

## Economic Policy

### Background

#### Introduction:

The completion of George Washington's reign as this fledgling nation's president has brought with it the end of an era of neutrality. His retirement to Mount Vernon and subsequent rise of John Adams, our new president, has coincided with the emergence of our two first political parties, the Federalists and the Democratic Republicans, and with it the forewarned rise of factionalism. While the Federalists led by Alexander Hamilton strongly believe that a unified nation could better solve our nation's pressing issues, the Democratic Republicans maintain that more localized state and county governments are more equipped to target their own issues by themselves, negating the need for the Federalist's strong central government. Although a cover of neutrality between the two schools of political thought was sustained during Washington's presidency, the election of 1796 has brought the partisan struggle out into the open. The intense election between John Adams, the nominee of the Federalists, and Thomas Jefferson, the Democratic Republican nominee, settled with a split presidency with John Adams as president and Thomas Jefferson reneged to the Vice Presidency.

Despite tensions over foreign policy and security matters, nowhere is this American political divide as prominent as in the country's economic interests. With foreign ships harassing American merchant fleets in waters both near and far, tax rebellions sparking in western lands, and pioneers pushing the boundaries of American expansion, how will you work to preserve the precarious economic stability of this untried nation?

#### History of the Problem:

During the Washington presidency, a scrappy youngster named Alexander Hamilton ascended to the height of political fame. Also known as our country's forgotten founding father, Hamilton served as the first Secretary of the Treasury, and he used his post to further his ambition for a strong national U.S. economy that would compete with other foreign economies on the international playing field. In order to reach this aim, he pushed through an enormous number of reforms including consolidating Revolutionary War debts, creating a central National Bank and an U.S. Mint, and using new constitutional taxing privileges to raise money for the other two programs.

First and foremost on Hamilton's mind was fulfilling the "good faith and credit" part of the new Constitution by solidifying the scattered state debts from the Revolutionary War. At the beginning of Washington's presidency, Congress owed approximately \$11 million in foreign loans and \$40 million in domestic debt, while the individual states themselves owed around \$25 million combined. In today's terms, the national government owed a whopping \$1.3 billion while the states added another \$641 million in debt.<sup>1</sup> Worse yet, because these debts were set prior to the adoption of the Constitution, which gave the U.S. government the power to tax citizens directly instead of using states as a proxy for tax collection, many debtors charged relatively high interest rates. For example, the average interest rate for domestic debt rested around 6%, which averaged out to an additional \$2.4 million in interest payments without the government having paid off any of the initial

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<sup>1</sup> Although this may not sound like a lot of debt in today's standards, for a beginning nation this was a significant amount albeit not ridiculous.

balance. Hamilton believed that the consolidation of state and national debts along with the new constitutional changes could convince debtors to refinance the debts at lower interest rates. The Funding Act of 1790, as it would later be titled, exchanged each certificate of state debt for three separate federal securities. The first two federal securities, which in total accounted for 7/9ths of the certificate worth, set interest rates at 6% and 3% APR respectively, while the third one that accounted for the remainder of the worth, promised 6% APR starting at the beginning of 1800. By splitting up the debts, Hamilton pushed some of the burden into the future, giving the government the maneuvering room necessary for pulling its strategy together.

Furthermore, as the Constitution set up with foreign policy, foreign nations, banks, and other financiers could deal with one central entity when collecting debts as opposed to thirteen (and growing) different states. This would make debts easier to manage, Hamilton reasoned, and further guarantee their repayment, both of which would incentivize future investment in the United States. Furthermore, by proving that the government could make regular debt payments, the U.S. could establish a positive reputation as a worthy debt payer.

