenues of the country. — By this means, they may create a national debt, so large, as to exceed the ability of the country ever to sink.” Brutus also accepted that borrowing was at times necessary, but he warned against borrowing from foreign countries and warned against giving Congress discretionary borrowing powers. He believed that such unlimited borrowing power could not be given to politicians without guaranteeing financial profligacy in the future. Politicians at the national level, Brutus thought, could not be trusted to exercise fiscal restraint. To ensure that Congress only borrowed in times of absolute necessity he recommended a requirement that two-thirds of the states approve any measure of borrowing. Opposition to a large debt was thus not new, and to a large extent the debate over Hamilton's funding proposal was a continuation of a debate that had begun at the Constitutional Convention.¹⁷

Another source of opposition came from those who wanted to discriminate between original and current holders of government debt. The fight over discrimination took on a decidedly sectional flavor that pitted primarily southern agrarian interests against northern speculators. After the war, many bonds found their way into the hands of northern speculators who hoped to profit on the eventual repayment of the bonds.

¹⁷Brutus “Certain Powers Necessary for the Common Defense, Can and Should be Limited,” 1788, in Bordern, *Antifederalist Papers*, 6-8

The collapse of the nation's credit and its inability to repay creditors caused the debt certificates to lose value, and many bondholders facing dire economic conditions during and after the Revolution had no choice but to sell their debt certificates to speculators at steep discounts.¹⁸

The problem grew worse after news broke about Hamilton's plan and northern speculators, eager to capitalize on the future repayment of the bonds, rode through the south and bought discounted debt certificates from southern bondholders who had not yet heard of Hamilton's plan. The repugnant actions of avaricious speculators disturbed congressmen from southern and frontier states such as James Jackson, Thomas Scott, Thomas Tucker, and others who decried the injustice of profiting from the misfortune of the patriots and soldiers who originally held the bonds. They pointed out that the government's failure to honor its contracts created the opportunity for speculation, and that the government was therefore responsible for making some provision of justice to original holders.¹⁹

James Madison, who opposed Hamilton's plan at every turn, joined the political fray on the side of discrimination. He too condemned the injustice in a situation where poor, downtrodden patriots sold their bonds for next to nothing to speculators who would now, under Hamilton's plan, reap enormous benefits. He then submitted a resolution to provide compensation to the original holders. Madison's support of discrimination is difficult to explain because he had straightly rejected discrimination in 1783 and any form of discrimination would further increase a debt that he already

¹⁸Wright, *One Nation*, 135-140

¹⁹*Ibid.*, 138-140.

feared would become too large to manage.²⁰ Elias Boudinot, who opposed discrimination but nonetheless resented the actions of speculators, may have been correct when he said that Madison, “had not viewed the subject with his usual accuracy . . . was led away by the dictates of his heart.”²¹ Another explanation could be that Madison was simply stalling as he waited for the arrival of delegates from North Carolina, the last state to ratify the Constitution, who would reinforce him in opposition to other aspects of the funding plan.²²

Hamilton anticipated such opposition and stressed in his report the need to honor the original contracts. He argued that a policy of discrimination “is inconsistent with justice, because in the first place, it is a breach of contract; in violation of the rights of a fair purchaser.” Discrimination violated the sanctity of private contracts and set a poor precedent for a nation trying to prove that it could honor its obligations.²³ Roger Sherman, a House representative from Connecticut, echoed Hamilton’s thinking and stated, “But here I must contend that they have no right to violate, alter or abolish [those contracts]. . .if this government once establishes such a principle, our credit is inevitably

²⁰ Lance Banning, *Sacred Fire of Liberty: James Madison and the Founding of the Federal Republic* (Ithaca, N.Y.: Cornell University Press, 1995) 314. Madison condemned discrimination during the debates at the Constitutional Convention, but when the subject of discrimination came up again during the funding and assumption debates he staunchly supported discrimination. It was not so much that Madison had changed his mind on discrimination, but rather it was that the circumstances surrounding discrimination had changed. Madison was as committed as Hamilton to establish sound public credit, but he increasingly saw the profits of speculators at the expense of downtrodden patriots as a great evil. As a result, Madison changed his stance and supported discrimination despite the consequence of a larger debt.

