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A Note on the Machiavellian Origins of Central Banking in America

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ABSTRACT: In *The Mystery of Banking*, Murray Rothbard explained how the origins of central banking in the U.S. were rooted in a lobbying effort by Robert Morris and other "nationalists" to create a bank modeled after the Bank of England that would subsidize their businesses with cheap credit and other forms of corporate welfare. This paper argues that there was more to it than that, namely, that the chief proponent of a central bank, Alexander Hamilton, wanted the bank to be a more comprehensive engine of political corruption because of his belief that, without such corruption, government would be too small and ineffective. Members of Congress had to be "bought off" if they were to support the nationalists' economic agenda, Hamilton believed, and a central bank was necessary to achieve that goal.

KEYWORDS: central banking, mercantilism, federalism, constitution, corruption

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INTRODUCTION

In *The Mystery of Banking* (2008, p. 191) Murray Rothbard explained how the first central bank in America, the Bank of North America, was "driven through the Continental Congress by (Philadelphia congressman and financier) Robert Morris in the spring of 1781." Morris (a native of Liverpool, England) was the leader of the "nationalists," also known as the Federalists, who wanted to impose the British mercantilist system on America immediately after having fought a revolution against that very system. As Rothbard (2008, p. 192) explained, Morris and his compatriots wanted

> To re-impose in the new United States a system of mercantilism and big government similar to that in Great Britain, against which the colonists had rebelled. The object was to have a strong central government, particularly a strong president or king as chief executive, built up by high taxes and heavy public debt. The strong government was to impose high tariffs to subsidize domestic manufacturers, develop a big navy to open up and subsidize foreign markets for American exports, and launch a massive system of internal public works. In short, the United States was to have a British system without Great Britain.

An important part of "the Morris scheme," as Rothbard called it, was "to organize and head a central bank, to provide cheap credit and expanded money for himself and his allies. The Bank of North America was deliberately modeled after the Bank of England" (Rothbard, 2008, p. 192). At the time, Morris had been appointed as America's first Superintendant of Finance, a position that would later be labeled Secretary of the Treasury.

The Bank of North America was given a monopoly privilege of its notes being receivable in all tax payments to state governments and the federal government, and no other banks were permitted to operate in the country. It lent most of its newly-created money to the federal government, and taxpayers were forced to pay the Bank principal and interest. Despite these monopolistic privileges, however, a lack of public confidence in the Bank's inflated notes led to their severe depreciation and the Bank was privatized in 1783, less than two years after it was created.

Morris and his business associates from New York, Philadelphia and New England did not give up on their goal of a bank modeled after the Bank of England that would provide them with cheap credit and subsidize their businesses in other ways. He recruited a man that Rothbard called "Morris's youthful disciple," Alexander Hamilton, to help resurrect a central bank in the form of the First Bank of the United States (BUS).

Indeed, Hamilton assisted in the creation of the Bank of North America while still an aid to George Washington during the American Revolution. Since he had no real knowledge or experience in finance and economics, he crammed enough information into his head to make himself appear to be credible. As described by Hamilton biographer Ron Chernow (2004, p. 156):

> Hamilton brushed up on money matters and had Colonel Timothy Pickering send him some primers—David Hume's *Political Discourses*, tracts written by the English clergyman and polemicist Richard Price, and his all-purpose crib, Postlethwayt's *Universal Dictionary of Trade and Commerce*.... Hamilton sent a marathon letter to Morris... that set forth a full-fledged system for shoring up American credit and creating a national bank.

The April 30, 1781 letter to Robert Morris[1] advocated protectionist tariffs, a central bank, taxes on land, poll taxes, and a large public debt. "A national debt, if not excessive, will be to us a national blessing. It will be powerful cement of our union," he wrote. Hamilton would spend much of the rest of his life agitating for *more* excessive public debt and spending.