Additionally, he wished to set up a bond program<sup>2</sup> to help consolidate a large portion of domestic debts. The program would issue new federal government bonds in exchange for the face value existing certificates of indebtedness<sup>3</sup>, which the Continental Congress had issued during the Revolutionary War to raise money for supplies and to pay troops. After the war, many farmers who had been granted these certificates, sold them off for nominal sums to speculators, who bought them up in hope of eventual repayment. As a result, Hamilton would create a new source of revenue while giving spectators a vested interest in seeing the new government succeed, as its success was a precondition of their repayment.<sup>4</sup>

However, these motions faced major problems upon reaching Congress. Many members, notably Democratic Republicans, strongly disliked the idea of consolidating the state debts. At the time, many states had already paid off a significant portion of their debts and disliked the idea of coddling other 'delinquent' states that had made minor payments. For example, prior to consolidation, Massachusetts still owed a whopping \$4 million, whereas other states like Georgia owed only \$300,000. Democratic Republicans despised the idea of forcing Georgia taxpayers to foot the bill for Massachusetts debt, and so the argument continued. Moreover, many Democratic Republicans loathed the new bond program, which they insisted should ensure some of the speculator's profits should be reinstated to the original owners, since they were the ones who supported the U.S. government in the first place. Viewing the speculators as crows that had come to prey on the common American people, DRs doubted that they deserved this kind of payoff. James

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<sup>2</sup> Bonds are pieces of paper that an entity or person may issue stating that the issuer is indebted to the receiver at a predetermined amount. The issuer pays the receiver interest in exchange for the debt and eventually must pay back the principal (the initial bond amount) at a designated later date (also known as the maturity date).

<sup>3</sup> In order to fund the war, the Continental Congress issued certificates of indebtedness, which were essentially non-guaranteed I.O.U.s from the federal government. Under the Articles of Confederation, the federal government was not allowed to tax its citizens directly, so with the government left without a way to raise revenue, no one who owned one of the certificates ever expected to get paid back. As a result, speculators bought up a majority of these pieces of paper in the hope that maybe someday the U.S. government would figure out a way to pay them back.

<sup>4</sup> Alexander Hamilton by no means expected nor aimed to pay off the entire national debt. Instead, his ambition laid in securing a stable revenue stream for the government to operate off of, which the bond program would create. By incentivizing the nation's wealthy, many of whom were at least part-time spectators, in the U.S. government's success, the nation would be less likely to become bankrupt. He expected that these bonds, coupled with demonstrating effort at repaying foreign debts, would guarantee another stable stream of revenue to fund programs in case Congress had trouble passing new taxes.

Madison in particular questioned the plan and frequently suggested that it “seemed to cheat poor soldiers”<sup>5</sup> who had sold their bonds in order to meet more pressing debts. At the same time, Federalists argued back that they ought to “do... justice to the creditors of the nation” by giving them their due worth.

Because failure in Congress seemed imminent, Hamilton invited Virginians Thomas Jefferson and James Madison to hammer out a suitable compromise. In exchange for Virginia’s support for both measures, New York would relinquish its place as the nation’s capital in place of a more southern location. Later, in July 1790, a piece of swampy land between Maryland and Virginia was selected to be built up and later called the District of Columbia. With the first segment of his economic plan in action, Hamilton turned his attention to his newest project, the creation of a National Bank.

At the beginning of Washington’s presidency, there were only a few banks headquartered in the United States and even fewer stable and/or non-provincial ones. With little to no place to put American funds, Hamilton proposed the creation of a National Bank that could provide loans and currency to businesses while also being a safe haven for federal funds. He envisioned it also as a tax collector and essentially a future money manager for the government as an extension of the Department of the Treasury with less government oversight and regulation. In fact, it would be controlled by a semi-independent Board of Directors, 1/5<sup>th</sup> of whom would be appointed by the government. Since the U.S. government didn’t have the \$10 million in capital to keep it afloat and Hamilton was hesitant to go further into debt to finance it, the rest of the seats would go to private entities who would provide the remaining 80% of funding. While many Democratic Republicans balked at the very idea of putting so much power in the hands of the few, Hamilton and his fellow Federalists argued that tying their monetary success to the nation’s success would only further incentivize their support of the federal government. In other words, their greed would indirectly serve the national good. Additionally, he packaged the bank with a proposal creating a U.S. Mint that would create currency while building trust in the dollar in order to solidify it as the national currency.