²¹Ibid. 312-316.

²²McDonald, *Alexander Hamilton*, 178.

²³Elias Boudinot, “From *Debates in the House of Representatives on the First Report on Public Credit*,” in *Liberty and Order: The First American Party Struggle*, ed. by Lance Banning. (Indianapolis: Liberty Fund, 2004) 53.

gone for ever.” A negation of contracts would set a dangerous precedent for the future and hamper the formulation of liquid capital markets in the United States.²⁴

Hamilton supporters in Congress argued that honoring the existing contracts was the only way to prevent speculation from happening in the future. A lack of faith in the country’s credit created a situation where speculators could profit, and the only way to stabilize bond prices and restore faith was to honor and uphold existing contracts. During debate in Congress, Elias Boudinot stated, “I wished for the means of compensating the original holders who had sold their certificates at a great loss; but I found the thing, upon long and careful examination, to be both unjust and impracticable.”²⁵

In addition to concerns about the justice of violating contracts, Boudinot argued that practical concerns also stood in the way of discrimination. Finding out who had original held certificates would be a bureaucratic nightmare and present opportunities for fraud. Other Hamilton supporters further reasoned that while the situation appeared unjust, in some circumstances the current holders of debt certificates took on significant risk themselves and helped the original holders by providing them with much needed cash in a time of despair. The necessity for secure contracts and the impracticality of discrimination convinced enough members of Congress to overwhelmingly defeat Madison’s resolution.²⁶

Congress may have voted down the Madison’s proposal, but the initial opposition to Hamilton’s plan had been important and set the tone for the assumption debate that

²⁴Roger Sherman, *Ibid.*, 56.

²⁵Elias Boudinot, *Ibid.*, 53.

²⁶Elias Boudinot, *Ibid.*, 53.

followed. Economic and political interests undoubtedly informed support for discrimination, and agrarian, southern representatives resented the injustice done to their constituents at the hands of northern speculators. Beneath the surface of economic interest lurked a more pervasive fear that Hamilton's program would diminish the power of the states and create a large moneyed interest that would corrupt government and threaten liberty.

Assumption: Debate and Compromise

The funding of the Revolution was carried on at both the state and federal levels, and the nature of the arrangement complicated settlement of the debt after the war. States had incurred varying levels of debt during the war, and some had already made headway on their debts. Assumption of the state debts was critical to Hamilton's plan and its difficult passage in Congress almost unhinged the entire program. Although Hamilton promoted assumption as an expedient measure whereby the single authority of the federal government could more effectually provide for the debt than the various states, assumption met numerous objections. Politicians from states that had already paid off much of their debt perceived only limited benefits and higher taxes from assumption. Others worried that assumption would create a moneyed interest in America that would benefit avaricious speculators at the expense of industrious farmers and corrupt the government. Finally, to Americans who were ever-watchful of federal encroachment on the rights of liberty, assumption sounded like the consolidation of government that they feared would lead to the annihilation of state governments.

Hamilton thought assumption prudent for several reasons. First, he believed that the federal government was better equipped to pay the debts and could do so more efficiently than the separate state governments. In remarks made in Congress on the raising of funds in 1783, Hamilton stated that general and uniform taxes set with the authority of Congress were preferable to taxes established independently by the states. Taxes made by Congress are “more simple and more certain,” than taxes collected by the states, which would “be more subservient to popularity than public revenue.”²⁷ He reiterated this view in his report to Congress saying that if each state were allowed to pursue its own plan of repayment they would compete for economic resources and pass interfering regulation that hindered growth. Thus, assumption would “[c]ontribute in an eminent degree to an orderly, stable, and satisfactory arrangement of the national finances” because a provision made by the single authority of Congress would be far more effective than different plans resulting from different authorities.²⁸

Another argument for assumption was that the debts had been incurred for the common cause of freedom, and it seemed just that a common provision should be made for their retirement. According to Hamilton’s logic, holders of American debt had all made the same sacrifice for freedom and deserved to be placed on the same footing in terms of repayment. Without assuming the states debts, federal bondholders would receive payment while holders of state bonds might not depending on the financial condition of their home state. Hamilton thought that no class of creditor should be

²⁷ Alexander Hamilton “Remarks in Congress on Raising Funds, January 27, 1783” in *Alexander Hamilton: Writings*. (New York: Library of America), 2001.

