Hamilton’s First Bank of the United States

Jesús Fernández-Villaverde\textsuperscript{1}

June 9, 2021

\textsuperscript{1}University of Pennsylvania
The Bank of England
Modern central banking starts when the Bank of England opens on July 30, 1694 (some predecessors in Italy, Dutch Republic, and Sweden).

Its creation is closely related with the institutional changes brought by the Glorious Revolution of 1688.

Its initial business is to fund the government with £1.2 million during the War of the Grand Alliance (1688-1697).

It does so by printing paper notes rather than in specie.

Thus, the Bank of England is an engine of credit from the start.

Sir John Houblon, Governor.
Sir John Somers, Lord Keeper.
Mr. Michael Godfrey, Deputy Governor.
The Bank of England and public debt

- Later, the Bank of England lent to the government either directly or through the purchase of government debt (discounting).

- The Bank helped establishing credible commitment on the part of the government by originating most of the loans.

- It thus provided oversight of the government, especially with respect to payment of interest on the debt.

- Eventually, the Bank started managing the government debt directly as well as a range of government securities.

- By 1770s, the Bank handled 3/4 of the government debt for a fee and held about £11.7 million.
The Bank of England and private businesses

- In addition to lending to the government, the Bank of England made commercial loans, took deposits, and issued notes aiding and deepening financial intermediation in Great Britain.

- Its short-term commercial lending grew in importance over time.


- The Bank of England, however, was not an overly dominant force. It did not have a (total) monopoly on note issue and it did not act as a clearing house.

- The Bank of England became a banker to banks only gradually.

- Nonetheless, the Bank is extremely profitable since it opens, paying dividends of 7% or more.
In summary, the Bank of England was an essential element in:

1. Managing the national debt.
2. Issuing notes.
3. Acting as a purveyor of credit to industry.

Hamilton admires these functions and wishes to copy them by creating a similar institution in the United States: the First Bank of the United States (technically, The President, Directors and Company, or the Bank of the United States).

Also, the First Bank’s creation is intimately linked with the funding of the debt we discussed in a previous lecture.
Hamilton’s plan
The financial situation in 1789

- The U.S. financial conditions are dire:
  1. Customs duties generate a mere $162,000 and country is in default on Revolutionary War debt.
  2. No national currency.
  3. No national bank.
  4. Poorly developed financial markets and banking system.
A radical transformation

- By 1793, however:
  1. Customs duties are $4.7 million, government can fund itself and pay interest on debt.
  2. Mint has opened and is coining gold and silver dollars, a common unit of account on a decimal basis that displaces foreign and local currencies (bimetallism, though, will cause many problems in the future).
  3. The First Bank of the United States is operating with branches in several cities, after having gathered $10 million in capital with an initial raising of equity.
  4. Additionally, 10 newly chartered state banks.
  5. 44 new business charters issued, compared to 7 during the entire colonial period.
  6. Securities markets in Boston, New York, and Philadelphia price the $63 million of national debt daily as well as valuing the National Bank's stock and state bank stocks.
  7. The financial system has survived financial panics in 1791 and 1792 (more later on these two panics).
An international comparison

- Historians tend to gloss over this, but at the time there were only 2 other modern financial systems:
  - Dutch, started around two centuries before.
  - Great Britain, started around one century before.

- By 1793, the U.S. system has caught on. All within the span of 3 years.

- Recall that it is historically impossible to find a modern, well-functioning economic system without a sophisticated financial system.

- Also, financial difficulties (especially in wartime) are common, but financial revolutions are rare.
Hamilton’s intellectual background

- Hamilton is well read in the economics of the time and is very familiar with the history of banking: Venetian, Dutch, and British.

- Probably related with his early life experience in St. Croix and New York City.

- Hamilton began on his plans for the U.S. financial system around 1779.

- By then, Hamilton is already anticipating a Constitutional Convention to reform the Articles of Confederation.

“The tendency of a National Bank is to increase public and private credit. The former gives power to the state for the protection of its rights and interests, and the latter facilitates and extends the operations of commerce among individuals. Industry is increased, commodities are multiplied, agriculture and manufactures flourish, and herein consists of the true wealth and prosperity of a state.” Letter to Robert Morris (1781).
A central bank for the United States

- Hamilton anticipates that the Bank of the United States would be privately chartered, funded by a combination of foreign debt and domestic equity.

- The government would be a part owner, receiving a share of profits and the Bank would loan money to the government, facilitating the development of a market in public debt and bolstering the public finances.