Despite the partisan criticism over the Board of Directors, Democratic Republicans brought up the first strict constructionist<sup>6</sup> argument against Hamilton’s proposal. Because the Constitution has no specific provision authorizing the creation of a National Bank, many Democratic Republicans (and even George Washington for a time) had a problem. Hamilton argued that it went along with the Constitution’s intent, thereby being the first major person to justify greater federal power using the elastic clause. Eventually Congress also passed this proposal, and it opened in 1791 with one small caveat. The Democratic Republicans included a sunset provision which authorized it for 20 years, after which Congress would vote on its existence again.

Because all of Hamilton’s plans cost money that the U.S. government did not necessarily have on hand, Congress enacted two new taxes to prevent further debts. The first and primary one was an excise tax<sup>7</sup> on alcohol distillers. The main burden laid on farmers who converted some of their corn or rye crops into whiskey, which only affected a mostly rural fraction of the population.

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<sup>5</sup> <https://courses.candelalearning.com/ushistory1os2xmaster/chapter/competing-visions-federalists-and-democratic-republicans/>

<sup>6</sup> As defined by Legal Dictionary, strict construction is a constitutional interpretation “based on a literal and narrow definition of the language without reference to the differences in conditions when the Constitution was written and modern conditions, inventions, and societal changes.”

<sup>7</sup> Excise taxes, as defined by Investopedia, is “an indirect tax charged on the sale of a particular good.” Typically the producer/seller raises the price paid by the buyer to shift the tax burden.

Additionally, after much bargaining between two regional factions, Congress also passed a tariff on imports to help sustain daily government operations<sup>8</sup>. Because the northerners wanted a high tariff to support their manufacturing industries while the southerners wanted a lower tariff to get cheaper goods, a median tariff was enacted, although not enough to be entirely effective at protecting new manufacturing industries.<sup>9</sup>

By the end of the Washingtonian Era, Hamilton had confirmed national support from most Northerners, notably manufacturers, merchants, speculators, and other members of the upper and urban classes. However, as a result of Hamilton's policies, Democratic Republicans had gained a foothold in non-elite circles, specifically farmers and Southerners. In what almost boiled down to urbanites versus country folk, much of the country has taken a side in this enormous partisan division.

### **Recent Developments on the Issue:**

Now that Washington has retired to his estate on Mount Vernon and our government has a split executive, factionalism is now out in the open air. With Democratic Republicans vying for more power and Federalists desperately trying to hold onto their governmental prowess, disputes have become ever more heated. In economic particulars, our founding fathers' main areas of contention include the protection of U.S. merchant fleets and the freedom of the seas, westward expansion, and the impact of higher taxes.

In order to grow into an independent economic power, U.S. merchants must have the ability to trade with other nations and peoples with relative ease. With a great majority of these nations and peoples an ocean away, most American merchants focused on their mercantile fleets and other trade ships that braved the Atlantic to exchange goods with other merchants of different nations. However, many merchant ships bearing the U.S. flag in open waters are being harassed by a multitude of other foreign peoples.

State sponsored piracy emerged as a pressing issue following American independence in 1776. Without the British protection afforded by being a colony, American ships were left to their own devices in open waters, and, as a result, shipping fleets quickly came under attack from the Barbary states located along the coast of North Africa. This conflict reached a fever pitch in 1785, when in the aftermath of the Revolutionary War, the Dey of Algiers declared outright war on the new United States government and seized dozens of ships in nearby waters.

Most states dealt with the barbarian piracy either by paying a hefty tribute to the respective nation's leadership, while other more militarized countries fought off the pirates with substantial navies. With a lackluster handful of ships in the Navy and an even smaller treasury, neither option was readily available for the United States. Instead, Washington sent Captain Richard O'Brien to negotiate a treaty between Tripoli, one of the more prominent Barbary nations, and our government. With the language finalized just earlier this year, its pending ratification remains a poignant issue in political circles around the country.

In addition to pressing conflicts from Barbary pirates, the British continue to harass our sailors abroad through the seizure of our ships and the forced impressment of our sailors.

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<sup>8</sup> This was under the Tariff of 1789.