²⁸Hamilton “First Report on the Public Credit,” in *Alexander Hamilton: Writings*, 542-544.

placed above any other, and to remedy the situation the federal government, in which the Constitution vested the primary source of revenue, should assume the debts.²⁹

Representative Benjamin Goodhue of Massachusetts expressed this sentiment in private correspondence saying that justice and future prosperity required that “those debts incurred for the attainment of our Independence whether in the hands of State or Continental creditors should stand on the same footing and receive a supply from one common fountain.”³⁰ President Washington also acknowledged that some states had borne heavier costs for the same goal of freedom, and that something should be done to aid them in paying those costs. “The Cause in which the expenses of the War was incurred, was a Common Cause. The States declared it so at the beginning and pledged themselves to stand by each other. If then, some States were harder pressed than others . . . it is but reasonable when this fact is ascertained that an allowance ought to be made them when due credit is given to others.”³¹ Washington appealed to the patriotism of Americans, and although Hamilton used the same tactics, he also had ulterior political motives shaped by his desire to strengthen the role of federal government.

Hamilton hoped that assumption would bind together the interest of creditors and give them a new common cause in the success of the federal government. The debt would thus serve the dual role of stabilizing the country’s financial situation while consolidating the power of the central government. Assumption could serve a political role and, in Hamilton’s words, “cement more closely the union of the states.” Hamilton reasoned that if the repayment of creditors were entirely the responsibility of the federal

²⁹Ibid.

³⁰Rep. Benjamin Goodhue of Massachusetts to Michael Hodge, February 24, 1790.

³¹George Washington to David Stuart, June 15, 1790.

government, then public creditors, who were often the wealthiest and most influential of the states' oligarchs, would have an economic interest in the perpetuation of the union. If the union dissolved, so would their investment. In this way assumption sought to replace local interests with the national interests and prevent the centrifugal pull of state interests that sank the Articles of Confederation.³²

Hamilton was not the only one who believed in the benefit of a funded debt, and many of the public creditors supported a provision for the state debts. In a memorial to Congress written before Hamilton's report, a group of influential creditors from Pennsylvania pressed the government for action and advanced numerous arguments that Hamilton later used to argue for the necessity of funding and assumption. The creditors recognized that the debts had undertaken for a common cause and supported assumption to unify local interests. Assumption, they argued was necessary for prosperity, because "to promote the Prosperity of the Confederation; each State will find an Interest in the Welfare and punctuality of the rest; the federal Government will be zealously supported as a general Guarrantee [sic]; and, in short, a Debt originating in the Patriotism that achieved the Independence, may thus be converted into a Cement that shall strengthen & Perpetuate, the Union, of America."³³

Although Hamilton gave compelling reasons for assumption, many opposed the idea out of personal economic considerations. The so-called frontier faction of Congress, which consisted of representatives from Georgia, northern New Hampshire, and the backcountry of Pennsylvania and South Carolina, was heavily involved in state-owned land speculation and stood to lose from assumption. Land speculation had

³²McDonald, *Alexander Hamilton*, 167.

³³Memorial of the Public Creditors of Pennsylvania, August 21, 1789

become immensely lucrative because land could be purchased using the face value of depreciated public securities. The certificates could be purchased at a fraction of their value and then accepted at full value for the purchase of lands. Assumption of state debt debts would restore the value of the securities to their market value and ruin the profitable scheme for speculators. Among the frontier faction, James Jackson, Samuel Johnston, and Thomas Sumter were some of the most actively engaged in land speculation, and their vehement opposition to assumption was more than coincidence.³⁴

Personal interests also informed support for assumption, and there were many in Hamilton's camp who would gain financially from funding and assumption. Elias Boudinot and Roger Sherman grounded their support of funding on principle and the moral obligation to fulfill contracts, but economic and personal interests may have played a role as well. Both held significant amounts of debt certificates, and Boudinot's holdings amounted to just under \$50,000 at face value. Several Hamilton supporters in both houses of Congress held large amounts of state securities, and opponents charged that personal interest were driving political decisions. While it is true that some Hamilton supporters owned debt securities and stood to profit from his plan, the generalization that private gain informed supporters' decision did not apply to everyone. Several debt holders in both houses opposed Hamilton, and Fischer Ames and Theodore Sedgwick, two of the most outspoken supporters of funding and assumption did not hold any debt. Personal interests undoubtedly played a role and informed the thinking of some politicians, but many formed their opinion based on the needs of their constituencies and their vision of the proper nature and role of American government.

