THE U.S. CENTRAL BANKING DEBATE: LESSONS LEARNED FROM 1791 TO GUIDE TODAY’S DISCOURSE

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ABSTRACT

Various laws, customs, dialogues, and values have shaped the development of financial and banking institutions in the United States in a unique way; however, none have done so more than the fierce debates between Thomas Jefferson and Alexander Hamilton over the creation of a central bank in 1791. As the U.S. looks toward banking reform following the 2008 economic collapse, it is critical to understand how these original debates have become institutionalized into our political fabric.

The Federalist and anti-Federalist debate about the creation of a central bank and the regulation of financial institutions created a “yes/no” and “either/or” framework that still dominates our national political debate and rests on the assumption that if one solution is wrong, then the opposite must be right. This type of dialogue distracts us from the complexities of our current economic reality by narrowly concentrating the debate around an all-government regulation or all-market regulation approach. Both solutions are flawed. We must change this overly simplistic dialogue to find real solutions to a complex problem.

To preserve financial stability, government, bankers, and the public must make a deliberate effort to identify and understand the complexities that exist in guiding fiscal policy. These three key stakeholders must take ownership of the issue and
achieve an unprecedented level of transparency. In the process, we must reframe the
debate around a middle ground that acknowledges the central bank’s relationship to
the broader political, social, and administrative environment. Only then can we define
an appropriate role for government in the marketplace and find solutions to solve
current central banking problems.
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INTRODUCTION

Various laws, customs, dialogues, and values have shaped the development of financial and banking institutions in the United States in a unique way; however, none have done so more than the fierce debates between Thomas Jefferson and Alexander Hamilton over the creation of a central bank in 1791. As the U.S. looks toward banking reform following the 2008 economic collapse, it is critical to understand how these original debates have become institutionalized into our political fabric. The following discussion provides a historical analysis of events, offering practical implications for today’s economic crises.

The Federalist and anti-Federalist debate about the creation of a central bank and the regulation of financial institutions created a “yes/no” and “either/or” framework that still dominates our national political debate and rests on the assumption that if one solution is wrong, then the opposite must be right. In the context of central banking, this mindset presents two extremes. On one side, regulations are faulty, therefore unregulated markets are perfect. On the other side, the free market cannot be trusted, and stringent government regulations must rein in Wall Street to protect American pocketbooks. This type of dialogue distracts us from the complexities of our current economic reality by narrowly concentrating the debate around an all-government regulation or all-market regulation approach. Both solutions are flawed. We must change this overly simplistic dialogue to find real solutions to a complex problem.
To preserve financial stability, government, bankers, and the public must make a deliberate effort to identify and understand the complexities that exist in guiding fiscal policy. These three key stakeholders must take ownership of the issue and achieve an unprecedented level of transparency. In the process, we must reframe the debate around a middle ground that acknowledges the central bank’s relationship to the broader political, social, and administrative environment. Only then can we define an appropriate role for government in the marketplace and find solutions to solve current central banking problems. This historical analysis surrounding the US Central Banking debate provides a rich context through which to view the current discussions regarding the banking debate today. By way of historical narrative this paper will bring forth lessons learned from our nation’s past that can inform the current discussions, and that lay the foundation for real solutions to our present day problems.

Chapter I will discuss the economic environment of 1776-1791 to establish historical context and help the reader understand why the central banking debate was so controversial. It examines the debate between Alexander Hamilton and Thomas Jefferson to glean two lessons. First, the central banking debate was largely rooted in anti-federalist and federalist tensions. Second, the battle over the bank became an overly simplistic debate founded on its constitutionality that left no room for negotiation. Chapter II shows how the central banking debate of 1791 created the very tensions that exist in our political discourse today, and is woven into the fabric of the current central banking debate.

Chapter III examines the nation’s return to central banking in 1913, the economic crisis of 2008, and the current U.S. federal government’s response to recover
our economic footing. In the process it will show that the recent recession triggered a similar debate to the one we saw in 1791. Finally, Chapter IV shows that like our country’s early debates over federalist and anti-federalist positions, the current discussion around central banking bears witness to the same persisting concerns of an overregulated banking system that hinders the economy and private interests versus an unregulated banking system that threatens our economic stability. The chapter will also discuss why we continue to have the same black and white debate about the Federal Reserve, how do we move past the partisan bickering and agree on a path forward, and why it is important to do so.

The conclusion argues that we must better manage these creative tensions around central banking to achieve a blend of these public versus private traditions and ultimately find resolution to this perpetual tension that began in 1791. To better manage these tensions, this paper proposes that the public, politicians, and bankers do the following: First, make a deliberate effort to identify and understand the complexities that exist in guiding fiscal policy. Second, understand that central banks are limited in their capacity to prevent or cure economic calamities. Third, take ownership of the issue. Lastly, achieve an unprecedented level of transparency in the process to gain the understanding and trust of the American people.
CHAPTER 1

U.S. CENTRAL BANKING 1776 TO 1791

Whereas it is conceived that the establishment of a bank for the United States, …will be very conducive to the successful conducting of the national finances; will tend to give facility to the obtaining of loans, for the use of the Government, …and will be productive of considerable advantage to trade and industry in general: Therefore, Be it enacted, etc. That a Bank of the United States shall be established…

Annals of Congress, 25 February 1791

On the frosty night of February 22, 1791, at 79 Third Street in Philadelphia, Secretary of the Treasury Alexander Hamilton was writing with a fury. Six days earlier, President George Washington had given him one week to respond to the arguments set forth by Virginians Thomas Jefferson, James Madison, and Edmund Randolph against the creation of the Bank of the United States. The three men, led by Jefferson, judged the bank to be unconstitutional. Torn between his closest economic advisor and his deep agrarian Virginia roots, Washington bluntly informed Hamilton that a strong rebuttal was needed:

The constitutionality of it is objected to. It therefore becomes more particularly my duty to examine the ground on which the objection is built. As a means of investigation I have called upon the Attorney General of the United States in whose line it seemed more particularly to be his official examination and opinion. His report is that the Constitution does not warrant the Act. I then applied to the Secretary of State for his sentiments on this subject. These coincide with the Attorney General’s; and the reason for their opinions having been submitted in writing, I now require, in like manner, yours on the validity & propriety of the above recited Act: and that you may know the points on which the Secretary of State and the Attorney General dispute the constitutionality of the Act; and that I may be fully possessed of the Arguments for and against the measure before I express any opinion of my own, I give you the opportunity of examining & answering the objections contained in the enclosed papers.¹

The President needed convincing. Unless Hamilton could offer a strong counterpoint, the bill would die. Hamilton alone had the power to save his own creation. For one week, he examined the opposing arguments, turning over every angle, both alone and with colleagues. Hamilton remained committed to his belief that the central bank was a cause worth defending. With his mind firmly set, he went home to transcribe his opinion on the constitutionality of the Bank of the United States. Working deep into the night with his wife, Eliza, assisting, Hamilton wrote as though his pen was on fire, laying down almost forty printed pages of what would be one of the most important legacies of his career. Eliza later recounted that sleepless night to a young man who recorded it in his journal:

He made your bank. I sat up all night with him to help him do it. Jefferson thought we ought not to have a bank and President Washington thought so. But my husband said, ‘We must have a Bank.’ I sat up all night, copied out his writing, and the next morning, he carried it to President Washington and we had a bank.

Hamilton once again produced an inspired analysis with the electrifying finish for which he was known by delivering his argument by the deadline he had promised President Washington.

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2 Ibid., 57. Hamilton reported to Washington that “The Secretary of the Treasury presents his respects to the President of the United States to request his indulgence for not having yet furnished his reasons on a certain point. He has been ever since sedulously engaged in it, but finds it will be impossible to complete before Tuesday or Wednesday morning early. He is anxious to give the point a thorough examination.”

3 Ibid., 62. Hamilton noted that the opinion “occupied him the greatest part of last night.”


5 Under fierce print deadlines, the pressures of his law practice, and time constraints to convince the states to ratify the proposed Constitution, Hamilton delivered 51 contributions to *The Federalist Papers* with similar intensity and speed in 1787 and 1788.
To understand the reasons the 1791 debate over central banking was so controversial, it is important first to examine the context in which the debate occurred. Two years earlier, President Washington had appointed Alexander Hamilton as the first Secretary of the Treasury. Hamilton had jumped at the chance to use the position as a platform from which he could remake the American economy and financial system. Hamilton was by no means new to the economic debate. In fact, he had been driving it since the new nation declared its independence. 6

Hamilton expressed his economic concerns with the public for the first time in The Federalist Papers. 7 Here he discussed the merits of taxation for creating an energetic government that could provide for the needs of the union. In particular, he described the power of taxation as “an indispensable ingredient in every constitution,” 8 without which “one of two evils must ensue: either the people must be subjected to continual plunder, as a substitute for a more eligible mode of supplying the public wants, or the government must sink into fatal atrophy, and in a short course of time, perish.” 9 His efficient tax system was the first building block for a powerful state; but, additional measures were critical to help the fledgling country escape its deep war debt and foster an environment for the economy to flourish.

6 Hamilton, along with James Madison and John Jay, authored The Federalist Papers, a series of essays that were critical to influencing the vote for the ratification of the Constitution and interpretation of the Constitution.


8 Ibid., 180.

9 Ibid.
In 1789, the federal government was not responsible for providing a national medium of exchange. States and private banks printed their own currencies, which were of value only for local circulation and were discounted by traders and merchants across the country according to the reported risk. Across the entire union, America was suffering from a scarcity of currency, with very little gold and silver coins in circulation and no paper notes at all. State bank notes rarely circulated beyond the cities in which they were printed. Without money circulating broadly, the federal government was hampered in its ability to collect revenues, to move its funds from one point to another, and to exchange money received into a medium current at the place of disbursement. As a result, the new nation was debilitated by high interest rates, agonizingly slow business development, and a federal government unable to collect the taxes it needed to establish credit – something upon which its existence depended.

Hamilton knew that merchants and businessmen needed both credit and a medium of exchange that was reliable throughout the nation in order to kick-start the fledgling economy. In *The Federalist, Number 30*, Hamilton had defined money as “the vital principle of the body politic; as that which sustains its life and motion and enables it to perform its most essential functions.” As Treasury Secretary, Hamilton


must have been well aware of how poorly the new country was faring by that
definition.

Fortunately, Hamilton’s position as Treasury Secretary was particularly
powerful. While today the Departments of State, Treasury, Commerce, and Defense
are all equally big and powerful organizations, Treasury’s influence in 1789 was the
focal point of the entire executive branch of government just by its sheer scope and
size. Hamilton’s initial 39 employees ballooned to 53 within the year. Compared with
Jefferson’s staff of five at State, and three at Henry Knox’s War Department, the
Department of Treasury was enormous. To add to its numbers, Treasury maintained a
comprehensive network of agents throughout the country.  

Treasury’s influence was also marked by its unique relationship with Congress.
Congress, to guard its powers to tax and appropriate money, required the Secretary of
the Treasury to report directly to the legislature, while the other department’s heads
reported to the President. In the fall of 1789, soon after the Senate confirmed
Hamilton as the Secretary of the Treasury, the House of Representatives directed him
to prepare a report on the public credit to deal with the large debt incurred during the
war.

13 Alexander Hamilton, John Jay, and James Madison, The Federalist: A Commentary on the

14 Robert E. Wright and David J. Cohen, Financial Founding Fathers (Chicago: The
University of Chicago Press, 2006), 22.

15 Annals of Congress, “An Act to Establish the Treasury Department,” September 2, 1789,
(accessed October 14, 2011).

16 Robert E. Wright and David J. Cohen, Financial Founding Fathers (Chicago: The
University of Chicago Press, 2006), 22.
In the *Report on Public Credit*, presented on January 14, 1790, and arguably one of Hamilton’s most important and influential funding plans, he proposed that the new national government take responsibility for all the state and national debts left over from the war. These debts totaled some $77 million in obligations. Of this total, $11.7 million was owed to foreign governments; $40.4 million was domestic debt; and $25 million was state debt. The sum of debt was massive, but where others saw a catastrophic problem, Hamilton saw an opportunity. Paying off the government debt would allow the country to borrow at affordable interest rates and act as a stimulus to the economy by providing liquid capital in the form of bonds. Used as loan collateral, government bonds could function as money.\(^{17}\)

To accomplish such an economic renewal, Hamilton first proposed that the foreign debt be paid in full. Second, he proposed that all citizens who owned government securities be paid the full value of the government’s original promise. Third, the federal government would assume all of the debts owed by the states, financed with new U.S. government bonds paying about 4 percent interest. The government would not pay back the principal on the bonds, merely the interest, which would be paid by a new tariff and a stiff excise tax on luxury items such as wines and liquor distilled in America, as well as tea and coffee.\(^{18}\)

The resulting process was innovative. The Treasury borrowed money from the banks and used it to buy government bonds, lifting the market price. Banks accepted


bonds as collateral for loans to securities brokers, with the government guaranteeing the collateral. Creditors who purchased the bonds could use them as collateral for loans, thus further stimulating the economy.¹⁹

The debt assumption concept was revolutionary, but it was a move that Hamilton had wanted to make for years. When Massachusetts’ farmers rose up in 1786 against soaring state taxes and foreclosures on their lands during Shay’s Rebellion, Hamilton understood the farmers’ grievances. By trying to settle its own war debt, Massachusetts was crushing its farmers with onerous taxes. Looking back years later, Hamilton wrote in 1795 that, “The insurrection was in a great degree the offspring of this pressure.”²⁰ In The Federalist Number Six, Hamilton argued that, “If Shays had not been a desperate debtor, it is much to be doubted whether Massachusetts would have been plunged into a civil war.”²¹ For Hamilton, Shay’s Rebellion was an example of why the federal government had to distribute the tax burden equitably among the states.