<sup>9</sup> Historians estimate that tariffs must amount to at least 20% in order to discourage foreign competition effectively.

Particularly in England where the majority of the navy's seamen came from pressed men, the men on unprotected US ships resembled fresh meat for press gangs that were tasked with producing a quota of available men. In practice, Royal Navy officers would run down a ship and board it. Upon inspecting the crew, the officers would seize sailors they believed had deserted British ships for work on American merchant vessels. While some British sailors did follow this methodology, many Americans have also been illegally abducted this way as well, and as tensions between Britain and France escalate, many Americans fear these problems may be exacerbated.

With the whole western section of the continent still undiscovered, many Americans are looking west at pioneering and other economic growth opportunities. However, with Spanish, French, and British forces still occupying parts of North America and territorial disputes painting relations with these nations, many settlers are facing undue hardships particularly along the Mississippi River. Amongst the variety of disputed territories, the Mississippi River remains the most pressing due to its economic importance. While the United States currently controls the northern section of the river, Spain claims much of the lower sections, including the Mississippi and Alabama territories and the port of New Orleans. As a result, shipping crops and other farm products along the Mississippi to other markets is expensive for farmers and settlers, which disincentivizes settling outside of the border. Recently, Washington sent Thomas Pinckney as a diplomatic envoy to Spain to clarify borders and open up Spanish trade policy. In a monumental treaty, Pinckney solidified a mutually beneficial agreement that not only eliminates duties on American shipping through New Orleans but also paves a path towards removing Spanish forts from disputed territories.<sup>10</sup>

At the same time, with the introduction of Hamilton's new tax program to fund his economic expansionary policies, public dissent and discord have arisen in more remote locations in the country. Following Parliament's introduction of laws such as the Townshend, Sugar and Stamp Acts, the general American population severely distrusts new taxes, particularly those that affect themselves. As a result, after The government enacted an excise tax on whiskey that mainly affected American farmers, many farmers and whiskey distillers made their voices heard. Particularly because this tax was the first such government tax directly placed on an American product, the outcry was severe, and actual rebellions arose along the countryside. Now known as Shays Rebellion and the Whiskey Rebellion, the government quickly put an end to them. However with newly introduced federal taxes on real estate and slaves, dissent is yet again fermenting, notably in rural Pennsylvania where many objected to the intrusive nature of tax collectors examining houses for their value in order to assess their due tax value. Most recently a German immigrant auctioneer named John Fries has begun to organize meetings to discuss resistance to the taxes, but no violence or other concrete actions have yet erupted.

### **Federalist Point of View**

In general, the Federalist Party led by Alexander Hamilton supported an urbanized, industrialized United States. With a strong central government at the helm, Hamilton believed that the US could grow into a mercantile force that could compete with European nations in terms of technology and economic prowess. The typical supporter of this faction is a New England merchant,

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<sup>10</sup> You can read the exact language of the proposed treaty at <http://www.mountvernon.org/educational-resources/primary-sources/pinckneys-treaty-1795/> While the treaty is still pending ratification by the Senate at the beginning of this simulation, its contents suggest major bonuses for proponents of westward expansion.

banker, or manufacturer that holds property and a decent level of education. Currently they hold the political lead and capital in the country.

### **Democratic Republican Point of View**

In contrast to the Federalist central government ideal, democratic republicans led by Thomas Jefferson hold a more provincial perspective of the country. In his opinion, "Agriculture is our wisest pursuit, because it will in the end contribute most to real wealth, good morals, and happiness." As such, they believed more localized governments could more easily deal with any problems that could pop up than any cumbersome federal government could. The typical Democratic Republican is a lower class farmer or pioneer located near the southern or western parts of the United States with little property and even less education.

### **Conclusion**

In his Farewell Address, President George Washington warned against increased factionalism and the rise of political parties. Nonetheless, in recent years, we've seen increased divisions – pitting the Hamilton-led Federalists against the Jefferson and Madison-led Democratic Republicans. This divide is especially pronounced on economic issues. Federalists generally believe that a strong central government is imperative for the nation's wellbeing, whereas Democratic-Republicans consider state and local governments as more suited for dealing with these key issues. Accordingly, Federalists hope to transform America into a strong mercantile and industrial force, whereas Democratic-Republicans favor a more agricultural-based economy. This committee will need to determine which vision is most appropriate for America's future and work towards this.