³⁴McDonald, *Alexander Hamilton*, 174.

Local interests and economic considerations also played a role for states that had the most to gain or lose economically from assumption. Virginia, for example, had paid off most of its debts and had little to gain from assumption. James Madison, who made a habit of opposing nearly every measure of Hamilton's plan, was mainly concerned with the equity of the Hamilton's assumption plan and believed that it would do "injustice to a majority of states." Only three states, Massachusetts, Connecticut, and South Carolina, were well behind on paying back their debts and had a vested interest in debt assumption. Virginia, on the other hand, stood only to lose from assumption in the form of higher taxes to a national government that would then pay the debts of other states. Assumption would increase the size of the national debt and lead to higher tariffs. The agrarian southern states, which relied more on foreign imports than the northern states, would then bear a greater amount the debt burden. Local economic interests informed Madison's opposition just as they informed the support of representatives from Massachusetts and South Carolina, whose heavily indebted states would receive the greatest share of the benefits of assumption.³⁵

Assumption also met ideological resistance from Americans who wanted to preserve state autonomy and prevent the establishment of an arbitrary government similar to the British government from which they had just freed themselves. Historian Joseph Ellis summarized the fears of some Americans best when he wrote that, "assumption was symptomatic of malevolent tendencies that transcended mere dollars and cents. It was about power. Under the guise of doing the states a favor by assuming their debts, the federal government was implicitly, even covertly, assuming sovereign

³⁵Banning, *Sacred Fire*, 313-321

authority over the economies of all the states.”³⁶ For some opponents, opposition to assumption was less about Madison’s concern for equity and more about preserving a decentralized view of federalism from where the state governments formed the primary units of political power.

This ideological opposition to perceived arbitrary government power was firmly entrenched in the American consciousness and had been an animating factor for the Revolution and the Anti-federalist opposition to the Constitution. To a large degree this opposition represented the Americanization of opposition ideas from English “country” opposition in the 18th-century. American colonists read works by English opposition writers such as Trenchard and Gordon, who warned about the fragility of liberty and fostered a consciousness towards the danger of consolidated power. This deep suspicion of aggrandizing power that led to the Revolution remained in the American psyche and to varying degrees informed opposition to the Constitution and later opposition to federalist programs such as assumption.³⁷

Hamilton’s program for assumption could not have been better designed to awaken the ever-present suspicions about the encroachments of national government and the skepticism of any action that would consolidate power at the expense of the states. Representative Theodorick Bland confessed his fear writing that, “absorption of revenue will Certainly follow Assumption of debt—so that our State governments will have little else to do than to eat drink and be merry . . .again Consolidation follows power—power has been given with a liberal hand.” Bland, a former delegate to the

³⁶ Joseph J. Ellis, *Founding Brothers: The Revolutionary Generation*. (New York: Alfred A. Knopf, 2000), 58.

³⁷ Lance Banning, *Jeffersonian Persuasion: Evolution of a Party Ideology*. (Ithaca, N.Y.: Cornell University Press, 1978) 72-73.

Virginia ratifying convention, had opposed ratification of the Constitution because he thought it gave too much power to the federal government and that once given, that power could never be taken away. Although Bland was concerned about the immediate impact of assumption, he was more concerned with where assumption might lead. Once the federal government began to encroach on the sovereignty of states and interfere with state finances, it would not stop until it had consolidated all significant power.³⁸

Philadelphia Physician Benjamin Rush, a signatory of the Declaration of Independence, saw Hamilton's funding and assumption proposal as a measure that would undermine the achievements of the Revolution. He believed that funding and assumption would create in America the British system of corrupt government and financial influence from which the colonies had just gained independence. He expressed his disgust at Hamilton's plan in a letter to James Madison saying, "I feel disposed to wish that my name was blotted out from having contributed a single mite towards the American Revolution. We have effected a deliverance from the national injustice of Great Britain to be *subjugated* by a mighty Act of national injustice by the United States. . . It will lay the foundation of an aristocracy in our country."³⁹ In another letter he wrote, "It will in seven years introduce among us all the corruptions of the British funding system." Rush thought that Hamilton's plan would undo the great work of the Revolution and replace the tyranny of British government with an equally oppressive and intrusive United States federal government. Rush's opposition to Hamilton flowed

³⁸ Theodorick Bland to St. George Tucker, March 6, 1790.