- The Bank would issue notes and these notes would be redeemable in specie, thus stabilizing the value of currency.

- Notably the Bank would not be a monopoly.

“Most commercial nations have found it necessary to institute banks and they have proved to be the happiest engines that ever were invented for advancing trade.” Letter to Robert Morris (1781).

- Hamilton goes on to publish 6 essays on his ideas in a New York newspaper in 1781 under the title “The Continentalist.”
A central bank as a foundation for U.S. financial development

- As we discussed before, restructuring the debt goes smoothly.

- Money is raised from an increase in import duties and some excise taxes.
  1. Tariffs kept relatively low; they are primarily for revenue not protection.
  2. Hamilton is also relying on improved prospect for growth and the ability to raise additional debt to smooth future taxes as needed.
  3. It is here where the Bank of the United States becomes a crucial ingredient. The Bank is needed to provide funding to the government and help developing financial markets so that debt can be easily subscribed.
In December 1790, Hamilton issues the Bank Report to Congress, where he emphasizes three main advantages obtained by creating the Bank of the United States:

1. It would deepen financial markets encouraging commercial activity and economic growth.
2. It would provide loans to the government, especially in emergencies.
3. It would facilitate the payment of taxes because Bank notes and deposits would increase money in circulation.

The Bank would be privately chartered by Congress:

1. Government retains 20% share.
2. Raise $8 million from private subscribers: Investors could pay for stock with 1/4 in specie and the rest in U.S. government 6% consols.
3. Some government oversight.
Implementation

- Congress approves the Bank and, on February 25, 1791, Washington signs the “bank bill” into law.

- Stock is oversubscribed by July, 1791 and operations start on December 12, 1791.

- The Bank opens branches in Boston, New York, Baltimore, and Charleston the following year.

- States copy the idea and 17 state Banks are chartered between 1791-1795 bringing the total to 20 by 1795 and to 28 by 1800.

- Soon, we have a national banking network.

- Securities markets expand with exchanges in New York, Boston, Philadelphia, Charleston, and Baltimore.

- New financial sector helps spur U.S. economic growth to the 1-1.5% range. Specially, New England and New York.

- 20 years chart. It expires in 1811 and it is not renewed. Why?
The operations of the First Bank
The initial public offering, I

- The $8m privately subscribed was the largest stock offering in the U.S. to date and it was oversubscribed.
  1. 25,000 shares at $400 each, with 20,000 being sold to the public on the first Monday in July.
  2. 1,000 share maximum for any individual, with a down payment of $25 and a schedule of later payments.
  3. Oversubscribed by 20%, so shares scaled down pro-rata.
  4. Widely distributed over the entire country. As much as 70% of shares would be eventually owned by foreign investors.

- It appears the IPO price was too low. Madison makes that point in a letter to Jefferson.

- The initial subscribers obtained large profits at the expense of the Treasury, which could have raised a good deal more capital than it did.
The initial public offering, II

• Speculative bubble erupts and then prices crash, resulting in a short-lived financial panic before the Bank even opened its doors.

• By early August, the share price or right to own the stock had increased 10 fold to $250, implying a fully paid share was worth $625, for a one-month profit of over 50%.

• Prices for a piece of scrip (the right to a share) topped out at around $325 on August 11th fueled by notions that the return on the stock could reach 12% per year.

• Bank of New York curtails loans to speculators and a panic sets in with prices plummeting to $110 on August 15th.

• Hamilton quells the plummeting by directing the Bank of New York to purchase stock, and in September purchases more.

• This measure stops the free-fall in the share price and it fluctuates between $130-$170 over the rest of the year.
Organization

- 25 directors elected by shareholders:
  1. 7 face reelection each year.
  2. Determine salaries of the officers and clerks.
  3. Supervise the supply of bank notes.
  4. Approve loan applications.
  5. Appoint the Bank President.
- Semi-annual dividends.
- Cap on property held of $15 million.
Hamilton preferred no branching or at least waiting until the Bank was operating effectively.

Board believes, instead, that branches improve profitability and information concerning any financial problems in the country.

How would towns who did not get branches react? How would state-chartered banks react to a branch opening in their town?

Thinking back then was that only one bank in a city would survive.

On November 8, full board approves branches in Boston, New York, Baltimore, and Charleston to open the following spring.

Richmond the following July, but there is significant local opposition and Board reverses its decision.
The loan book

“A general circulation of Bank paper, which is to be expected from the institution lately established will be a most valuable means to promote pecuniary remittances from place to place.” Hamilton in his report on manufactures.