Hamilton’s fiscal plan would create one overarching scheme managed by the federal government for settling debt, as opposed to many small competing schemes. Without assumption, Hamilton argued, indebted states would raise their taxes while healthy states would lighten their loads, thus triggering, “a violent dislocation of the population of particular states.”²² The move was also rooted in political logic. Federal


government assumption of state debt would ultimately strengthen the federal government. Bondholders would have a stake in preserving any government that owed them money. As a result, creditors would shift their allegiance to the federal government as opposed to the states. By aligning the interests of the wealthy with those of the government, Hamilton’s strategy would further strengthen the federal government’s stability and survival.\textsuperscript{23}

Getting the bill through Congress, however, proved almost impossible. The most incendiary issue was how to fund the domestic debt. During the Revolution, many veterans had been paid with government securities, which plummeted in price after the war. Desperate for cash or convinced they would never be repaid, many veterans had sold their securities to speculators for as little as 15 cents on the dollar. Under the new funding scheme, however, Hamilton expected bond prices to again soar. The question became who should be the recipients of the potential windfall of money as a result of the new scheme. Should the original holders, many of whom were patriotic war veterans, have their money reinstated? Or, should the speculators who had hazarded their money and assumed the risk receive the money?\textsuperscript{24}

Hamilton knew the answer was pivotal to the character of American financial markets. Not only was the prospect of tracking down the original holders an administrative nightmare, the government would essentially be interfering in financial transactions retroactively. Furthermore, the original bondholders had received the


\textsuperscript{24} Ibid., 298.
cash when they wanted it and had shown little faith in the government, while speculators hazarded their own money and had taken on that risk. Hamilton wrote that “after mature reflection,” he had decided that such an approach would be “ruinous to public credit.”  

In the report’s final section, Hamilton wrote that a well-funded debt would be a “national blessing” that would protect American prosperity. He added, however, an important passage to caveat this view: he “ardently wishes to see it incorporated as a fundamental maxim in the system of public credit of the United States, that the creation of debt should always be accompanied with the means of extinguishment.”

This, Hamilton regarded, as “the true secret for rendering public credit immortal,” and that the United States may “commence their measures for the establishment of credit with the observance of it.”

Congressman James Madison, in his first break with Hamilton, railed against the idea of compelling states to contribute to funding the public debt, “after having done their duty, to contribute to those states who have not equally done their duty.” On February 11, 1790, Madison -- then the House floor leader -- argued vehemently against the fiscal plan in a speech on the House floor:

I regret, as much as any member, the unavoidable weight and duration of the burdens to be imposed; having never been a proselyte to the doctrine, that public debts are public benefits. I consider them, on the contrary, as evils


26 Ibid.

27 Ibid., 45-46.

28 Ibid.
which ought to be removed as fast as honor and justice will permit, and shall heartily join in the means necessary for that purpose. 29

Thomas Jefferson arrived in New York in the thick of the debate, returning from a five-year post in Paris as Ambassador to France. He later wrote that the debate was, “the most bitter and angry contest ever known in Congress before or since the Union of the States. I arrived in the midst of it.” 30 So intense were the feuds, Jefferson said, “Congress met and adjourned from day to day without doing anything, the parties being too much out of temper to do business together.” 31 Four times between February and July 1790, Madison managed to thwart Hamilton’s attempts to enact assumption.

With his prospects looking grim, Hamilton finally searched for a compromise to break the stalemate. The issue that he seized upon was the controversial issue of the location of the national capitol. Both issues of assumption and the placement of the capitol had become so vitriolic that they threatened to tear the country apart. While Hamilton yearned for the capitol to be placed in New York, he knew that assumption would better unite the states into a more permanent union. He knew he had to act fast after the House enacted the funding bill without the assumption component on June 2, 1790. 32


30 Thomas Jefferson, The Anas of Thomas Jefferson, 1791, in The Complete Anas of Thomas Jefferson, ed. Franklin B. Sawvel, Ph.D. (New York: The Round Table Press, 1903), 31. Jefferson goes on to describe the intensity of the debate, writing, “So high were the feuds excited by this subject that on its reception business was suspended.”

31 Ibid.

In his private notes, Jefferson painted a dramatic picture of Hamilton’s anguish and went to great lengths to separate himself from the fray:

Hamilton was in despair. As I was going to the President’s one day, I met him in the street. He walked me backwards and forwards before the President’s door for half an hour. He painted pathetically the temper into which the legislature had been wrought; the disgust of those who were called the creditor States; the danger of the secession of their members, and the separation of the States....I told him that I was really a stranger to the whole subject; that not having yet informed myself of the system of finances adopted, I knew not how far this was a necessary sequence....

Jefferson then proposed that Hamilton dine with him the next day, telling him, “I would invite another friend or two, bring them into conference together, and I thought it impossible that reasonable men, consulting together coolly, could fail, by some mutual sacrifices of opinion, to form a compromise which was to save the Union.”

Early in the process, it seemed that both sides wanted to find a middle ground for the good of the country.

Jefferson, as much as he loathed assumption, worried that the ongoing stalemate and bitter fighting might eventually shatter the union. He invited Hamilton and Madison, and possibly one or two others, to his lodgings for dinner. After weeks of tenacious political maneuvering, the deal was finally achieved. Madison, while he voted against the measure, arranged for four congressmen from Virginia and Maryland to change their votes in favor of assumption. Hamilton, for his part, persuaded the Pennsylvania congressional delegation to accept Philadelphia as the provisional capital and a Potomac site as the permanent location in two years’ time. Jefferson again


34 Ibid.
removed himself from any potential blame that moving the capital could entail, writing, “The discussion took place. I could take no part in it but an exhortatory one, because I was a stranger to the circumstances which should govern it.” On July 26, the House narrowly passed the assumption bill.\(^{35}\)

The bill, however, proved to be the first seed planted in Jefferson’s ultimate contempt for Hamilton’s pursuit of federal power. Jefferson later castigated Hamilton for the assumption bill, writing:

> It was unjust in itself, oppressive to the States, and was acquiesced in merely from a fear of discussion. While our government was still in its most infant state, it enabled Hamilton so to strengthen himself by corrupt services to many that he could afterwards carry his bank scheme, and every measure he proposed in defiance of all opposition. In fact, it was a principal ground whereon was reared up that speculating phalanx, in and out of Congress, which has since been able to give laws to change the political complexion of the government of the United States.\(^{36}\)

With the assumption bill, precedents were set that would be hard to revoke later on and were changing the “complexion of the government.”\(^{37}\)

With that foundation in place, Hamilton looked to refinance the $75 million in debts and further strengthen the financial system by creating a national bank. He knew that funding and assumption, which created national and international markets for U.S. bonds, were only a start. The country still had no access to circulating medium or short-term credit, which was the life-blood of commerce and manufacturing. A national bank would hold the federal government’s deposits and

\(^{35}\) Ibid., 34.


\(^{37}\) Ibid.
lend to the government and business. It would serve as a place where paper money could be created and be easily converted into specie (gold and silver coins), and where both governments and entrepreneurs could safeguard their cash and receive loans.\textsuperscript{38}

Most important, it would inject currency into circulation and give it new life. “Gold and silver,” Hamilton wrote, “when deposited in Banks, to become the basis of a paper circulation, which takes their character and place, as the signs or representatives of value, they then acquire life, or, in other words, an active and productive quality.”\textsuperscript{39}

The bank, for Hamilton, was an essential ingredient to helping the new country grow and prosper.

A central bank would do all of the things that Hamilton had for so long envisioned: lend the government money and safely hold its deposits, provide currency, and promote business and industry by extending credit. Most importantly, it would create a foundation upon which to bring the country together and unite it through the economy, something the fledgling country so desperately needed. For Hamilton, the central bank would give the country the stability it needed to grow. In 1791, the central banking argument was based upon a fundamental need for economic stability and consistency. It is a theme that we see present in today’s debate as well.

Hamilton presented his case to Congress in his “Report on a National Bank” on December 14, 1790. The report proposed a Bank of the United States with a $10 million capital and the ability to issue paper money. It would be based in Philadelphia.


and chartered for twenty years. Hamilton’s initial blueprint focused largely on the economic benefits. The establishment of a national bank, he argued, would be “of primary importance to the prosperous administration of the Finances, and would be of the greater utility in the operations connected with the support of the Public Credit.”

Hamilton argued the principal advantages of a bank on three main points: the augmentation of capital, the availability of emergency funds for the government, and the facilitation of tax payments. In Hamilton’s words, the advantages of a national bank included assistance “to the Government in obtaining pecuniary aids, especially in sudden emergencies...‘facilitating of the payment of taxes,’” and the promotion of industry by enabling gold and silver to “become the basis of a paper circulation.”

The federal government would have a minority stake in the bank, but its board of directors would be private individuals, thus ensuring a mix of public oversight and private enterprise. The composition of the bank was carefully designed by Hamilton to check and balance the powers of government and the desires of private interest.

Hamilton’s first concern was the temptation of the federal government to print paper money in economic emergencies, thus causing massive inflation. To offer the bank protection from this misuse, he first stipulated that it be managed by private citizens. Hamilton writes:

To attach full confidence to an institution of this nature, it appears to be an essential ingredient in its structure, that it shall be under a private not a public direction – under the guidance of an individual interest, not of public policy; which would be supposed to be//make sure this is correct//, and in certain

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40 Ibid.

41 Ibid., 54.
emergencies, under a feeble or too sanguine administration would really be liable to being too much influenced by public necessity.\textsuperscript{42}

To further protect the bank from a government that might, at some point, try to overdraw loans, Hamilton set a limit to the amount it could borrow from the bank. The government, as the largest stockholder in the institution, would share in its profits but have no direct participation in its management. As Hamilton noted, historically, governments were never “blessed with a constant succession of upright and wise Administrators.”\textsuperscript{43} But the bank, as a private institution, would have a “magnetic sense” of its “own interest…the prosperity of the institution” and thereby prevent the government from succumbing to “the temptations of momentary exigencies.”\textsuperscript{44}

On the other hand, Hamilton well understood the weakness of man, and was careful not to give the bankers a wholly free hand in regulating the country’s economy. Given the opportunity, he knew that even the most affluent and well-educated bankers could succumb to private interest over that of public good. Thus, to provide a safeguard, he set forth several stipulations. First, he insisted that bank notes issued by the bank be made redeemable in coin, thus preventing the over issue of notes. Second, he also gave the government the right to take an active part in the bank. The government was authorized to appoint five of the 25 directors and purchase 5,000 of the 25,000 shares of the bank’s stock. The Treasury Secretary was permitted to inspect the books at least once each week. Finally, if those checks failed to secure federal government compliance, Hamilton stipulated that, as a last resort, it should

\textsuperscript{42} Ibid., 83.

\textsuperscript{43} Ibid.

\textsuperscript{44} Ibid.
exert pressure through its power of conferring benefits, including the condition that the bank’s debts would never exceed the amount of capital in stock. To ensure that the government would have access to funds when it needed loans, restrictions were placed in the bank’s ability to lend to individual states and foreigners. Finally, to make certain the bank made mostly safe loans, interest rates were capped at six percent, which meant the bank had to seek out the safest borrowers.45

From the onset, Hamilton sought to achieve a balance between free market economics and government regulation. While his enemies were building a simple argument against the bank’s establishment, Hamilton was far ahead of this limited anti-federalist/federalist thinking. He already well understood the foibles of on both sides and knew he must build in checks against such weaknesses. With skillful craftsmanship, he would build a central bank that would mitigate the weaknesses of both the individual and the federal government, harness the strengths of federal regulation and the free market economy, and establish a well-balanced fiscal institution. Now all he needed to do was to get Congress to agree.

The bill to charter the Bank of the United States flew through the Senate on January 20, 1791, with little opposition.46 The reaction from the House, however, proved a different story. At the surface, the dissent was largely rooted in sectional differences. Southern states favored an agricultural economy while northern states favored an economy rooted in commerce and manufacturing. The most vocal of opposition to the establishment of a national bank came predominantly from the


south. James Madison, from the largest rural state, was one of the loudest dissenting voices against Hamilton’s fiscal plans.

However, the real debate was centered on the fundamental question of whether the Constitution allowed a central bank. Madison, again, was its most vocal opponent, denying that the Constitution granted the federal government powers not specifically enumerated. From the House floor Madison argued: “Reviewing the Constitution with an eye to these positions, it was not possible to discover in it the power to incorporate a bank.”