³⁹ Benjamin Rush to James Madison, February 27, 1790. "From *Liberty and Order: The First American Party Struggle*, ed. by Lance Banning. (Indianapolis: Liberty Fund, 2004.) 65.

from the same ideological beliefs that informed his opposition to the British government and arbitrary power.⁴⁰

Another strain of ideological opposition saw assumption as a measure that would corrupt American virtue in the same way that the creation of a monied interest had corrupted the British government. This thinking did not oppose commerce, but rather it opposed speculation, stock jobbing, and the single-minded pursuit of economic gain. Commerce became a problem when it led to an avaricious spirit that corrupted public virtues, and many Americans saw assumption as a policy that would concentrate wealth and create a powerful commercial class that sought only economic enrichment. Virginia Senator John Taylor claimed that funding and assumption would deprive republican state assemblies of political importance and replace the American system of federalism with a “a court-style English government” through the “accumulation of great wealth in a few hands.” For Taylor and other opponents of assumption, Hamilton’s plan advocated a monied interest that subverted the ideals of an American republic based upon diverse interests and restrained power.⁴¹

Patrick Henry and Henry Lee, former antifederalists, revived the Revolutionary rhetoric in the debate against assumption. They charged Hamilton’s plan with the same violations of liberty that they had charged against the British government leading up to the Revolution. Hamilton’s funding and assumption plan threatened their vision of a virtuous republic characterized by local government and individual liberty. Henry and Lee believed that states were the primary units of political authority, and they

⁴⁰Benjamin Rush to James Madison, April 10, 1790. *Ibid.*, 67.

⁴¹Thomas DiLorenzo. *Hamilton’s Curse: How Jefferson’s Arch Enemy Betrayed the American Revolution—and What It Means For Americans Today*. New York: Crown Forum Publishers, 2008.

championed a decentralized view of federalism. Such thinking believed that a strong federal government could not accommodate the diversity of economic and public life in America, and it held that only localized authority could protect liberty. This thinking led Henry and Lee to a literal interpretation of the constitution that viewed it as a restraint on, rather than a grant of, federal power. No section of the Constitution permitted a federal assumption of state debts, and Henry and Lee viewed Hamilton's plan for funding and assumption as nothing less than a subversion of liberty.⁴²

Patrick Henry and Henry Lee led a committee of the General Assembly of the Commonwealth of Virginia that issued an official remonstrance against Hamilton's plan. The committee explicitly laid out its objections to funding and assumption and stated, "[i]n an agricultural country like this, therefore, to erect and concentrate and perpetuate a large moneyed interest . . . must, in the course of human events, produce one or other of two evils: the prostration of agriculture at the feet of commerce, or a change in the present form of Federal Government fatal to the existence of American liberty." The Virginia Remonstrance reveals the beliefs and fears of Henry, Lee, and other Virginians. They saw America as a primarily agricultural nation, and they feared that assumption would grant too much power to the federal government. In this sense, their opposition to funding and assumption represented a continuation of the ideological opposition that led to the Revolution and persisted during the ratification debate, and it was an ideology informed by hypersensitivity to the danger of consolidated power and the loss of liberty.