### **Questions to Consider:**

1. Is citizens' despair over taxes valid? What is the best way to deal with any possible protests or rebellions?
2. How did Hamilton's economic program affect current economic policy?
3. Are there any aspects of his program that should be re-examined or further refined?
4. What diplomatic moves could our nation make to further our economic and trade interests?
5. In terms of sailor impressment, what actions are warranted by the continued disregard for the integrity of American shipping vessels?
6. Should Pinckney's treaty be ratified? Why or why not? Are there any better alternatives?
7. How can the United States government best incentivize pioneering and westward expansion? Should our government attempt to incentivize this expansionary policy, or should we focus on improving our current condition before looking outwards?
8. Should the United States adopt a protectionary policy towards our fledgling manufacturing industry? If so, what is the best way to set up protections and other incentives for manufacturing?
9. What type of economy should the United States aspire to achieve? What types of economic opportunities should be favored or disincentivized?
10. Do you agree more with Thomas Jefferson's agrarian model or Alexander Hamilton's manufacturing one? Why, and what motions or proposals can you put into action in committee?

## Sources for Additional Research:

### Primary Documents of American History

<http://www.loc.gov/rr/program/bib/ourdocs/NewNation.html> *(This source links to the language of many primary sources from this time period, both leading up to this simulation's occurrence and during it. Looking at historical documents themselves gives you a more comprehensive picture of what actually happened, unbiased from secondary authors. Specifically relevant to this simulation, albeit not specifically this topic, include the Constitution of the United States, the Bill of Rights, Jay's Treaty, George Washington's Farewell Address, and the Alien and Sedition Acts.)*

<https://courses.candelalearning.com/ushistory1os2xmaster/chapter/competing-visions-federalists-and-democratic-republicans/> *(This mini-history course guides you through the historical lead-up to the partisan fighting between Federalists and Democratic Republicans. In addition, you can click forward or backward to examine other parts of history if you so desire to learn more about the time period of this simulation and its impact on the nation's future.)*

<http://www.davemanuel.com/inflation-calculator.php> *(This online tool is immensely useful for adjusting prices between the modern day and back in the late 1700s. Prior or during debate, you can use this tool to put various amounts of money into perspective in order to make better sense of it all.)*

<http://www.sparknotes.com/history/american/statebuilding/section9.rhtml> *(A briefer version of the history section briefing which you can use to update yourself before committee if so desired.)*

<http://www.mountvernon.org/educational-resources/primary-sources/pinckneys-treaty-1795/> *(This link gives you the exact text of Pinckneys treaty and links to other historically relevant primary sources.)*

<http://faculty.polytechnic.org/gfeldmeth/chart.feddr.pdf> *(Quick cheat sheet for the differences between the two major factions.)*

[https://youtu.be/Zt4lmLK\\_OUc](https://youtu.be/Zt4lmLK_OUc) *(Video summary of differences between Hamilton and Jefferson)*

<http://youtu.be/r161cLYzuDI> *(Crash course video that explains the how US politics began during the Washingtonian era)*

*Hamilton's Blessing: The Extraordinary Life and Times of Our National Debt* by John Steele Gordon *(This book gives a comprehensive look at our nation's economic history starting at its beginning under Hamilton's reign as Secretary of the Treasury. Although this book is rather dense and takes some effort, it is impeccably researched and contains further additional background material that supplements the History portion of this briefing.)*

[https://en.wikisource.org/wiki/United\\_States\\_Statutes\\_at\\_Large/Volume\\_1](https://en.wikisource.org/wiki/United_States_Statutes_at_Large/Volume_1) *(This source literally lists out every act that Congress passed and/or considered. Volume 1, which is linked above, specifically deals with the First through Fifth Congresses, while Volume 2 goes onward. Should you desire specific language of bills and/or acts during debate, you can check here for neat summaries and actual text.)*

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