When Hamilton countered with article 1, section 8, which gave Congress the right to pass any legislation deemed “necessary and proper,” Madison accused him of exploiting the phrase, stating: “In fine, if the power were in the Constitution, the immediate exercise of it cannot be essential; if not there, the exercise of it involves the guilt of usurpation, and establishes a precedent of interpretation leveling all the barriers which limit the powers of the general government and protect those of the state governments.”

Madison saw Hamilton’s interpretation as a slippery slope toward tipping the balance between executive and legislative power. Precedents were being set that would be hard to revoke. As Madison wrote, “If it is admitted that the right exists there, every guard set to the powers of the Constitution is broken down, and the limitations become nugatory.”

The agrarian Republican forces behind Madison were

47 Ibid.
49 Ibid.
50 Ibid.
beginning to fear an executive driven and Treasury-dominated central government. A
national bank, in their mind, was an infringement on states’ rights and personal
liberties.

Despite efforts by Madison and southern Republicans, Congress approved the
bank bill on February 7, 1791, by a vote of thirty nine to twenty.\textsuperscript{52} The day after,
Jefferson wrote to a friend in Virginia stating that there were objections that Congress
had transcended its powers. He wrote, “There are certainly persons in all the
departments who are driving too fast.”\textsuperscript{53} He also asserted that: “Government being
founded on opinion, the opinion of the public, even when it is wrong, ought to be
respected to a certain degree. The prudence of the President is an anchor of safety to
us.”\textsuperscript{54} Before the bill to charter the bank was sent to the President for his signature,
Washington asked both Jefferson and Attorney General Edmund Randolph for their
opinions before deciding whether to sign it. Both men responded quickly, arguing
against its constitutionality.\textsuperscript{55}

In conclusion, despite dissent to the idea of a national bank that largely came
from the South, the bill advanced through Congress and was sent to the president’s
office for approval. However, the President recognized the need to careful

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\textsuperscript{51} U.S. Congress. \textit{The debates in the several state conventions on the adoption of the Federal


\textsuperscript{53} Thomas Jefferson to Nicholas Lewis, February 9, 1791, from \textit{The Papers of Thomas

\textsuperscript{54} Ibid.

\textsuperscript{55} George Washington to Alexander Hamilton, February 16, 1791 from \textit{The Papers of
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consideration, given the question of the bill’s constitutionality. This is a point of significant relevance to today’s debate because the constitutionality of the central bank’s existence continues to be a question posed by Congressional Republicans. It was a decision that President Washington weighted heavily, and one that has been supported again and again ever since.

In a letter to the President dated February 15, 1791, Jefferson outlined a powerful argument that reasoned that Hamilton was perverting the meaning of the “necessary-and-proper” clause. Using the 12th Amendment as his foundation, which states that, “all powers not delegated to the United States, by the Constitution, nor prohibited by it to the States, are reserved to the States or to the people,” Jefferson asserted:

To take a single step beyond the boundaries thus specially drawn around the powers of Congress is to take possession of a boundless field of power, no longer susceptible of any definition. The incorporation of a bank, and the powers assumed by this bill, have not, in my opinion, been delegated to the United States, by the Constitution.\(^{56}\)

For Jefferson, the proposed bill clearly stepped outside the boundaries of the enumerated powers of Congress to “lay taxes, to borrow money, and to regulate commerce with foreign nations and among states.” “Nor,” Jefferson wrote, “are they within either of the general phrases, which are the two following, 1) to lay taxes to provide for the general welfare of the United States, and 2) to make all laws necessary\(^{57}\) and proper for carrying into execution the enumerated powers.”\(^{58}\)


\(^{57}\) Italics are Jefferson’s.
Of the first general phrase, “to lay taxes to provide for the general welfare of the United States,” Jefferson argued that this phrase does not give Congress the ability to do whatever they please in order to pay the debts or provide for the general welfare. As such, this loose interpretation would, “render all the preceding and subsequent enumerations of power completely useless.” Jefferson writes, “They are not to lay taxes ad libitum for any purpose they please; but only to pay the debts or provide for the welfare of the Union. In like manner, they are not to do anything they please to provide for the general welfare, but only to lay taxes for that purpose.”

On the second phrase, “to make all laws necessary and proper for carrying into execution the enumerated powers,” Jefferson argued that creation of a national bank was not necessary to execute the enumerated powers of Congress. He explained, “But they can all be carried into execution without a bank. A bank therefore is not necessary, and consequently not authorized by this phrase.” Continuing along the lines of what is considered necessary and proper, Jefferson then attacked Hamilton’s assertion that a bank will give “great facility, or convenience in the collections of taxes.” Jefferson responded,

Suppose this was true: yet the constitution allows only the means, which are “necessary,” not those which are merely "convenient" for effecting the enumerated powers. If such a latitude of construction be allowed to this phrase as to give any non-enumerated power, it will go to everyone, for [there] is no one which ingenuity may not torture into a convenience, in some way or other, to some one of so long a list of enumerated powers…Can it be thought that the Constitution intended that for a shade or two of convenience, more or less,

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59 Ibid., 278. Italics are Jefferson’s.
Congress should be authorized to break down the most ancient and fundamental laws of the several states, such as those against Mortmain, the laws of alienage, the rules of descent, the acts of distribution, the laws of escheat and forfeiture, the laws of monopoly? Nothing but a necessity invincible by any other means, can justify such a prostration of laws which constitute the pillars of our whole system of jurisprudence.\(^{61}\)

To pass the constitutional test, said Jefferson, the measure had to be more than just convenient in executing federal powers; it had to be truly necessary.

Underneath this anti-constitutional argument, however, was Jefferson’s deep-seated concern for the individual and for the sovereignty of the states. In his mind, the bank contradicted individual independence, equality, and virtue. Under the guise of serving a public purpose, the bank would concentrate wealth and power for private economic and political ends. Even worse, this corporation or monopoly would dictate policy that violated the laws of the states in which it operated, thus Americans would be affected by an institution in which they had no voice. The bank, Jefferson believed, with its branched structure, would be a “monster extending its tentacles throughout the United States – beyond the control of democratic processes, a threat to the stability of the central government.”\(^{62}\) Jefferson’s argument was clearly on the “no” side of this simple “yes or no” framework that already defined the central bank debate in 1791. Rather than work with Hamilton to achieve a blended anti-federalist and federalist solution to the economic issue, Jefferson clearly argued against the creation of the bank. On this point, Jefferson seemed unwilling to find a middle ground.

Unlike Hamilton, Jefferson believed wholly in the moral sense and sympathetic instinct of all people. All human beings, said Jefferson, had “implanted in their

\(^{61}\) Ibid.

breasts” a “moral instinct” and “love for others.” Historian Gordon Wood describes Jefferson’s deep belief in minimal government in an essay on the radicalism of Thomas Jefferson and Thomas Paine. Wood writes, “Jefferson and Paine’s assumption that people possessed an innate moral or social sense had important implications. It lay behind their belief in the natural harmony of society and their advocacy of minimal government.”63 Wood goes on to explain that citizens’ participation in society, with the fellowship and affection it developed, was what Jefferson believed the only adhesive force necessary to holding enlightened people together. Unlike monarchies, “republics held themselves together from the bottom up, and from citizens’ willingness to sacrifice their personal desires for the public good – their virtue.”64 Jefferson and Paine, Wood writes, “had so much confidence in the natural harmony of society that they sometimes came close to denying any role for government at all in holding the society together.”65

Thus, the question of economic efficiency was never really the issue for Jefferson and his fellow Virginia farmers when they attacked the merits of the bank bill. For those who disputed the bill -- Jefferson in particular -- the heart of the matter went beyond the economic question. First, the national bank not only changed the dynamic between states rights and federal power, but it threatened the rights of the individual. This artificial interference by government into civilized society would deprive it of its natural cohesion. Secondly, Jefferson feared that Hamilton was

64 Ibid.
65 Ibid., 219.
building a structure upon which federal power would continue to grow and ultimately be set in stone. Hamilton’s expansive interpretation of the federal government's authority could fundamentally change the course of the country forever.

Jefferson summed up this fear in his personal notes when he described the assumption bill and the bank bill; he did so in his *Anas*, a collection of notes and second-hand gossip he compiled years later, and largely discrediting of Hamilton:

> I know well, and so must be understood, that nothing like a majority in Congress had yielded to this corruption. Far from it. But a division, not very unequal, had already taken place in the honest part of that body, between the parties styled republican and federal. The latter being monarchists in principle, adhered to Hamilton of course as their leader in that principle, and this mercenary phalanx added to them, insured him always a majority in both Houses: so that the whole action of legislature was not under the direction of the Treasury. Still the machine was not complete. The effect of the funding system, and of the Assumption, would be temporary; it would be lost with the loss of the individual members whom it has enriched, and some engine of influence more permanent must be contrived, while these myrmidons were yet in place to carry it through all opposition. This engine was the Bank of the United States.  

To Jefferson, this issue went far beyond the economics of the debate, and became a defining moment for the new government.

If Jefferson’s argument sounds familiar, it is because it is the same argument used against the central bank today - that the central bank is a threat to our individual liberties and inches the country one step closer to monarchical reins held by the federal government. Jefferson’s argument, unlike Hamilton’s well-balanced fiscal plan, could not account for a middle ground on which to compromise. By resting his argument on the issue of Constitutionality, Jefferson gave the debate no room for discussion. Either the bank was constitutional, or it was not. There was no in-between. This type of

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dialogue, which gives us no middle ground upon which to negotiate, has arisen time and time again since the founding of our nation. It is an argument that is clearly present in our dialogue about the central bank today.

Hamilton’s response was described by one of his editors as “the most brilliant argument for a broad interpretation of the Constitution in American political literature.” In forty pages of articulate, powerful prose, Hamilton began his opinion by telling Washington that “principles of construction like those espoused by the Secretary of State and the Attorney-General would be fatal to the just and indispensable authority of the United States.” Their premise was “founded on a general denial of the authority of the United States to erect corporations.” In blazing italics he answered their objection by arguing that the government must possess the means to attain the ends of such power:

Now it appears to the Secretary of the Treasury that this general principle is inherent in the very definition of government, and essential to every step of the progress to be made by that of the United States, namely: That every power vested in a Government is in its nature sovereign, and includes by force of the term, a right to employ all means requisite and fairly applicable to the attainment of the ends of such power.

This principle, Hamilton wrote, was “essential to the preservation of social order.”

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69 Ibid.

70 Ibid. Italics are Hamilton’s.

71 Ibid.
Furthermore, according to Hamilton, the bank, though not mentioned explicitly in the Constitution, was constitutional because the government enjoyed all powers necessary for functioning that were not expressly forbidden. This, Hamilton explained, was the doctrine of “implied powers.” Hamilton wrote, “It is not denied that there are implied, as well as express powers, and that the former are as effectually delegated as the latter.” He continued:

> It is conceded that implied powers are to be considered as delegated equally with express ones. Then it follows, that as a power of erecting a corporation may as well be implied as any other thing, it may as well be employed as an instrument or means of carrying into execution any of the specified powers, as any other instrument or mean whatever.

In Hamilton’s opinion, the Constitution authorized the national government to levy and collect taxes, pay debts, and borrow money. Since a national bank would help in performing these functions efficiently, Congress was entitled, under its implied powers, to create such a bank.

As to Jefferson’s argument that all government policies had to be deemed “absolutely necessary,” Hamilton argued that it would paralyze the government. “Such a construction would beget endless uncertainty and embarrassment… There are few measures of any government which would stand so severe a test.” To insist upon

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72 Ibid., 104.
73 Ibid.
74 Ibid.
75 Ibid., 107.
such a severe definition would essentially create a rule to “justify the overleaping of
the bounds of constitutional authority, than to govern the ordinary exercise of it.”\textsuperscript{76}

What was not explicitly stated in his Report was that Hamilton deeply believed
that a bank would provide the critical infrastructure necessary to build an integrated
national economy, and ultimately an integrated national state. Economic health was
surely important to Hamilton, but his aim was for something much bigger. His case
emphasized economic development, but it was \textit{integrated} economic development he
was after. Hamilton viewed the national bank and fiscal prosperity as a means of
uniting the country. Hamilton’s underlying argument was that the bank was critical to
building the strength of the nation into an interdependent whole.

Integrating the country was what kept Alexander Hamilton up at night.
Federalists like Hamilton envisioned the United States as a powerful nation with a
diverse, interdependent economy equal to that of other enlightened commercial
nations. This powerful state, united “for the accomplishment of great purposes” would
be led by a strong and energetic central government composed of the most
distinguished men of society.\textsuperscript{77} In building such a state, however, Federalists were
confronted with the issue of adhesion.

Gordon Wood writes in \textit{The Idea of America} that Federalist leaders such as
Hamilton saw their principal problem as finding a way to

\begin{quote}
\ldots keep people in such a large sprawling republic from flying apart in pursuit of
their partial local interests…Republics were supposed to rely for cohesion on
the moral qualities of their people – their virtue and their natural sociability;
\end{quote}

\textsuperscript{76} Ibid.