Despite strong opposition to Hamilton's plan, many recognized the need for public credit and sought political compromise. Thomas Jefferson fiercely opposed a

⁴² Saul Cornell, *Other Founders: Anti-federalism and the Dissenting Tradition in America, 1788-1828*. (Chapel Hill: University of North Carolina Press, 1999) 11-12, 175-178.

national debt and disagreed with Hamilton's means of securing public credit, but he nonetheless agreed with the importance of good credit. Jefferson admitted in private correspondence to his political ally James Madison that, "[t]hough I am an enemy to the using our credit but under absolute necessity, yet the possessing a good credit I consider as indispensable in the present system of carrying on war. The existence of a nation having no credit is always precarious."⁴³ Jefferson, having just returned from a stint as the Minister to France, understood that the United States could not achieve credibility in the eyes of European powers without addressing its outstanding debt. He believed that a plan for the public credit was necessary to "save us from the greatest of all calamities, the total extinction of our credit in Europe." For Jefferson, Hamilton's plan represented a necessary evil to ensure the future security of the young nation.⁴⁴

Jefferson believed that the passage of Hamilton's plan, although repugnant to many of his ideas about the nature of American government, was also politically necessary. He worried that the longer the debate over Hamilton's proposal carried on, the more it undermined the faith of the American people in the new government's ability to get things done. Fisher Ames, a representative from Massachusetts, spoke to how acrimonious the debate had become when he wrote, "The spirit of debate is a vice that grows by indulgence. It is a sort of captiousness that delights in nothing but contradiction. Add to this, we have near twenty *antis*, dragons watching the tree of liberty, and who consider every strong measure, and almost every ordinary one, as an attempt to rob the tree of its fair fruit."⁴⁵ The debate was increasingly becoming a back-

⁴³Thomas Jefferson to James Madison, 1788.

⁴⁴ Thomas Jefferson to James Monroe, June 20, 1790

⁴⁵ Fisher Ames, in *Liberty and Order : The First American Party Struggle*, ed. by Lance Banning. (Indianapolis: Liberty Fund, 2004) 11.

and-forth dialogue between opposing groups that tried to stifle the other at every turn. Continued debate, Jefferson believed, threatened both the economic stability and political viability of the new government, and he thought that the failure of Hamilton's proposal would lead to the dissolution of the union.⁴⁶

Jefferson hoped that changes could be made to the assumption plan that would make it more palatable to the states, and he eventually brokered a compromise that ensured the bill's passage. Jefferson wanted to admit assumption "in so qualified a form as to divest it of its [sic] injustice." He hoped to solve the problem by settling the state debt accounts in a way that so that each state's tax contribution would equal the amount of debt assumed. In this manner, no state would gain or lose from assumption.

⁴⁷ In late June of 1790, Jefferson invited Hamilton and Madison to a gathering at his home to work out the details of assumption. At what has famously become known as the "dinner-party compromise," Hamilton agreed to rework the assumption bill to terms more favorable to the settlement of Virginia's debt, which helped satisfy Madison's concern over the bill's equity. Furthermore, they agreed to locate the new nation's capital somewhere along the Potomac River. Where to locate the nation's capital had become a debate nearly as frustrating as the debate over assumption, and Hamilton happily submitted to the compromise to ensure that his proposal achieved passage.⁴⁸

Jefferson thus brokered the political compromise that ultimately secured passage of Hamilton's funding and assumption plan, and ended a debate that threatened the political and financial stability of the union. Although members of both sides of the debate sought similar ends and wanted to establish sound public credit, they varied

⁴⁶ Thomas Jefferson to Francis Eppes, July 4, 1790

⁴⁷ Thomas Jefferson to Thomas Mann Randolph, Jr., June 20, 1790.

⁴⁸ McDonald, *Alexander Hamilton*, 184-187.

wildly in their means of doing so. Distinct visions of the role of central government in America led to varying levels of support and opposition to Hamilton's plan. Hamilton's supporters, who saw central government as the driving mechanism for political and economic change, stood in stark contrast to his opponents, who saw consolidation of power and exaltation of commerce as threats to liberty and local interests. The debate over Hamilton's economic program became the first real political battle of the new government, and the opposing parties that grew out of the debate held opposing theories of government and divergent visions of American federalism.

Lessons and Legacy: The Debate Today

What has been the legacy of the 1790 assumption debate and what lessons can be learned from the nature of the debates? The debate over assumption left an indelible mark that influenced the political, governmental, and economic character of America going forward. The institutions that Hamilton set-up have become vital parts of the American economic system, and the country's impressive growth in the years following the passage of funding and assumption testify to its economic success. The French Foreign Minister Tallyrand remarked on the smashing success of Hamilton's funding and assumption plan saying, "[United States Bonds] have been funded in such a sound manner and the prosperity of this country is growing so rapidly that there can be no doubt of their solvency." Hamilton's plan created more liquid capital and helped secure the credit and prosperity of the United States.⁴⁹

⁴⁹Gordon, *Hamilton's Blessing*, 38-41.