- Initial limit on loans to specie was 5 to 1 or 5 times capital. A very low leverage ratio compared to modern banking. Stayed pretty much in line with this directive.

- As part of a loan, the borrower received the Bank’s notes or a credit to his account at the Bank. Loan was discounted at 6%. For example if a merchant was granted a $100 loan for thirty days, he would receive $99.52. This is why loans are often referred to as discounts.

- Initial maturities on loans set a 30 days, although board had the authority to issue 60 day loans.

- Prefers business loans to personal loans or accommodations, but insider lending existed and may have been fairly widespread. Substantial uncertainty regarding the extent.
INSIDER LENDING

Banks, Personal Connections, and Economic Development in Industrial New England

NAOMI R. LAMOREAUX
The Panic of 1792

- Initially, the First Bank floods the market with credit, but changes course in February 1792.

- This change causes a stock market crash, the first in U.S. history.

- The largest speculator was William Duer, whose financial company failed in March, paralyzing credit markets.
  
  - Old friend of Hamilton: invited to work on *The Federalist* and in the Treasury, related also through the Society for Establishing Useful Manufactures.

- Once again Hamilton order the Treasury to purchase securities and branches of the Bank are opened during the panic.
Underpinning of the crash

• In December, 1791, William Duer and Alexander Macomb try to secretly corner the U.S. securities market including the stock of the First Bank and the Bank of New York (“Six Per Cent Club”).

• In particular William Duer goes after the fixed income market consisting of U.S. government securities.

• There is a schedule of payments investors must make for their shares in the First Bank and those payments can be made in 6% U.S. bonds.

• This created a natural demand for bonds and if you hold most of them, you can reap a sizeable profit as those bonds are sought to satisfy payments.

• However, with the Bank withholding credit, security prices drop by \(\sim 25\%\) between January and April.

• The price fall bankrupts Duer, who used loans to purchase the security. He may have owed as much as $500,000.
Consequences of the crash

- The crash may have resulted in $3 million loss in New York.
- Changes in the rules to negotiate securities (collateral, etc.).
- Some evidence that First Bank was partly to blame as it starts restricting credit the previous February.

<table>
<thead>
<tr>
<th></th>
<th>Dec 29</th>
<th>Jan 31</th>
<th>Mar 9</th>
</tr>
</thead>
<tbody>
<tr>
<td>Outstanding notes</td>
<td>134,268</td>
<td>886,684</td>
<td>891,873</td>
</tr>
<tr>
<td>Bills discounted</td>
<td>964,260</td>
<td>2,675,441</td>
<td>2,051,564</td>
</tr>
<tr>
<td>Cash on hand</td>
<td>706,048</td>
<td>510,345</td>
<td>244,371</td>
</tr>
<tr>
<td>Deposits</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>1,031,125</td>
<td>1,279,041</td>
<td>1,169,419</td>
</tr>
<tr>
<td>Individual</td>
<td>898,125</td>
<td>811,863</td>
<td>569,550</td>
</tr>
<tr>
<td>Government</td>
<td>133,000</td>
<td>467,178</td>
<td>599,869</td>
</tr>
<tr>
<td>Capital</td>
<td>496,550</td>
<td>993,775</td>
<td>993,775</td>
</tr>
</tbody>
</table>

Table 1: Balance sheets: Philadelphia December 29, 1971; January 31, 1792; March 9, 1793
Bum and bust, 1

- The First Bank floods market in January 1792: $964,000 in first 2 weeks of operation.

- Bank of New York stops accepting notes on January 26th.

- Did the First Bank curtail lending in February?
  
  1. The next existing balance sheet that survived is March 9, 1792. The Bank did not renew almost 25% of the 30 day discounts from the end of January until March ($625,000 in loans called in).
  
  2. There is evidence that the First Bank started curtailing issuance in mid-February (letters of the times).

- Why? The First Bank realizes that it has been too aggressive, causing its notes to trade at a discount in Boston and for Bank of New York to stop accepting its paper. Anything but a secure medium of exchange.
Spectre of paper being returned for specie. Between the end of January and March 9th, almost $270,000 of notes returned.

Specie is flowing out too quickly.

Additionally, branches were set to open in 2 months and $500,000 in seed money is needed for each branch.

The First Bank needs to curtail the expansion of credit.

Curtailment appears to be happening in Boston at the Massachusetts Bank and at Bank of New York, but it appears their actions were rather small compared to First Bank. They are much smaller in size.