Unlike monarchies they had to be held together from below, by their natural affection and benevolence and by their willingness to sacrifice their partial and private interests for the sake of the public good.\footnote{Gordon S. Wood, \textit{The Idea of America: Reflections on the Birth of the United States} (New York: The Penguin Press, 2011), 256-257.}

Yet in 1789, Hamilton and many of his Federalist colleagues had little faith in the virtue of the American people as an adhesive force. Wood writes:

> By 1789, many of the Federalists, particularly Hamilton, had no confidence whatsoever left in the virtue of the national sociability of the American people as adhesive forces: to rely on such wild schemes and visionary principles, as radicals like Jefferson and Paine did, to tie the United States together, the Federalists said, was to rely on nothing. Hence Hamilton and the other Federalist leaders had to find things other than republican virtue and natural sociability to make the American people a single nation. Tying people together, creating social cohesiveness, making a single nation out of disparate sections and communities without relying on idealistic republican adhesives - this was the preoccupation of the Federalists, and it explains much of what they did - from Washington’s proposals for building canals to Hamilton’s financial program.\footnote{Ibid., 256.}

Something more tangible was needed to make the American people into a single nation, and for Hamilton, the federal government could and should use its power to help aid the process. For Hamilton, the federal government would not act, as Wood writes, “as a disinterested umpire, making judicial-like decisions among a number of competing interests.”\footnote{Ibid., 257.} Hamilton wanted to use central power positively to transform the fledgling country into a strong, consolidated, and prosperous nation state. The national bank was a tool to help build the ties that Hamilton believed the country so desperately needed. It would do more than ease the country’s fiscal troubles and pay off its debts -- a national bank would help bring the country together.
In pursuit of this consolidated and energetic nation state, Hamilton looked east to the great monarchies of Europe as examples. Hamilton’s model of choice was England, which had emerged as the most dominant power in the world. After decades of civil war, the small island had established a powerful fiscal-military state that could mobilize money and wage war with ruthless efficiency. Hamilton had studied England’s system for years, and realized its success lay in its system of funded debt, its banking structure, its market in public securities, and a powerful centralized administration that could tax and borrow from its subjects without impoverishing them.  

He sought to emulate that structure to build an integrated nation that commanded the respect of the world. Even the opening lines of Hamilton’s Report of a National Bank point out the importance of public banks to the most powerful European nations, and America’s reliance on their aid:

It is a fact well understood, that public Banks have found admission and patronage among the principal and most enlightened commercial nations…Trade and industry, wherever they have been tried, have been indebted to them for important aid. And Government has been repeatedly under the greatest obligation to them, in dangerous and distressing emergencies.

Wood carefully notes, however, that Hamilton, though driven by enhancing the commercial prosperity of the United States, was not a promoter of a capitalist society. He had only contempt for those who believed in laissez-faire and thought that trade and interests could regulate themselves. “This,” Hamilton said, “is one of those wild speculative paradoxes which have grown into credit among us; contrary to the uniform

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81 Ibid.

practices and sense of the most enlightened nations…it must be rejected by every man
acquainted with commercial history.”\textsuperscript{83} In contrast, Hamilton strongly believed in
government as a means to harness the interests of man and provide a critical “common
directing power.” His national bank and financial system would strengthen the
national government “by increasing the number of ligaments between the Government
and the interests of Individuals.”\textsuperscript{84}

Thus the national bank debate was deeply rooted in two conflicting public
philosophies, each with a different view on the appropriate focus of public policy:
should it be grounded on concern for the nation, or the individual? Jefferson and his
agrarian compatriots, focused on the needs of the individual and the sovereignty of the
states. The national bank, in Jefferson’s opinion, conflicted with the conditions
necessary for individual independence, equality, and virtue, and would ultimately
remove democratic power from the hands of the people and place it into the hands of a
monarchical federal government.\textsuperscript{85} Hamilton, on the other hand, thought in terms of a
unified nation with a powerful central government. His priority was on building the
strength of the nation by integrating its states, and the national bank would help him
achieve that goal.

After writing his defense right up to his looming deadline, Hamilton delivered
his report to President Washington before noon on Wednesday, February 23, 1791.

\textsuperscript{83} Gordon S. Wood, \textit{The Idea of America: Reflections on the Birth of the United States} (New

\textsuperscript{84} Alexander Hamilton, “Defence of the Funding System,” July 1795, from \textit{The Works of

\textsuperscript{85} Susan Hoffman, \textit{Ideas, Public Policy, and the Creation of Financial Institutions} (Baltimore:
On Thursday, Washington examined the report. On Friday, the President signed the bank bill. In the end, Hamilton wrote of the debate, “A mighty stand was made on the affair of the Bank. There was much commitment in that case. I prevailed.” Hamilton, like Washington and Jefferson, well understood the weight of the decision and how important it was towards unification of the country.

The bank that Hamilton created was publicly chartered but privately owned. Its charter was valid for twenty years. Like other banks, the First Bank made business loans, accepted deposits, and issued notes that circulated as currency and were convertible into gold or silver. As a commercial bank, it was subject to redeeming its notes in gold and silver on demand. Unlike state banks’ notes, however, First Bank notes were valid for payment of federal taxes. Also unlike the state banks, it was not to be subject to the constraints of any one set of state laws; but it would have branches in the states. Therefore, it could issue a uniform national currency that would facilitate the payments and receipts required of a national government. The First Bank served as the federal government’s fiscal agent, receiving its revenues, holding its deposits, and making its payments. Its stock was publicly traded and held by both foreign and domestic investors.

The First Bank was promoted both as a private commercial bank and as a public (or national) bank, but it was not promoted as a central bank. It would serve as a fiscal agent to the Treasury, issue a uniform national paper currency based on

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commercial credit, and furnish credit to the government. It would not, however, increase or decrease its issues of paper money as a means of stabilizing trade. 88

While the First Bank was not a central bank in the modern sense, it showed early natural tendencies of a central bank. For instance, with branches in eight port cities, its large size and broad geographic presence gave it significant influence over the economy, particularly as changes in its lending policies influenced state banks’ lending practices. It essentially regulated the state banks by returning their notes for redemption in specie, which forced the banks to hold specie in reserves and prevented them from over issuing notes. The bank and the Treasury also cooperated closely in controlling the money market and maintaining the value of its notes. The Treasury, with the bank’s aid, often acted as the lender of last resort, acting to stabilize the market when necessary. It used several tools in its arsenal – the purchase of debt securities, the manipulation of specie payments to banks, the regulation of Treasury drafts, and when necessary, the addition of funds to ailing banks. Both worked together closely to ensure the economy’s health. 89

The main branch opened to receive deposits on December 12, 1791, at Carpenter’s Hall in Philadelphia. Soon thereafter, the bank began making loans. Loan recipients could take their loans in the form of notes, deposits, or a combination thereof. Whatever their choice, the loans could be turned into gold or silver on demand, or tendered in payment of federal taxes. Borrowers included merchants, politicians, manufacturers, landowners, and most important, the government of the


89 Ibid.
United States. By the spring of 1792, the bank opened branches in Baltimore, Boston, Charleston, and New York, making it the first nationwide enterprise in American history.\(^{90}\)

For the moment, Hamilton seemed to achieve a complete triumph. His objectives in creating the bank were fully realized. The bank increased and stabilized the circulating medium and made short-term credit available for the first time. It was of enormous value in helping the government pay its foreign and domestic debt, transmit funds across the country and to Europe, collect revenue, loan money, and serve as a depository for government funds. It also facilitated the payment of taxes by increasing the amount of money in circulation.\(^{91}\)

For the first time, the new country had a bank to provide economic stability. It was a monumental moment for the country and one that moved it closer towards economic independence and unification. For the moment, anti-federalist and federalist tensions were quieted. The bank was working well and helping the country prosper. It would, however, be a short-lived period of calm.

\(^{90}\) Ibid.

\(^{91}\) Ibid.
CHAPTER 2
THE BANK BILL’S POLARIZING EFFECT

Hamilton’s victory in establishing a bank that would unify the country would, ironically, also intensify sectional schisms between anti-Federalist Republicans and the Hamiltonian Federalists. These sectional schisms have remained ever since, and are even more deeply rooted in our political structure today on every issue including central banking. John Marshall writes in his “life of George Washington” that Hamilton’s economic measures, especially his plan for a National Bank, “made a deep impression on many members of the legislature; and contributed, not inconsiderably, to a complete organization of those distinct and visible parties, which, in their long and dubious conflict for power, have since shaken the United States to their centre.”1 The bank debate that began in 1791 would eventually find its way into the political discourse of 2008, as we will see in following chapters.

Indeed, when the House passed the bank bill by thirty-nine to twenty on February 8, 1791, the voting record foreshadowed deep divisions between politicians who advocated for states’ rights and those who sought to build a strong federal government. Almost all of the congressmen from north of the Potomac sided with Hamilton, whereas almost all of their southern counterparts opposed the bill. This implied that political views were becoming aligned across geographic lines, something we often see today. Historian Ron Chernow writes in his biography on Hamilton, “As philosophical views

increasingly dovetailed with geographic interests, one could begin to glimpse the contours of two parties taking shape. Individual issues were coalescing into clusters, with the same people lining up each time on opposite sides.” The public versus private debate was beginning to gain steam.

Hamilton’s supporters were men allied with powerful banking and merchant interests. Calling themselves Federalists, the term used for supporters of the Constitution, they cleverly insinuated that those who opposed them did not support the nation’s founding document. Equally strategic, Hamilton’s opponents began to call themselves Republicans, in an allusion to the ancient Roman Republic. Largely composed of rich southern farmers and planters, Republicans dreaded the Hamiltonian system, and believed that the bank was a basis for monarchy, one in which Hamilton was quickly becoming the king. Jefferson characterized it as follows:

Two political Sects have arisen within the U. S. the one believing that the executive is the branch of our government which the most needs support; the other that like the analogous branch in the English Government, it is already too strong for the republican parts of the Constitution; and therefore in equivocal cases they incline to the legislative powers: the former of these are called federalists, sometimes aristocrats or monocrats, and sometimes tories, after the corresponding sect in the English Government of exactly the same definition: the latter are stiled republicans, whigs, jacobins, anarchists, disorganizers, etc. these terms are in familiar use with most persons.

In Jefferson’s mind and those of his fellow Republicans, the economic and political values of the new nation were on a slippery slope toward centralization of power and inching closer to monarchy.

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Jefferson, in fact, seemed convinced that supporters of Hamilton’s fiscal plans were solely motivated by greed and pursuing their own personal interests, rather those of the people.⁴ On February 4, 1791, he wrote to George Mason:

What is said in our country of the fiscal arrangements now going on? I really fear their effect when I consider the present temper of the Southern states. Whether these measures can be right or wrong abstractedly, more attention should be paid to the general opinion . . . The only corrective of what is corrupt in our present form of government will be the augmentation of the numbers in the lower house, so as to get a more agricultural representation, which may put that interest above that of the stock-jobbers.⁵

Later, Jefferson pointed out that Hamilton’s system had been carried “by the votes of the very persons who, having swallowed his bait, were laying themselves out to profit by his plans,”⁶ and added:

Had these persons withdrawn, as those interested in a question ever should, the vote of the disinterested majority was clearly the reverse of what they made it. These were no longer the votes of the representatives of the people . . . and it was impossible to consider their decisions, which had nothing in view but to enrich themselves, as the measures of the fair majority, which ought always to be respected.⁷

Yet while Jefferson claimed that the Federalists were motivated by greed, the conflict was actually deeply rooted in the economic interests on both sides of the debate. As Ron Chernow points out in his biography of Hamilton, it is misleading to think of the

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⁷ Ibid.
Federalists as the party of the elite, and the Republicans as the party of the common man. On Hamilton’s side were self-made lawyers, bankers, and merchants; on Jefferson’s were men of extraordinary inherited wealth.

Jefferson’s compatriots, such as James Madison and George Mason, were men of immense inherited wealth who had achieved a measure of independence from the marketplace by relying on static forms of property, such as rents from tenants, bonds, interest from loan money. These southern “monied-gentry” such as Jefferson, relied on their property as their source of income. Inflation from the printing of paper money, therefore, could sink their fortune. The bank, which served to issue paper money, could therefore signal the end of their economic independence. Historian James T. Flexner, author of Washington: the Indispensable Man observed: “the controversy which embroiled the two champions was not basically concerned with haves and have nots. It was between rival economic systems each of which aimed at generating its own men of property.”

The debate was rooted in fear in other ways. Political parties had an extraordinary negative connotation at the time. Without the knowledge that parties could alternately rise and fall from power, politicians considered these factions as evil conspiracies that could permanently exclude the other with disastrous results. Thus, the

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turmoil was often characterized as intensely treasonous and disloyal. The country was in a fragile state, and politicians at the time thought that political parties could wrench it quickly apart. Federalists feared the country would slide into anarchy, with no established economic policy for the country to grow. Republicans feared an end to liberty and a move toward monarchy.