Despite the economic success of his program, Hamilton may have pushed too far with his economic plan and his broad interpretation of the Constitution. The opposition that rose against him later took charge of the government and moved it in a direction toward their vision of the virtuous American republic. Jefferson, who had been integral to the passage of Hamilton's funding and assumption bill, later regretted his role and accused Hamilton's plan of being "adverse to liberty" and "calculated to undermine and demolish the republic."⁵⁰ At the time of the assumption debate, Jefferson could not see Hamilton's entire plan, which later included the establishment of a national bank and the mint. Hamilton's use of the necessary and proper clause to justify the national bank appalled Jefferson and set a frightening precedent for those opposed consolidated government power. Hamilton's plan succeeded in enlarging the national government and fostering the conditions for economic prosperity, but it also created opposing political parties gave his opponents the political firepower to take power and work towards their view of a more decentralized government.

The results of the assumption debate have had lasting effects on the American government and economy, and the debate itself continues to provide important lessons about American policymaking. Although the debate showed the importance of economic considerations in policymaking, it also revealed the limits a purely economic understanding of the debate. While economic interests to some extent informed the opinion of men such as Georgia representative James Jackson, who had a personal interest in land-speculation, political and ideological convictions were often more important. Economic interest did not always explain the actions of politicians, and

⁵⁰ Thomas Jefferson to George Washington, September 9, 1792

members on both sides of the debate voted against their own economic self-interest. Jackson himself abhorred the speculation of government bonds and grounded his opposition to assumption in an ideological vision that promoted public virtue and saw the unrestrained pursuit of personal wealth as a danger to American government.

History can never be viewed only in narrow economic terms, because while such a rigid framework can provide useful insights into thoughts and actions, it misses other important considerations that influence decision-making. Many actors in the assumption debate had bigger practical and political considerations that influenced their thinking and led them to worry about the consequences of assumption. Opponents such as Benjamin Rush and Representative Bland believed that assumption was a slippery slope that would ultimately lead to the submission of state governments to the power of the federal government. Others, such as James Madison, were more concerned about the practical implications and the equity of assumption, while supporters of the plan saw it as an equitable and practical solution for public creditors. Hamilton himself wanted economic growth, but also viewed funding and assumption as a chance to give more power to the federal government and move farther away from the weaknesses that had doomed the Articles of Confederation. Economic factors certainly played a role, and an important one at that, in the assumption debate, but political and practical considerations were also important in shaping opinions and stimulating action.

Perhaps the most salient lesson from the assumption debate is the importance of political context to understanding the debate. The assumption debate of 1790 may have been the most important such debate in American history, but it was not the only time that the debts of the various states have taken national prominence. Debate over

national assumption of state debts has reappeared several times throughout American history, and most notably following the Panic of 1837. Several states had defaulted on their debt obligations, and five states had repudiated their debts. This time, however, “Assumption was condemned as a gross and flagrant violation of the United States constitution.”⁵¹ The conditions surrounding the 1840’s assumption debate were far different from those of the 1790 debate, and most Americans rejected assumption on the grounds that it was unconstitutional, and that it encouraged risky behavior by the states.

By 1840, the states had gotten themselves into trouble by borrowing heavily to invest in costly internal improvement projects. Also, in the south, state governments were investing large sums of public funds into private banks. When the cotton market collapsed and land prices fell, many states found themselves unable to pay off their debts, and European creditors stopped purchasing state securities. The fallout of state defaults and debt repudiations was not limited to the financially weak states, and even the strongest states found it more difficult to borrow money.⁵²

The honor and credit of the American people was at stake, and some thought that the national government should remedy the situation by assuming the state debts and paying for them through the sale of western lands. Some easterners supported this proposition, which did achieve passage in the House of Representatives, because it was the only way they would ever see any of the profits from the sale of western land, but for the most part assumption met fierce resistance in 1840. Opponents condemned

⁵¹ Reginald McGrane, *Foreign bondholders and American State Debts*, (New York: Macmillan, 1935) 28.