The letter essentially laid out the nationalists' agenda and provided Morris with arguments that he could use to persuade Congress to adopt the Bank of North America. He started out by advocating a king: "I was among the first who were convinced that an administration by single men was essential to the proper management of the affairs of this country." He also wanted to abolish state sovereignty altogether and consolidate all political power at the national level: "Congress ought to have complete sovereignty in all but the mere municipal laws of each state."

[1] *See* www.familytalies.org/dbDisplay.php?id=ltr_alh3414&person=alh.

Hamilton condemned America's first constitution, the Articles of Confederation, as "futile and senseless," and began agitating for a "convention of the states" that would replace the Articles with a new constitution that would presumably go a long way toward his (and his fellow nationalists') goal of total political centralization and the creation of a mercantilist empire. A central bank was the keystone of this enterprise. "Great Britain is indebted for the immense efforts she has been able to make in so many illustrious and successful wars," he wrote, because of the existence of the Bank of England. Hamilton also spoke of the "imperial glory" that Americans, too, could achieve with the help of a central bank modeled after the Bank of England. "The tendency of a national bank is to increase public and private credit," Hamilton wrote in his letter to Morris. "The former gives power to the state, for the protection of *its* rights and interests" (emphasis added).

In short, the purpose of America's first central bank, according to its founders, was not only to dispense corporate welfare subsidies to politically-connected businesses, as Rothbard correctly perceived, but also to grow the state, finance an empire modeled after the British empire, and to prosecute "illustrious" wars that would provide America—and presumably people like Hamilton—with "imperial glory." Of course, the two purposes are not mutually exclusive: dispensing subsidies to big business will always guarantee that big business will become a lobbyist for even bigger government. But Alexander Hamilton, above all others, believed that mere subsidies would not be sufficient—a degree of old-fashioned political corruption would also be necessary (Bowers, 1925).

THE BANK OF AMERICA AS AN ENGINE OF CORRUPTION

It is well known that Hamilton championed a large national debt as part of a political strategy to get the central government to grow faster than it otherwise would. His rather Machiavellian logic was that the wealthier people of the country would become the government bondholders; therefore, they would always be a lobbying force for higher taxes to ensure that their bonds could be paid off. As William Graham Sumner (1905, p. 156) explained, Hamilton favored a large public debt because of "its tendency to strengthen... government by increasing the number of ligaments between the government and the interests of individuals." Douglas Adair (1980, pp. 171–172), a one-time editor of *The Federalist Papers*, was more explicit:

> With devious brilliance, Hamilton set out, by a program of class legislation, to unite the propertied interests of the eastern seaboard into a cohesive administration party, while at the same time he attempted to make the executive dominant over the Congress by a lavish use of the spoils system [i.e, giving government jobs to political supporters]. In carrying out his scheme... Hamilton transformed every financial transaction of the Treasury Department into an orgy of speculation and graft in which selected senators, congressmen, and certain of their richer constituents throughout the nation participated.

An example of what Adair is talking about here is how Hamilton, as Treasury Secretary, nationalized all of the old government debt. New government bonds were issued, backed by revenue from a new tariff that Hamilton was instrumental in having enacted into law. The old debt was to be cashed out at face value. This plan "immediately became public knowledge in New York City," wrote John Steele Gordon (1997, p. 25), "but news of it spread only slowly, via horseback and sailing vessel, to the rest of the country."

Thus, a tremendous arbitrage opportunity was established, and the New York/Philadelphia/New England business establishment—the core of Hamilton's Federalist Party—took full advantage of it. These political insiders, in possession of inside political information, embarked on a mad scramble down the eastern seaboard to purchase the old government bonds from unsuspecting Revolutionary War veterans who had been paid in government bonds, among others, at prices as low as ten percent of full value. As historian Claude Bowers (1925, p. 47) explained the scene in a biography of Jefferson and Hamilton:

> [E]xpresses with very large sums of money on their way to North Carolina for purposes of speculation in certificates splashed and bumped over wretched winter roads.... Two fast-sailing vessels, chartered by a member of Congress who had been an officer in the war, were ploughing the waters southward on a similar mission.