Jefferson’s problem, however, was that President Washington sided with Hamilton on almost every point. As Washington was still America’s hero and beloved by voters, Jefferson knew that to criticize him outright could be political suicide. As Secretary of State, he needed a venue to assert his claims without making them a personal attack on the President. A newspaper was the answer. Since Hamilton had become Treasury Secretary, he had used the nation’s leading newspaper, the *Gazette of the United States*, to espouse his views with fantastic success – an observation not lost on Jefferson. Three days after the bank bill was signed by Washington, Jefferson, and James Madison contacted the writer and poet Philip Freneau, a former classmate of Madison’s, about editing a rival newspaper. To sweeten the deal, Jefferson also offered Freneau a post in the State Department. By July 1791, Freneau had accepted a job as an official State Department translator and on October 31, launched the Republican newspaper, the *National Gazette.* This newspaper allowed Jefferson the voice that he would otherwise

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lack. Similar to the way in which Hamilton accessed the *Gazette of the United States*, Jefferson could now articulate his concerns in another national forum.

During the ensuing months, both newspapers were filled with vitriolic attacks pitting Hamilton against Jefferson and embarrassing President Washington, who had prided himself and his Cabinet as above partisanship bickering. Newspapers at the time were short on reporting, long on opinion, and notoriously slanted toward one faction. The *Gazette of the United States* and the *National Gazette* were no exception, and were read widely by a notably literate American public. The attacks began immediately. On July 4, Freneau ran a front-page article listing fifteen “rules for changing a limited republican government into an unlimited hereditary one” and mentioned Hamilton’s programs, including a funded public debt, a central bank, and the “view that the limitations in the Constitution are ultimately to be explained away” as the most effective means of doing so. On July 25, Hamilton fired back, taking a direct shot at Jefferson in the *Gazette of the United States* by questioning Freneau’s State Department stipend.

The editor of the National Gazette receives a salary from government. Quere.-- Whether this salary is paid him for translations or publications, the design of which is to vilify those to whom the voice of the people has committed the administration of our public affairs – to oppose the measures of government, and, by false insinuations, to disturb the public peace? In common life it is thought ungrateful for a man to bite the hand that puts bread in his mouth; but if the man is hired to do it, the case is altered.

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The heated volleys continued unabated for almost two years.\textsuperscript{16} Throughout this very public and embarrassing display of political turmoil, Washington continued to support Hamilton’s policies, though he became increasingly upset by the tumult.\textsuperscript{17} In a letter dated July 29, 1792, to Hamilton, Washington listed twenty-one grievances about his administration that he had heard at home. Most of the grievances listed were related to Hamilton’s fiscal policies. Washington told Hamilton that the rumor about these initiatives was “to prepare the way for a change from the present republican form of government to that of a monarchy, of which the British Constitution is to be the model.”\textsuperscript{18}

Hamilton, for his part, was deeply hurt by the criticisms of his integrity. In a letter to President Washington on August 3, 1792, he defended his tenure as Treasury Secretary, writing of the objections as follows:

I am happy to be able at length, to send you, answers to the objections, which were communicated in your letter of the 29th of July. They have unavoidably been drawn in hast, too much so, to do perfect justice to the subject, and have been copied just as they flowed from my heart and pen, without revision or correction.\textsuperscript{19}

\textsuperscript{16} The National Gazette folded in 1793, citing "a considerable quantity of new and elegant printing types from Europe" to be obtained, but it is believed that the outbreak of yellow fever in Philadelphia combined with dwindling subscriptions contributed to the paper's demise. Jefferson would later resign as Secretary of State, ending Freneau's main source of income aside from the paper.

\textsuperscript{17} Jefferson complained at length to Washington about Hamilton’s policies, both in private and in letters, unbeknownst to Hamilton. To colleagues in Congress, Jefferson complained that Washington was easily manipulated by flattery, “His mind has been so long used to unlimited applause that it could not brook contradiction or even advice offered unasked.”


Of the accusations, Hamilton wrote, “I feel that I merit in no degree and expressions of indignation sometimes escape me in spite of every effort to suppress them.” In typical Hamiltonian fashion, he then proceeded to lay out a long and passionate missive, answering every objection posed by Jefferson, and denying that any member of Congress “can properly be called a stock-jobber or a paper dealer.”

The cold, but cordial relationship between Hamilton and Jefferson quickly dissipated into hostile loathing. Jefferson characterized their relationship as “daily pitted in the Cabinet like two cocks.” It was a conflict that ultimately became much more than a personal argument between two powerful men. The tension polarized Washington’s Cabinet, threatened to tear the country apart, and firmly solidified two camps divided over two visions of American government. Historians Stanley Elkins and Erik McKitrick wrote of the period, “Of all the events that shaped the political life of the new republic in its earliest years, none was more central than the massive personal and political enmity, classic in the annals of American history, which developed in the course of the 1790s between Alexander Hamilton and Thomas Jefferson.”

Thus, the bitter factionalism that had so worried Hamilton and most of the founders, characterized the political life of the new nation during the tumultuous decade of the 1790s. Both camps were equally frightened by the direction the country was

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20 Ibid.

21 Ibid.


taking. Jefferson and the Republicans seriously believed that the Federalists were out to create a British-backed monarchy. Hamilton and the Federalists, who always claimed with equal fervor that monarchy was never their aim, believed they were protecting a legitimate government from Republicans who were out to destroy the Union. In their minds, the bank and economic policy would save the country from anarchy by tying economic interests together. The issue created a deadlock that the country would see again every time the economy faltered and the issue of central banking reared its head.

The bank bill was the opening salvo of a decade of vicious partisan politics that included riots, duels, and bitter attacks in the press. It was an uneasy time in which every crisis threatened to destroy the new and fragile federal government. As the first decade under the new American Constitution, everyone knew the United States was a political experiment and most had little faith in its success. Tension about the future of the country ran high. It was a decade in which partisan politics was still new, and certainly not considered “normal;” thus every crisis was perceived as a potential disaster.24 By 1798, as the United States stood on the brink of war with France, the Federalists felt compelled to pass Alien and Sedition Acts aimed at Republicans. The Acts gave the federal government astonishing power to deport aliens and prosecute libel against the federal government, making it a crime for American citizens to “print, utter, or publish . . . any false, scandalous, and malicious writing” about the Government.25

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When Jefferson was elected President in 1800, he set out to reverse a decade of Federalist policy. In his first message to Congress, he asserted that the federal government was “charged with the external affairs and mutual relations only of these states.”

Considering that “the states themselves have principal care of persons, our property, and our reputation, constituting the great field of human concerns,” Jefferson pointed out that “we may well doubt whether our organization is not too complicated, too expensive; whether offices or officers have not been multiplied unnecessarily and sometimes injuriously to the service they were meant to promote.”

He continued, “Agriculture, manufactures, commerce, and navigation, the four pillars of our prosperity, are the most thriving when left most free to individual enterprise.” As a result, Jefferson immediately reduced the number of federal officials in government. All federal taxes were eliminated along with all tax collectors and administrators. The military was cut in half. All of Hamilton’s fiscal plans were either dismantled or allowed to lapse.

Without any middle ground to stand on, the First Bank was vulnerable to anti-federalist forces. Conflict over the First Bank continued to be touchstone for anti-federalist rhetoric without any real resolution. During its twenty years of operations, critics continued to fight hard against the renewal of its charter. Their grounds for ending the bank were


27 Ibid.

28 Ibid.

consistent with those Jefferson had espoused in 1792. The question of the banks constitutionality continued to be an ever-present question. Protesters continued to believe the bank would benefit the rich at the expense of the poor. They doubted that a large and privileged corporate bank with a special relationship to the federal government was a good and proper institution. Some, like Jefferson, believed the regulatory power possessed by a large corporation as inconsistent with Democratic and Republican principles. Third was the great concern for states’ rights and state sovereignty. Many state legislatures adopted resolutions against the renewal fearing the bank would compromise state sovereignty.\(^\text{30}\)

Ultimately, the anti-bank protesters were successful in their campaign. Under President James Madison’s leadership, the bank’s charter was allowed to expire in 1811. When the War of 1812 broke out with Great Britain, Republicans under Madison continued to refuse to strengthen the government’s capacity to wage war. Instead the war was fought without raising taxes, increasing the debt, enlarging the military, or expanding the executive.\(^\text{31}\) The result was disastrous. With the nation’s capital burned, Congress introduced a bill to charter a Second Bank of the United States for another twenty years. Henry Clay, Speaker of the House, explained his reasoning for the importance of a central bank to the U.S. economy when he said that, “The Constitution, it is true, never changes; it is always the same; but the force of circumstances and the lights


\(^{31}\) Ibid.
of experience may evolve, to the fallible persons charged with its administration, the
fitness and necessity of a particular exercise of constructive power to-day, which they did
not see at a former period." In 1816, the bill narrowly passed both houses and was
signed into law by Madison. Federalist forces had won again, in this black or white
debate. The pendulum would soon swing the other way, however.

Like its predecessor, the Second Bank of the United States wielded immense
power. But again it was perceived as a menace to personal interests and democracy. In
1829, when the charter still had seven years to run, President Andrew Jackson made clear
his opposition to the bank and to the renewal of its charter, his argument resting on his
belief that “such a concentration of power in the hands of a few men irresponsible to the
people” was dangerous. In Jackson’s mind, the Second Bank had become far too
powerful. Its ability to control commerce, to control credit, to buy votes in Congress, and
to distort the economy, was unacceptable. This attack on the bank’s power drew public
support, and when the charter of the Second Bank of the United States expired in 1836, it
was not renewed.

From 1836 to the creation of the Federal Reserve in 1914, the United States
lacked a central banking system. In the 78 years in between, the economy was anything
but smooth. When the Second Bank of the United States closed its doors, a severe

32 Carl Schurtz, The Life of Henry Clay, (Boston: Houghton Mifflin and Company, 1899), 1: 126,


34 PBS News Hour, “Do Obama’s Financial Reforms Measure Up Against Past Attempts?,” May
February 5, 2012).
financial panic followed, plunging the nation into a five-year economic depression. Six more financial crises occurred, culminating with the Panic of 1907, which forced the nation once again to reconsider the value of a central bank.35

In summary, the struggle over forging the nation’s economic future set the stage for ongoing political tensions surrounding the role of federalism – the relationship between the national, state, and local governments. This tension between the two distinct parties has been present in almost every facet of American politics since the First Bank’s establishment in 1791. But whenever economic times get tough, the debate centers again on its original conflict: whether the central bankers should steer monetary policy. Almost always, central bankers take a beating.

Such lessons inform the current debate over the economy in several distinct ways. First, the central banking debate has been present throughout our nation’s history, whenever the economy falters. Second, until 1907, every time the debate arises, the solution has been one of two extremes: creation or abolishment. Finally, neither solution seems to have worked effectively for very long. Instead, what remains, in a political discourse that has become woven into the fabric of our current debate.

CHAPTER 3
A RETURN TO CENTRAL BANKING: THE FEDERAL RESERVE

Time and again, politicians look to the central bank as part of the issue when economic times get tough. The pendulum swung back in the central banks favor in 1907 when Wall Street experienced a severe financial panic. The crisis was triggered by a failed speculation that caused the bankruptcy of two brokerage firms and it led to a six-week stretch of runs on banks by depositors to simultaneously withdraw their deposits. At the time, the United States did not have a central bank to inject liquidity back into the market. Fortunately financier J.P. Morgan intervened, pledging large sums of his own money to secure the banking system, and convinced other bankers to do the same.1 While the panic did not trigger a complete economic collapse, it did act as a catalyst to convince Americans that their banking structure was out of date and in need of major reform.

In 1912, the House Banking and Currency Committee held hearings to examine the control of the banking and financial resources of the nation. They concluded that America's banking and financial system were in the hands of a “money trust” or, monopoly, defining the trust as “an established and well defined identity and community of interest between a few leaders of finance . . . which has resulted in a vast and growing concentration of control of money and credit in the hands of a comparatively few men.”2

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President Woodrow Wilson and his Secretary of State William Jennings Bryan were forcefully opposed to “any plan which concentrates control in the hands of the banks.” Like Jefferson warned in 1791, President Wilson worried that a central bank would lead the country toward a monopoly in the hands of the political and economic elite, thwarting American’s individual liberties.

On December 26, 1912, Congressman Carter Glass and Senator Robert L. Owen submitted their proposal to President-elect Wilson. Instead of suggesting the creation of one central bank, the proposal called for a central banking system that included twenty or more privately-controlled regional reserve banks. These banks would hold a portion of member banks' reserves, perform other central banking functions, and issue currency against commercial assets and gold. Wilson approved of this idea, but also insisted upon the creation of a central board to control and coordinate the work of the regional reserve banks. For the first time, the decision was based on a compromise that was not based upon partisan or extreme ideals. Instead of basing the argument solely on either the creation or abolishment of a central bank, Wilson would develop an institution that was evolved and balanced to meet the needs of the time.

The Federal Reserve Act presented by Glass and Owen incorporated modifications by Woodrow Wilson and allowed for a regional Federal Reserve System. The Federal Reserve System was comprised of twelve public-private regional Federal

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3 Ibid.