⁵² McGrane, *Foreign Bondholders*, 5-7.

the policy as inexpedient, unjust, and unconstitutional. First, state governments had gotten themselves into trouble, and debt assumption would set a dangerous precedent of the federal government coming to the aid of financially irresponsible states governments. Second, assumption would force non-indebted states to bear the debt burden of other states, and third, the Constitution did not give the federal government the power to assume the debts of the states. Arguments over debt assumption in 1840 even entered into the presidential campaigns, but the calls for assumption drowned amidst a wave of cries that such a policy had no constitutional merit.⁵³

The starkly different results in the 1790 and 1840 assumption debates reveals the importance of political context to any debate. Why they reached different conclusions in each debate has to do to some extent with the varying political conditions and conceptions of federalism surrounding each debate. In the 1790 debate, the state debts had been incurred for a common cause, and American politicians recognized the importance of good credit to the honor and future security of the young nation. The failure of funding and assumption in the 1790 debate risked dissolving the fragile union, and in the end members of both sides were willing to compromise to protect their newly won freedom. In the 1840's debate, states had taken on debt to pursue internal improvements and fund local banks, and while Americans still believed in the necessity of good credit, their constitutional concerns and desire to protect state power led them to reject assumption as a viable policy. The conditions that prevailed during the 1790 assumption debate were peculiar to that time, and any attempt to analogize between other assumption debates risks losing sight of the characteristics specific to that episode. As a result, an important lesson from the 1790 assumption debate is that the

⁵³ Ibid., 24-28.

profound way in which political context informs a debate makes it difficult to compare similar debates across time.

Conclusion

Today, there is a growing fear that state debts could become the next big crisis in the American economy. Although more recently the ever-increasing national debt has received more attention, state and local governments face huge debt obligations that may pose a serious issue in the near future. The recent recession has hurt state tax revenues, and the government stimulus that helped states get through the recession is set to run out. Even worse, much of the debt of the state and local governments is in pension plans, which are off the books and often underestimated in value. No state has defaulted since the Great Depression, but the situation of financially distressed state such as Illinois or California could end up requiring federal assistance.⁵⁴

Should state or local governments need help, it is unclear how the federal government will react. Federal intervention could help greater fallout from state debt problems. Past experience has shown that debt problems cannot be easily contained to one state, and that the downgrade of one state's credit rating is likely to worry creditors about the credibility of other states as well. A state debt default would cause chaos in municipal bond markets and threaten the ability of states to borrow and finance activities. Nonetheless, there are some members of Congress who would reject a federal bailout because of the moral hazard that it would create. Wisconsin Representative Paul Ryan noted that, "If we bailed out one state, then all of the debt of

⁵⁴Michael Cooper and Mary Walsh "Mounting Debts by States Stoke Fears of Crisis." *New York Times*, December 4, 2010.

all of the states is not just implied, it's almost explicitly put on the books of the federal government.” The worry of setting the precedent of federal bailout is not a new one, and it comes from the notion that states should deal with their financial situation on their own.⁵⁵

Unfortunately for American policymakers, the nature of American federalism makes problems concerning state debts difficult to solve. In many instances the federal government is better equipped to address the financial difficulties of the states, but federal policymakers must balance their desire and ability to help with the constitutionality and consequences of their actions. Although an understanding of the 1790 assumption debate may not help predict the outcome of future state debt debates, it does provide insight into what factors may be important in such a debate. The nature of the debt and the manner in which it was incurred are important to determining how people react to and attempt to deal with state debts, and people's perception of the role and scope of federal government can also help determine how they view a policy of federal aid. In 1790, Americans faced a commonly incurred debt but worried about encroachments on power by the new national government. Today, the debate will be different because states have run up large debts in pursuit of their own individual ends, and because Americans have grown accustomed to an expansive federal government. The 1790 assumption debate raised fundamental questions about the relationship between federal and state governments as economic entities, and those questions will continue to evolve and receive attention in future debates.

⁵⁵ Simone Baribeau and James Rowley, “House Budget Chief Ryan Says Republicans Won't Bail Out States in Default” *Bloomberg News*, January 7, 2011.

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