Among the men who became instantly wealthy through this scheme were "leading members of Congress who knew that provision for the redemption of the paper [at full face value] had been made (Bowers, 1925, p. 48). New York newspapers speculated that Hamilton's political benefactor, Robert Morris, made at least $18 million in the deal; Governor George Clinton of New York made $5 million; and Hamilton himself purchased some of the bonds "through buying agents in Philadelphia and New York" (Bowers, 1925, p. 50).

Upon observing this, and Hamilton's role in it, Thomas Jefferson came to understand that Hamilton and his party (the Federalists) were intentionally creating a system of organized corruption in order to expand the size and scope of the state beyond what the Constitution would allow, and that a central bank would be an integral part of this system of organized corruption. Every member of Congress, and every businessman who profited from the debt nationalization scheme, would become a loyal supporter of the Federalists and their big government agenda.

In a February 4, 1818 essay, written long after Hamilton's death in 1804, Jefferson (1984, pp. 661–696) explained what the Machiavellian Hamilton—and his political heirs—were up to. "Hamilton's financial system," Jefferson wrote, "had two objects. 1st as a puzzle, to exclude popular understanding & inquiry. 2ndly, *as a machine for the corruption of the legislature*" (emphasis added).

With regard to the first "object," Jefferson is referring to Hamilton's long-winded reports on public debt and central banking, which he believed were purposefully confusing so as to intimidate potential opponents in Congress who themselves knew little or nothing about economics and finance. With regard to the second object, Jefferson said that Hamilton :

> ...avowed the opinion that man could be governed by one of two motives only, force or interest: force he observed, in this country, was out of the question; and the interests therefore of the members must be laid hold of, to keep the legislature in unison with the Executive. And with grief and shame it must be acknowledged that his machine was not without effect. That even in this, the birth of our government, some members were found sordid enough to bend their duty to their interests, and to look after personal, rather than public good.

Jefferson is alluding here to Hamilton's scheme to nationalize the debt. A few sentences later he notes that "the distresses of those people [i.e., the original bondholders] often obliged them to part with these for the half, the fifth, and even a tenth of their value; and Speculators had made a trade of cozening them from the holders, by the most fraudulent practices and persuasions..." (Jefferson, 1984, p. 666).

Jefferson also described the above-mentioned arbitrage by Hamilton's political insiders:

> [T]he base scramble began. Couriers & relay horses by land, and swift sailing pilot boats by sea, were flying in all directions. Active partners & agents were associated & employed in every state, town and country neighborhood, and this paper was bought up at 5 and even as low as 2% in the pound, before the holder knew that congress had already provided for its redemption at par. Immence sums were thus filched from the poor & ignorant, and fortunes accumulated by those who had themselves been poor enough before.

"Men thus enriched by the dexterity of a leader," Jefferson wrote, "would follow of course the chief who was leading them to fortune, and thus become the zealous instruments of all his [political] enterprises" (Jefferson, 1984, p. 667). Next, Hamilton orchestrated the nationalization of the state government debts, which had the same corrupting effect. It "added to the number of votaries to the treasury and made its Chief the master of every vote in the legislature which might give to the government the direction suited to his political views" (Jefferson, 1984, p. 669).

But Hamilton's debt-assumption policies were one-time-only events. They enriched numerous members of Congress and businessmen who were sure to support the nationalists' agenda of protectionism, corporate welfare, heavy taxes and a large public debt, but as Jefferson remarked, the political power created by these schemes would "be temporary. It would be lost with the loss of the individual members whom it had enriched." That is, as these men retired or passed away, so would the nationalist political machine.

"Some engine of influence more permanent must be contrived," said Jefferson, describing the thinking of Hamilton and the nationalists. And, "this engine was the Bank of the U.S." (Jefferson, 1984, p. 670). A central bank would be the financial vehicle for a *permanent* system of corruption, vote-buying and influence peddling, in Jefferson's view. He held this view because of his belief that "Hamilton was not only a monarchist, but for a monarchy bottomed on corruption" (Jefferson, 1984, p. 670). Jefferson then describes a conversation that he had with Hamilton, Secretary of War Henry Knox, John Adams, and U.S. Attorney General Edmund Randolph in 1791, "for the truth of which I attest the God who made me" (Jefferson, 1984, pp. 670-671).