4 Ibid.
Reserve banks operating under a supervisory board in Washington, D.C. Congress approved the Act, and President Wilson signed it into law on December 23, 1913. The Act, “Provided for the establishment of Federal Reserve Banks, to furnish an elastic currency, to afford means of rediscounting commercial paper, to establish a more effective supervision of banking in the United States, and for other purposes.”

The Federal Reserve Act established two key objectives for monetary policy—maximum employment and stable prices—sometimes referred to as the Federal Reserve's dual mandate. The duties of the Federal Reserve, also known simply as “the Fed,” have expanded over the years and today the Fed is tasked with managing U.S. monetary policy, regulating bank holding companies, and other member banks, and monitoring systemic risk. The Fed also conducts research into the economy and releases numerous publications, such as the Beige Book.

Structurally, the seat of power of the central bank is situated in the Washington, D.C.-based seven-member Board of Governors, currently headed by Chairman Ben Bernanke. Each member is appointed by the president and subject to confirmation by the Senate. The members of the Board of Governors are part of a larger board that includes five of the regional bank presidents, known as the Federal Open Market Committee.

\[5\] Ibid.

\[6\] The Beige Book is a report published eight times per year composed of anecdotal information gathered from each Federal Reserve Bank on current economic conditions in its District through reports from Bank and Branch directors and interviews with key business contacts, economists, market experts, and other sources.
(FOMC). The FOMC is responsible for making decisions on open market operations, including determining interest rates and purchasing U.S. treasuries.⁷

In the past decade, the Federal Reserve has wielded more power than ever before in history. Using its ability to change interest rates and purchase vast amounts of financial assets, the Fed influenced U.S. economic growth and the level of employment more than any other government entity.⁸ But in 2008, after decades of government deregulation, corporate mismanagement, overt greed, and heedless risk-taking by Wall Street, a series of bank and insurance company failures triggered a financial crisis that effectively halted global credit markets that led to unprecedented government intervention. The ensuing fall-out was catastrophic.

On September 7, 2008, the U.S. government seized control of Fannie Mae and Freddie Mac, the largest U.S. mortgage-finance companies. Eight days later, Lehman Brothers Holding, Inc. filed the largest bankruptcy in history and the Bank of America agreed to purchase Merrill Lynch in an effort to save it. The next day, American International Group Inc. was saved by an $85 billion capital injection by the Fed to avert the worst financial collapse in history, and the government took over the company. Shortly after, on September 25, JP Morgan Chase agreed to purchase the assets of Washington Mutual in what was the biggest bank failure in history. By October 13, 2008, the Fed began to lead an unprecedented push by central banks to flood the financial

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system with money, backing up government efforts to revive confidence in the market. However, the culmination of these failures caused a crisis of confidence pervasive around the world that stunted bank lending.⁹

When Wall Street fell and the U.S. economy began its downward spiral in 2008, the Fed engaged in an all-consuming effort to stimulate growth and help the U.S. and the world markets regain their economic footing. In December 2008, central bankers held short-term interest rates near zero. To further reduce long-term interest rates, the Fed amassed more than $2 trillion in government debt and mortgage-backed securities. During a two-year period ending in March 2009, the central bank provided emergency loan, asset purchases, and other aid totaling roughly $7.8 trillion.¹⁰

But when the fall-out of the economic meltdown was beginning to be assessed, the Fed became the target. The Financial Crisis Inquiry Commission, created after the collapse to investigate the underlying causes of the crisis, cast a wide net of blame, accusing several financial institutions of greed, ineptitude or both, and pointed some of its gravest conclusions to government failings. It faulted two administrations, the Federal Reserve and other regulators for permitting shoddy mortgage lending, the excessive packaging and sale of loans to investors, and risky bets on securities backed by the loans. “The crisis was the result of human action and inaction, not of Mother Nature or

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computer models gone haywire,” the report states. “The captains of finance and the public stewards of our financial system ignored warnings and failed to question, understand and manage evolving risks within a system essential to the well-being of the American public. Theirs was a big miss, not a stumble.”

Once again, the expansion of the Fed’s mission exposed it to heavy criticism and second-guessing. The question of the day became, “should we be guiding economic policy through the Fed?” Either way, the Fed's large-scale interventions into the financial system during the height of the crisis triggered another debate over the U.S. central bank's existence and authority. Unfortunately, unlike Federal Reserve Act presented by Glass and Owen, the dialogue in 2008 would not provide the framework necessary to help the central bank and fiscal policy evolve to account for the new economic reality.

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12 Ibid.
In 2010, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act in an effort to rein in abusive lending practices and high-risk bets on complex derivative securities, and address the evolving role of the Fed. The Act was meant to be a clear turning point to manage Wall Street and the increasing complexity of technology-driven markets, and build in significant government regulations and protections to protect consumers.¹

The Act created a Consumer Financial Protection Agency to protect consumers from financial fraud, cut the fees that banks charge for debit card use, and set up a means for the government to supervise the nation’s largest financial institutions more efficiently, including granting the Fed new powers to dismantle large companies that pose a threat to economic stability. With Dodd-Frank, monetary policy was now subject to audits by Congress and the Consumer Financial Protection Agency. Most importantly, Dodd-Frank instituted a third official mandate for the Fed, empowering it to regulate systemic risk and preserve financial stability. The bill created a nine-member council, led by the Treasury secretary, to detect risks in the markets and give the Fed supervisory authority over the nation’s largest and most interconnected financial institutions. The Fed is now required to present its findings on risky, non-bank financial firms to the Financial

Stability Oversight Council, which instructs the Fed on how to sanction those institutions. But with two-dozen bills now in Congress seeking to dismantle parts of Dodd-Frank, the bill has fueled an intensely partisan and volatile debate.

The central bank component of the debate, in particular, is framed around a similar dialogue to that of 1791. At both ends of the spectrum are two camps deeply divided over the way fiscal policy and financial stability should be managed. On one end are Republicans, who, much like their Jeffersonian predecessors, now portray the Fed as the embodiment of big government with far too many regulatory powers. On the other end are Democrats who have accused the Federal Reserve of caving in to demands by banks for huge bailouts, for failing to protect consumers against dangerous financial products, and for being too secretive about the size and process of its bailout program. At the heart of the argument is the question of whether the Fed is doing too little or too much.

There is speculation that economic manipulation by the Fed is a strong reason for concern. For instance, Congressman Ron Paul from Texas, a Libertarian who is currently seeking the 2012 presidential nomination, recently has been the most prominent voice about his opposition to the Fed and is one example of this extreme “yes or no” debate that the central bank is currently fueling. Not only does he think the Fed has too much power, but he vehemently believes it should be dismantled. In his book, End the Fed, Paul argues to abolish the Fed, freeze the money stock, and reintroduce a gold standard.

2 Ibid.
3 Ibid.
Specifically, Paul argues that the Federal Reserve manipulates the money supply, which erodes Americans' standard of living, enlarges big government, and enriches well-connected elites.⁴

In a recent opinion piece reminiscent of Jefferson, Paul blames the Fed as the reason behind the economic crash, namely for setting loose an artificial monetary policy that did not allow the “free market to work on its own.” Paul writes:

In its unchecked power to print money out of thin air, the Federal Reserve continues to devalue the dollar while the middle class continue to see their savings eaten away by inflation. Who benefits from this inflation? Big-spending politicians and politically favored bankers. Who is hurt? Hard-working Americans, who, when they take a financial risk and lose, are never bailed out. It was the Federal Reserve that caused the housing bubble by lowering the interest rate to an artificial low, far beyond what the market could bear, which encouraged people to buy homes who could not afford them. With the mortgage crisis, the Fed hurt a lot of Americans by not allowing the free market to work on its own. It is the Federal Reserve that cannot account for trillions in off-sheet balances, except the money we do know about that went to overseas banks. The Fed continues to do all of this with no oversight, no accountability, and no transparency.⁵

Paul’s argument conjures up the same Jeffersonian concern for the individual and for the sovereignty of the states. Like Jefferson, Paul seems to believe that the bank contradicts individual independence, equality, and virtue and instead concentrates wealth and power for “big spending politicians and politically favored banks.”⁶ By not allowing the free market to dictate the fate of the economy, the Fed led to its demise. Even worse, in


⁶ Ibid.
Paul’s eyes, the Fed led the country down an economic downward spiral without any oversight or transparency. Thus, in Paul’s opinion, Americans were directly impacted by an institution in which they had no voice. He might go so far as to quote Jefferson, describing the bank as a “monster extending its tentacles throughout the United States – beyond the control of democratic processes, a threat to the stability of the central government.”

In his criticism of the Fed, Paul also uses the same constitutionality argument that Jeffersonian Republicans used in 1791, saying:

The most important boundaries the Federal Reserve oversteps every day are the legal parameters of the U.S. Constitution. Many of the Founders feared a central bank because they predicted it would cause the kind of damage characteristic of the Federal Reserve today.

According to Paul, abolishing the Federal Reserve will allow “Congress to reassert its constitutional authority over monetary policy” which Paul asserts is the authority to coin money and regulate the value of the currency. The Constitution, in Paul’s eyes, does not give Congress the authority to delegate control over monetary policy to a central bank or dictate an inflationary monetary policy.

Other Republican presidential candidates have similar, albeit slightly more moderate criticisms of the Fed. In August of 2011, Texas governor Rick Perry, another

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9 Ibid.
Republican presidential hopeful, took aim at the Fed for taking actions intended to boost the economy. When asked about his views on the Federal Reserve, Perry responded with an attack on Ben Bernanke,

If this guy prints more money between now and the election, I don’t know what you would do to him in Iowa but we would treat him pretty ugly down in Texas. Printing more money to play politics at this particular time in American history is almost treasonous in my opinion.10

Perry's comment drew a sharp rebuke from White House spokesman Jay Carney, who said Perry should choose his words carefully. "President Obama and we take the independence of the Federal Reserve very seriously and certainly think threatening the Fed chairman is probably not a good idea,"11 Carney said.

Other Congressional Republicans share Ron Paul’s and Rick Perry’s fear of monetary manipulation by the Fed. The threat of inflation at the hands of the Fed, in particular, is as big a concern today as it was for the monied-gentry back in 1792. Specifically, Republicans are concerned that the Fed’s effort to spur short-term job growth for political gain is leading to long-term inflation. In a February 2012 hearing before the House Budget Committee, Congressional Republicans criticized the Fed for working to reduce unemployment and revive the housing market rather than maintaining a single-minded focus on inflation. Ben Bernanke was sharply criticized for the Fed’s


announcement that it planned to hold short-term interest rates near zero until late 2012 to support a faster pace of economic recovery.\textsuperscript{12}

Representative Paul Ryan, the Wisconsin Republican who is chairman of the House Budget Committee, voiced his concern, telling Bernanke, “I think this policy runs the great risk of fueling asset bubbles, destabilizing prices and eventually eroding the value of the dollar. The prospect of all three is adding to uncertainty and holding our economy back.”\textsuperscript{13} Bernanke responded by laying the onus on Congress, saying that the economy and the housing markets needed help for years to come from both the Fed and from Congress, in particular by enacting a plan to reduce the federal debt.\textsuperscript{14}

Like Paul Ryan, Republicans believe the Fed is undermining the country’s long-term financial health for a short-term recovery that will help Democrats win the next election cycle. When the Fed published a formal interpretation of its Congressional mandate on January 25, 2012, it said it would seek a two percent annual inflation rate and try to limit unemployment as much as possible, but that one goal may take priority over the other. Republicans began to worry. Congressman Ryan again responded, saying, “My interpretation is that the Fed is willing to accept higher levels of inflation than your preferred rate in order to chase your unemployment mandate,”\textsuperscript{15} said Mr. Ryan. “Is that not what we should interpret out of this?” While Bernanke responded that the Fed is not


\textsuperscript{13} Ibid.

\textsuperscript{14} Ibid.

\textsuperscript{15} Ibid.
seeking higher inflation, Ryan continued to press against unemployment taking priority over inflation. Democrats defended the Fed Chairman. “To deprive you of the tools necessary to boost employment would be a big mistake,” said Representative Chris Van Hollen, the committee’s ranking Democrat. “Indeed, without those tools, the economy today would be in much worse shape.”\^16

Democrats continue to press the Fed to do more. In response to the Fed’s announcement of “Operation Twist” in September 2011, the Fed’s attempt to spur lending and reduce unemployment, Democrats asserted that the central bank should be doing much more to expand economic growth. Barney Frank, the ranking Democrat on the House Financial Services Committee said, “I think it’s a good idea, but I would have gone further.”\^17 According to The Hill, Democratic policy experts have looked to fiscal stimulus as the most effective way to boost the economy in the short term, much like President Obama’s $447 billion jobs package. However, it is clear to that any type of stimulus as little chance of passing Congress because of Republican opposition in the House of Representatives. Democrats are looking to the Fed, therefore, as another avenue to boosting the economy before the 2012 election cycle.\^18 In support of this push for more Fed action, Democratic Representative Brad Sherman from California stated, “You and I know most of it can’t get through, which is why it’s on the Fed to use every

\^16 Ibid.


\^18 Ibid.
arrow in its quiver and invent more arrows. They could do a little bit more twisting; multiply whatever they’re doing by 120 percent or 140 percent. We need to bring down long-term interest rates.”\(^{19}\)

The Federal Reserve’s legal responsibility to pursue a “dual-mandate” to create the conditions for both low inflation and for high employment has also been the subject of contention between Democrats and Republicans. Representative Chris Van Hollen from Maryland, the ranking Democrat on the Budget Committee, and a member of the deficit-reduction super committee, asserted in September 2011 that he wants the Fed to pay more attention to its employment mandate. “Congressman Van Hollen feels the Fed should place a greater weight on its employment mandate than it has in the past,”\(^{20}\) Nu Wexler, Van Hollen’s spokesman, said.

A bill, however, introduced in March 2012 by Representative Kevin Brady, the top Republican on the Joint Economic Committee, would eliminate the employment leg of the dual mandate, requiring the Federal Reserve to focus only on price stability. “Except in the very short term, monetary policy can’t boost the economy and job creation,”\(^{21}\) Brady said. “It makes no sense for Congress to charge the Federal Reserve to control what it cannot. Let’s give the Fed a clear mandate, focus it on the mission of

\(^{19}\) Ibid.

\(^{20}\) Ibid.

stable prices and hold it accountable for the results.” In a response letter to Representative Spencer Bachus, an Alabama Republican and the committee chairman, Representative Frank and the panel’s 26 other Democrats opposed the legislation and requested a hearing on the bill. “We believe strongly that the dual mandate should be maintained, and we believe that the Federal Reserve’s actions in pursuit of that mandate have been helpful in dealing with our unemployment problem,” the letter stated. Like Hamilton, Democrats seem to worry that the country will slip deeper into an economic recession it will not be able to recover from without the monetary policy of the Federal Reserve, essentially tearing it apart, or at the very least weakening its bonds.

The argument between how much the Fed can and cannot do within the context of the economy and politics continues to be a fundamental issue between both parties. In January 2011, the Fed was blasted by Republicans for its publication of a white paper to Congress describing current housing market issues and encouraging Congress and the administration to address those issues. Representative Scott Garrett, a New Jersey Republican, said the Fed overstepped its bounds by giving unsolicited advice to Congress about fiscal policy. “You have two mandates in the areas of employment and fiscal policy,” Mr. Garrett said. “That’s obviously a lot. We have a mandate in the area of fiscal policy and we would like to retain that.”

22 Ibid.

23 Ibid.

Chairman Bernanke apologized, responding, “We are trying to provide useful background,” he said. “I apologize if it was misinterpreted. Our goal was just to be helpful.” Yet on the same issue, Democrats pressed the Fed about why it was not taking an even stronger position on housing issues. Chairman Bernanke, in response, again deflected some of the onus back on Congress, saying that the Fed believed that Congress should do more. “I think it would repay your efforts,” Mr. Bernanke said, “to remove some of the barriers to a recovery in housing.”

On September 20, 2011, the top four congressional Republicans took the unusual step of sending a letter to Chairman Bernanke urging the Fed not to engage in further stimulus. The letter was sent in the midst of a two-day meeting in Jackson Hole, Wyoming, in which Fed officials were expected to announce policies to lower long-term interest rates. “We have serious concerns that further intervention by the Federal Reserve could exacerbate current problems or further harm the U.S. economy,” said the letter, signed by Mitch McConnell of Kentucky, the Senate Republican leader; Jon Kyl of Arizona, the Senate Republican whip; House Speaker John Boehner of Ohio and House Majority Leader Eric Cantor of Virginia. The letter concluded, “Ultimately, the American economy is driven by the confidence of consumers and investors and the innovations of its workers. The American people have reason to be skeptical of the

25 Ibid.

26 Ibid.
Federal Reserve vastly increasing its role in the economy if measurable outcomes cannot be demonstrated.”

But Democrats immediately cried foul, saying Republicans had no business pressuring an independent agency that was designed to be free from political influence. "This is a heavy-handed attempt to meddle in the Fed's independent stewardship of monetary policy," accused Sen. Chuck Schumer, D-NY. “It should be ignored by Chairman Bernanke and the Fed’s policymakers,” Schumer said. Senate Majority Whip Dick Durbin of Illinois, in a Senate floor speech added, "This morning we learned that the Republican leaders of the House of Representatives and the United States Senate have done something which may be unprecedented. We are searching for some example in the past when this has occurred." Asked by a reporter about whether the move by the Republican leaders was an effort to influence the Fed policymakers, Senator Durbin responded, “Why else would they send the letter? They are trying to put political pressure on them not to lower interest rates.” Durbin continued, “When I go home to Illinois, the businesses I meet are struggling to borrow money, to expand their businesses and hire people. Lower interest rates will help them. Homeowners who are facing the restructuring of their mortgages would welcome lower interest rates.” Durbin said that

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the move by congressional Republicans is “not one that’s going to play well across America.”

Despite the letter, on September 22, 2011, the Fed announced it would shift some $400 billion from short-term Treasury bonds to long-term bonds in an effort to lower interest rates, including mortgage interest rates, and boost investment and spending. House Speaker John A. Boehner (R-Ohio) immediately castigated the Fed, saying that the central bank was "enabling" Washington's political gridlock by again intervening in the economy. "We continue to have concerns with the activities of the Fed because it appears to us that they’re taking actions because they don’t believe the political system can do what needs to be done," Boehner said, a day after the House was unable to pass a temporary spending bill to keep the government running past November 18. He continued, “Frankly, I think that’s enabling the political process, rather than forcing the political process to do what it should do, and that’s to deal with our deficit and our debt, which is imperiling jobs and imperiling the future for our kids and grandkids.”

At the root of the arguments made by Republicans is a deep-seated fear that Donald Kettl, Dean of the School of Public Policy at the University of Maryland, explains in a recent editorial piece:

30 Ibid.


33 Ibid.
What if the incumbent, in secret negotiation with the Federal Reserve, concocted a plan to boost the money supply and juice the economy just as voters were making up their minds? The shortest road to the White House has long been on a rising economic tide. Juicing the economy through more government spending is too obvious and inconvenient, since it takes too long to push enough projects down the line to boost employment, and the opposition would never allow it. But the Fed can act very fast and can push interest rates very low.\(^\text{34}\)

Kettl continues to explain that at the heart of the issue is the inherent battle between elected officials, who tend to like the easy money that comes from printing money, and central bankers, who fear the instability that comes from inflation. Politically, short term economic successes are better for the party in power. Thus Republicans fear that the Democratic administration of President Obama will push for monetary policies that lead to long-term inflation. It is a concern that Alexander Hamilton held back in 1791 too, and one in which he attempted to mitigate through administrative checks and balances on the First Bank.

This concern has come up time and time again in the long history of central banking. Hamilton and contemporary politicians attempted to mitigate this risk by creating an independent Federal Reserve that is shielded from short-term political interests. The Fed today knows that this level of independence is critical to its effectiveness and authority. Even appearing to cave to political interests could compromise the Fed’s ability to stabilize the markets more than any policy decision. Yet it is not unreasonable for Republicans to worry whether the lines separating the Fed from the politics of the Obama administration have become blurred. The fear that

administration officials will use monetary policy to “juice” the economy is compounded by the new reality created in the aftermath of the 2008 economic crash. When the Fed took aggressive action to save the economy in 2008, it closely coordinated its decisions with elected officials within Treasury and the White House. It also aggressively injected the economy with billions of dollars without regard to inflation. The Fed may argue that it is a non-partisan organization, but its actions since 2008 speak otherwise.

So Republicans argue that the federal government should back-off, balance the budget, and step away from monetary policy to let the economy right itself. But the reality of the current fiscal situation is an out-of-control budget due to bitter infighting between parties. In Kettl’s eyes, monetary policy is the only choice the country has right now to steer the economy. And while the rhetoric about the Fed is at an all time high, it seems clear to Kettl that neither Congress nor the White House is willing to step in to exert change. Congress has not touched the Fed’s increasing role, for fear of being stuck politically with any potential economic fallout. The White House must work closely with the Fed to influence the outcome as much as possible to avoid the same economic fallout that would destroy the administration as it enters into a presidential election year. So, since neither Congress nor the White House will claim responsibility for the economy, they are leaving the onus on the Fed without taking real responsibility for fiscal policy.

What remains is a powerful institution that is used by both parties to drive partisan rhetoric, rather than develop real solutions. Instead of using the Federal

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35 Ibid.
36 Ibid.
37 Ibid.
Reserve’s policy to discuss their own policy values and objectives, Democrats and Republicans are now using the Fed as a term of derision against the opposing party. Much like 1792, the Fed has become a bitter dividing line in partisan politics.

One example of this is the manner in which the Fed is being used as a politically divisive touchstone for Republican presidential candidates. Republican presidential candidate hopefuls even invoke the Founding Fathers and their opinion on central banking to provide a political precedent for their views. In a Washington Post editorial piece, “GOP presidential candidates bring Founding Fathers back into spotlight,” reporter Stephen Mufson describes an array of issues in which presidential candidates are invoking the founding fathers to drive partisan rhetoric. He begins, “This year’s candidates are hoping to ride those two-centuries-old coattails into the Oval Office. And they are trying to turn issues on which reasonable people can disagree into battles over what it means to be an American and who is being true to a patriotic legacy.” On the central banking issue in particular, Mulson writes:

The Federal Reserve has also become embroiled in the founders fetish. Paul wants to abolish it. Gingrich wants to rein in its independence and oust the Fed chairman. “Since I’m a historian who’s written a whole series of books about the Founding Fathers, I would think that they had the better grasp consistently and that’s why I would substantially reduce the power of the Federal Reserve,” Gingrich said in January. “I would audit it annually; I would call for Bernanke to resign or ask that he be fired the first week I’m president.”


39 Ibid.

40 Ibid.
Of course Gingrich fails to account for the fact that the First Bank was supported by Alexander Hamilton and George Washington and later supported by another founding father, James Madison. The reality of this comparison, however, is that candidates are summoning the founding fathers in a divisive way, and central banking is yet another means to drive that divisive debate.

Mitt Romney, who is also seeking the 2012 Republican presidential nomination, takes a more moderate approach from his Republican counterparts, but seems to waver on this contentious issue. Drawing an important distinction between himself and Governor Rick Perry’s inflammatory charge of a “treasonous” Ben Bernanke, Romney, in an interview in April 2011, refused to attack the Fed Chairman. "I think Ben Bernanke is a student of monetary policy; he's doing as good a job as he thinks he can do," he told Kudlow. "I'm not going to spend my time going after Ben Bernanke. I'm not going to spend my time focusing on the Federal Reserve."41

Yet a few months later, in September 2011, Romney said that if he were elected president, he would not keep Ben Bernanke as chairman of the Federal Reserve. "I'd be looking for somebody new,"42 Romney said in response to a question at a Republican debate held at the Ronald Reagan presidential library. "I think Ben Bernanke has


overinflated the amount of currency he has created."\textsuperscript{43} Romney also said the Fed's quantitative easing program – increasing the money supply by buying up securities to help boost the economy - had not worked.\textsuperscript{44}

At another debate later the same month in September 2011, Romney argued for a more moderate approach, saying that the central bank is necessary to establish economic confidence in the dollar, but added that the Fed requires additional oversight. He said:

Well, my own view is that, quite simply, that the Federal Reserve has a responsibility to preserve the value of our currency, to have a strong American currency, such that investors and people who are thinking about bringing enterprises to this country have confidence in the future of America and in our currency. People will not invest in this country and create jobs in this country for the American people if they don't have belief in our currency. Of course we should see what the Fed is doing. There should be some oversight to make sure that it's -- it's acting properly. But at the same time, we recognize that we need to have a Fed. Why -- why do I say that? Because if we don't have a Fed, who's going to run the currency? Congress? I'm not in favor of that. I'd rather have an agency that is being overseen rather than have the United States Congress try and manage our currency.\textsuperscript{45}

Surprisingly, Romney’s latest argument invokes the Federalist voices of 1791 who wanted a central bank to establish a national currency and inspire economic confidence in the dollar. Even Alexander Hamilton would agree with that.

The Fed, for its part, seems to acknowledge that this type of divisive bickering is hampering economic process and is pointing the finger back at Congress. In an August 26, 2011 speech in Jackson Hole, Wyoming, given at the annual Federal Reserve Bank of

\textsuperscript{43} Ibid.

\textsuperscript{44} Ibid.