Jefferson recalled how John Adams made the statement regarding the British government to the effect that "purge that constitution of its corruption, and give to its popular branch equality of representation, and it would be the most perfect constitution ever devised by the wit of man." To which Hamilton objected: "[P] urge it of its corruption, and give to its popular branch equality of representation, & it would become an impracticable government; as it stands at present, with all its supposed defects, it is the most perfect government which ever existed."

Hamilton was "so bewitched & perverted by the British example," wrote Jefferson, "as to be under thoro' conviction that corruption was essential to the government of a nation" (Jefferson, 1984, p. 671). And *that* is why he wanted a central bank—to finance that corruption. He got what he wanted: the Bank of the United States was created in 1791, the same year of the meeting between Hamilton, Jefferson, Knox, Randolph, and Adams.

Hamilton was perhaps the main instigator of the movement to replace America's first constitution, the Articles of Confederation, with a new constitution. The former document did not permit a national bank. He lobbied for a constitutional convention for seven years, and finally succeeded. At the constitutional convention he laid out his plan for the new government: a permanent president who would appoint all the governors, who would in turn have veto power over all state legislation. Virtually all political power would have been consolidated at the national level (DiLorenzo, 2008, p. 17). His plan was rejected, however, in favor of the system of federalism or states' rights that is embodied in the original U.S. Constitution.

A king-like president would have had the power to create a national bank, which was always a top priority of Hamilton and the other Federalist political leaders. A national bank was in fact debated *and rejected* at the constitutional convention. But Hamilton and his fellow nationalists did not give up. As Treasury Secretary, Hamilton composed a lengthy report to Congress making the case for the constitutionality of a national bank (Cooke, 1964). Since he knew that such a bank had been rejected by the constitutional convention and was not included in the enumerated powers contained in Article 1, Section 8 of the Constitution, he invented the concept of "implied powers" of the Constitution. The power to create a national bank was "implied," Hamilton wrote, because of the "Necessary and Proper Clause" of the Constitution, which gives Congress the power "to make all Laws which shall be necessary and proper for carrying into Execution the... [enumerated] Powers." He argued that a national bank run by political appointees that would be a depository of tax revenues was necessary to carry out the constitutional functions of government.

Secretary of State Thomas Jefferson debated Hamilton with a report of his own, presented to the president, in which he argued that a national bank would merely be a *convenience* as a depository of tax revenues, but not a necessity since there were already many private banks that could easily serve that purpose (Mayer, 1994, p. 191). In the end, President Washington signed the legislation creating the First Bank of the United States in 1791 after a compromise was reached that enlarged the area of the District of Columbia by three miles so that it would be adjacent to Washington's property along the Potomac River. Federalist senators had blocked Washington's request until he agreed to sign the bank bill. Thus, the First Bank of the United States was literally born of a corrupt political deal, not the strength of Alexander Hamilton's rhetorical flourishes.

The First Bank of the United States "promptly fulfilled its inflationary potential by issuing millions of dollars in paper money and demand deposits," wrote Rothbard (2002, p. 69). The "result of the outpouring of credit and paper money by the new Bank of the United States was... an in increase [in prices] of 72 percent" from 1791 to 1796.

All of this suggests that President Andrew Jackson knew what he was talking about when he condemned the Bank of the United States as "subversive of the rights of the States, and dangerous to the liberties of the people" (Jackson, 1832, p. 1). He understood that "Every monopoly, and all exclusive privileges are granted at the expense of the public," and that "the many millions which this act (the re-chartering of the BUS) proposes to bestow on the stockholders of the existing Bank must come directly or indirectly out of the earnings of the American people" (Jackson, 1832, p. 1). These stockholders, said Jackson (1832, p. 2), were profiting from "their connection with the Government" only, and not any productive efforts on their part.

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