Kansas City Economic Symposium, Bernanke gave a particularly strong speech on the need for Congress to manage its share of the economic policy burden by reducing spending and deficits, given that “most of the economic policies that support robust economic growth in the long run are outside the province of the central bank.” Pointedly blaming Congress, Bernanke suggested that the summer 2011 political battles over the federal government’s borrowing and spending “disrupted financial markets and probably the economy as well,” and said that the country needed a better fiscal policy process to “set clear and transparent budget goals” along with budget mechanisms to establish the credibility of those goals.\(^{46}\)

The Chairman went so far as to spell out the steps necessary for economic recovering, saying:

> The quality of economic policymaking in the United States will heavily influence the nation's longer-term prospects. To allow the economy to grow at its full potential, policymakers must work to promote macroeconomic and financial stability; adopt effective tax, trade, and regulatory policies; foster the development of a skilled workforce; encourage productive investment, both private and public; and provide appropriate support for research and development and for the adoption of new technologies.\(^{47}\)

Such specific fiscal policy recommendations are highly unusual for the Federal Reserve. Traditionally, Fed officials refrain from commenting on the fiscal policy of Congress. The Federal Reserve was meant to be independent so that it would be shielded from short-term political interests, and Fed officials have repeatedly said they are unmoved by


\(^{47}\) Ibid.
external political pressures. The message Bernanke seems to be sending to Congress is that politicians must find a way to work together and establish middle ground if the economy is to recover. The fact that Bernanke was forced to send this unprecedented message is yet another example of how deeply partisan and extreme the debate has become.

Thus, today the Fed is being invoked as a means for presidential candidates to speak derisively against the other. Rather than use the argument as a means to develop solutions that have real impact and meaning or provide context for their own beliefs, candidates are using the Fed to show how the other candidates, the party, and the administration are wrong. The Fed once again is being used to drive divisive political rhetoric.

In 1791, Hamilton and the Federalists believed they were protecting a legitimate government from Republicans who were out to destroy the Union. In their minds, the bank and economic policy would save the country from anarchy by tying economic interests together. Republicans believed that a central bank would destroy the individual freedoms and liberties of all citizens and move the young country closer to monarchy. The same tensions exist today. Democrats worry that the country will slip deeper into an economic recession it will not be able to recover from without the monetary policy of the Federal Reserve, essentially tearing it apart, or at the very least weakening its bonds. Republicans believe the administration is manipulating the Fed for its own political gain,

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thus inching the country closer to a monarchical type administration without letting the free market work its magic. Bail-outs and increased government oversight, in their minds, give the government too much power over a free market, which should reign supreme.

On both sides, the parties take an “either-or” approach to the debate. Either the Federal Reserve is necessary and should be guiding monetary policy, or it is unnecessary and should be abolished. As we’ve seen in the past chapter, there is very little argument in the middle ground between two extremes. The questions we must address are first, why do we continue to have the same black and white debate about the Federal Reserve? Second, how do we move past the partisan bickering and agree on a path forward? Third, why it is important to move past this type of argument?

We continue to have the same debate about the Federal Reserve for several reasons. First, the power and mystery of the Fed make it an easy target for the same fears that we dealt with in the founding era. The Fed is an entity that everyone fears but almost no one understands. Monetary policy is complex, even for regulatory officials. Politicians have a difficult time understanding it, and to the majority of the public, it might as well be written in another language.

Take, for instance, the Volcker rule, named for former Federal Reserve Chairman Paul Volcker and mandated by the 2010 Dodd-Frank financial oversight law. The rule aims to prevent financial institutions that receive government backstops, like deposit insurance, from making risky trades with their own money. Yet even a top regulatory official at the Federal Reserve acknowledged that the Volker rule was overly
complicated. Mark Van Der Weide, a director at the Fed's division of banking supervision, said it was "an understatement to say that the Volcker rule is a complicated statute that presents complicated implementation challenges."49

Frighteningly, financial regulators struggle with the same complexity. Even as the country stood on the brink of economic collapse in 2006, Federal Reserve leaders did not seem to understand the mechanics of the economy nor foresee the impending crash. Transcripts show that Federal Reserve officials, meeting every six weeks to discuss the economic health of the nation, did not understand that the faltering housing market would affect the economy. Instead they continued to tell one another throughout 2006 that the greatest danger was inflation — the possibility that the economy would grow too fast. “We think the fundamentals of the expansion going forward still look good,” Timothy F. Geithner, then president of the Federal Reserve Bank of New York, told his colleagues when they gathered in Washington in December 2006.50

Susan Bies, a Fed governor, even suggested that a housing downturn actually could bolster the economy by redirecting money to other kinds of investments. The general consensus on the board was that problems in the housing market had few broader ramifications. “We just don’t see troubling signs yet of collateral damage, and we are not expecting much,” Geithner said at the September 2006 meeting. And when former Fed Chairman Alan Greenspan left in January 2006, records show there was a chorus of


praise from officials who widely believed him to be a masterful central banker. Janet Yellen, then president of the Federal Reserve Bank of San Francisco, said: “It’s fitting for Chairman Greenspan to leave office with the economy in such solid shape. The situation you’re handing off to your successor is a lot like a tennis racquet with a gigantic sweet spot.”

With the apparent failure of financial regulators to themselves understand the complexities of the economy, it is no wonder that neither Congress nor the public understand, nor trust the Fed. The result is a Congress and public fearful of an institution that they do not understand, but which wields enormous power. In such a context, it is easier to understand why politicians and the public draw a narrowly focused opinion on the subject. Without understanding the layers of complexities, they are forced to resort to a black or white conversation on whether the Fed is an institution for good or evil.

Second, the lack of transparency by the Fed feeds this inherent fear. In November 2001, Bloomberg Markets magazine reported that the Fed secretly committed more than $7 trillion as of March 2009 to rescuing the nation’s top financial institutions, and that these banks "reaped an estimated $13 billion of income" on the below-market rates. The number was staggering, especially considering that the controversial $700 billion Troubled Asset Relief Program (TARP) bailout had required Congressional approval.

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51 Ibid.

Yet the size of the $7 trillion bailout came to light only after Bloomberg LP, the parent of Bloomberg News, won a court case against the Fed and a group of the biggest U.S. banks called Clearing House Association LLC to force lending details into the open. Chairman Bernanke had argued that revealing borrower details would create a stigma -- investors and counterparties would shun firms that used the central bank as lender of last resort -- and that needy institutions would be reluctant to borrow in the next crisis. Clearing House Association fought Bloomberg’s lawsuit up to the U.S. Supreme Court, which declined to hear the banks’ appeal in March 2011. Yet even when the Fed lost the court case, Chairman Bernanke left it up to the press and the public to interpret the data it eventually provided.53

Information about the loans was withheld from Congress as lawmakers debated and passed the Dodd-Frank financial regulatory reform bill and Consumer Protection Act of 2010. Banks also failed to disclose the information to their shareholders. Stunningly, the Bloomberg report disclosed that total assets at the largest six banks increased by 39 percent and executive compensation increased by 20 percent in the past five years, or by more than $146 billion in compensation in 2010. House Oversight and Government Reform Committee ranking member Elijah Cummings from Maryland responded by saying, “Many Americans are struggling to understand why banks deserve such preferential treatment while millions of homeowners are being denied assistance and are at increasing risk of foreclosure.”54

53 Ibid.
Not only did the $7 trillion bailout show a complete lack of transparency by the Fed, but it illustrates the third reason that we continue to have the same black and white argument about the Fed: a perception that the Fed and bankers are working hand in hand together. This was a concern for Jeffersonian Republicans in 1791 and it continues to be a concern for politicians and the American public today. As banking rules are rewritten, banks play a large role in drafting them. Yet the main participants, according to the *New York Times*, end up being lawyers and lobbyists for the nation’s largest financial institutions. It cites, for example, 34 meetings the S.E.C. hosted with groups proposing changes to the way the Volcker Rule is implemented. Most of the meetings ended up being with big banks and their representatives. Only one was with a consumer-advocacy group.55

If the central bank cannot demonstrate that it is working with bankers constructively to do what is best for the American people, the Fed will never be trusted, and it will continue to fuel this extreme partisan debate about its existence and value to the country.56

We must change the dialogue of our debate from the “yes or no” approach, because this line of debate gets us nowhere. Due to entrenched partisan politics, the Fed is all we have to drive fiscal policy. As we have seen since 2008, Congress cannot and will not find a middle ground to balance the budget or agree on federal spending, thus we


56 Ibid.
cannot rely on these tools to drive fiscal responsibility. The Fed is not something we can walk away from, abolish, or let run unregulated. This extreme thinking gets us nowhere and puts us back at square one – 1791 to be exact – and asking ourselves the same question: Should the federal government guide federal monetary spending? As history has shown time and time again, the Fed is necessary. It was a question that President George Washington answered in 1792, and it is one that has come up again and again with the same answer. Yes, we need the Fed to shape economic policy.

The problem with the central banking argument in the context of economic fiscal policy is that it rests on the assumption that if one solution is wrong, then the opposite must be right. The prevailing attitude in Washington right now is that unhampered pursuit of self-interest will bring about eventual economic stability. In this mindset, regulations are faulty, therefore unregulated markets are perfect. On the other side, the free market cannot be trusted, and stringent government regulations must rein in Wall Street to protect American pocketbooks. This, however, is an oversimplification. Both solutions on their own are flawed.

From a practical standpoint, such extreme versions of central banking will unlikely make any progress in their current form due to politics. Partisan gridlock in Washington has already limited the government's ability to respond to the economic downturn and has forced the Fed to take on a greater policy role to battle the country's economic malaise. Arguing for an unregulated Fed or for abolishing it will go nowhere. Second, central banks are not only limited in their capacity to prevent or cure economic
calamities, but can even be part of the problem when they combine low interest rates with feeble regulation. Blaming central banks is again an oversimplification of the problem.⁵⁷

America is not an "either-or" society. The Jeffersonian and Hamiltonian traditions have been managed in creative tension since the country’s founding. Sometimes one tradition overpowers the other, but for the most part they balance each other out. As long as both views have the power of healthy advocacy and the ability to compromise, it is fair to say that we can achieve a balance of these creative tensions. As George Soros, a prominent business magnate and philanthropist, writes of this public versus private battle, “ultimate victory for either camp would diminish our personal and civic lives. Indeed, ensuring that the tension continues in a productive way ought to be an aim of public policy.”⁵⁸

Healthy advocacy for each side, however, suggests that bankers and politicians advocate for their traditions, but eventually come together to achieve a middle ground. This has not been the case in the central banking argument. Thus, we must better manage these creative tensions around central banking to achieve a blend of these public versus private traditions and ultimately find resolution to this perpetual tension that began in 1791.


CONCLUSION

To move the dialogue towards a more constructive framework and better manage these creative tensions, I propose that the public, politicians, and bankers do the following: First, there must be a deliberate effort to identify and understand the complexities that exist in guiding fiscal policy. Second, the public and their elected officials need to take ownership of the issue and understand that central banks are limited in their capacity to prevent or cure economic calamities. Lastly, they should achieve an unprecedented level of transparency in the process to gain the understanding and trust of the American people. Reframing the debate in a manner that is nuanced and transparent will give politicians and voters to better understand, feel comfortable with the Fed and thus utilize the Fed in the best way possible. Perhaps then achieve a blend of these public versus private traditions and find resolution to this perpetual tension that began in 1791.

To change this overly simplistic dialogue and bargain for real solutions to a complex problem, we must begin first by developing a more informed debate. The dialogue around central banking must be reframed to account for the nuances and complexities that fiscal policy entails. The “big thing that’s missing” in U.S. politics today, Bill Gates said in a recent interview to columnist Tom Friedman from the New York Times, “is this technocratic understanding of the facts and where things are working and where they’re not working.” As Friedman elaborates, the technocratic ideal is an informed state where political debates can be "driven by data, not
ideology."¹ The same is true for the central banking debate. Reframing the dialogue will require government, bankers, and the public to focus on the nuances of fiscal policy. Ideology has driven the discussion thus far, and it has not moved us forward. A data driven debate can help us escape the same circuitous debate.

It is a big step, given the complexities of the market and financial regulation, but we can begin by taking ownership of the issue. No longer can Congress, the White House and the public shift all the blame to the Fed. If we understand the complexities, we can better understand that central banks are limited in their capacity to prevent or cure economic calamities. The Fed is not a cure-all. Congress must take responsibility for driving economic policy in the legislative process and the public must take responsibility by electing the right officials into office. Above all, we need the political will in Congress and the White House to take action as well as the understanding that policy will be something that needs continual refinement.²

Third, transparency in central banking is critical. The American people were blindsided by a $7 trillion bailout, and lost in the economic jargon of the Fed. What they did see, however, were central bankers and regulators working hand in glove with private financial elites. It is a disconcerting picture, and one that continues to drive partisan rhetoric. The Fed must open its books and begin to articulate its position in a manageable and understandable way. Perhaps then we can understand and change the


fact that the political power of Wall Street and the largest financial institutions remains oddly intact.

The creation of a central bank was one of the first and most important decisions that George Washington made as our first President. He well understood the weight of the decision, and carefully reviewed the merits of its constitutionality as presented by Alexander Hamilton, Edmund Randolph, and Thomas Jefferson - three men whom he deeply respected and trusted. In the end, Washington signed the bill. It was a decision that has been supported and reinforced time and time again since the country’s founding. It is also a debate from which we have not been able to escape. Federalists and anti-federalists in 1791 were equally frightened by the direction the country was taking. Republicans and Democrats today are just as afraid that the country will splinter in tough economic times. All point to the central bank when these fears arise. Yet while the very tensions that exist in the central bank dialogue are important to the fabric of our political institutions, we must move past the same partisan rhetoric if we are to resolve our fears. It is time to find a common solution that allows American capitalism to evolve and thrive in a new century.
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