Fortunately, the 1792 financial panic did not lead to a recession. Similar to black Friday in October 1987, when market tumbled more than 25% with no discernible economic effect.
The 4 branches open during the crisis. Local boards elected by the main board. The last to open is in Baltimore in June.

Hamilton stems the crisis by injecting liquidity into financial markets in March. He also secures a new loan from the Dutch of 3 million florins, which calms fears.

New York branch adds liquidity as well. And, in Philadelphia, First Bank resumes discounting to merchants in May following a large infusion from the Treasury in mid-April.

It is possible that Hamilton coordinated the events.

Safe principles would guide the Bank over the next 20 years.

The financial machinations draw the ire of Jefferson and he and Madison attack Hamilton viciously.

“take up your pen, select the most striking heresy and cut [Hamilton] to pieces in the face of the public” (Jefferson to Madison)
Initially, the First Bank’s primary role is in assisting the Treasury, acting as its fiscal agent collecting tax receipts and making payments as well as transferring funds on its behalf:

- Treasury earns interest on its deposits.
- Transfers specie to foreign governments.
- Lends directly to the Treasury. Initially, $6 million lent to government.
An Example: the Whiskey rebellion

- In 1791, U.S. government imposes excise tax on distilled liquors: “whiskey tax.” A good revenue source and one that Hamilton wants to avoid falling in the hands of the states.

- Why so problematic?

- Farmers in western Pennsylvania refuse to pay (similar rebellion to Shay’s Rebellion in 1786-1787 and Fries’ in 1799-1800).

- Washington tries to enforce tax more vigilantly in 1794, which leads to open revolt and riots from Pennsylvania to western Virginia.

- The U.S. sends in troops raising a militia of 13,000 troops. The overwhelming force suppresses the rebellion without a shot being fired.

- Government needs money and needs it quickly to put that many men in the field. Calls on First Bank for two loans of $1 million dollars each.
Additional borrowing

• Additionally, the loan is used to cover government shortfalls at the time and to build a fleet to send against the Barbary pirates. But costs of Whiskey rebellion so large that shipbuilding put on hold.

• Hamilton borrows another $2 million to cover the payment on the initial loans, and the Bank raises the funds by issuing $2 million in 6% bonds.

• In total, the Bank lends $5.5 million to the government during 1794 and 1795.

• This comes at the cost of issuing less private loans to private business.

• Evidence of “crowding out” comes from the decline in private deposits as these are drawn down to pay for existing loans.

• As well, the proportion of loans granted fell drastically, in Baltimore by as much as 2/3 (goes from $1.22 of loans requested for each dollar lent to $2.03 requested for each dollar lent).
The First Bank as a central bank

- To be a central bank, there needs to be a banking system.

- At First Bank’s inception, there are only 3 other banks: Bank of New York, Bank of North America, and the Bank of Massachusetts.

- By 1811, there are 88 banks. U.S. moves to a fairly developed financial system in a very short time.

- The First Bank takes on a supervisory role by reigning in state banks that it believed were over issuing notes. It would gather up state bank notes and tender them for specie, thus constraining further issuance.
  
  - Boston branch president (1807): “We are charged with doing injury to other Banks by draining them of their specie and retaining it by limitation of our discounts.”
  
  - So sacrificing its own profits to ensure stability of banking system.

- However, the First Bank does not act as a lender of last resort by lending to other banks in a crisis.
Overlaps between the First Bank and the Treasury, I

- Hamilton promotes state banks as well and the Treasury acts to some extent as a regulator asking for monthly statements of various bank’s accounts.

- Treasury under Albert Gallatin (1761-1849) reigns in the First Bank when it believes it is excessively calling in bonds from state banks.
  - “A complaint has been made that at Baltimore the drafts of the Branch Bank on the other Banks of that city have been unusually large & particularly draining…”
  - He tells the Baltimore branch to back off (following Hamilton’s precedent with the New York Branch).
  - Further, the First Bank is not truly independent. Both Hamilton and Gallatin are clear that the Treasury can inflict great harm on the First Bank if it does not serve the government’s interest.
  - Indeed some individuals were employed simultaneously by the Treasury and the First Bank.
• Lending to Banks is an activity of the Treasury, which demands adequate security that its loans will be repaid.

• During yellow fever epidemic in New York in 1798, the Treasury made sure there was adequate liquidity by discounting acceptable paper.

• Treasury also boosts deposits to First Bank during the shortfall in specie during 1804, so that the Bank does not have to curtail lending.

• So, it is basically the Treasury that acts as the central bank using the First Bank as its instrument.
An economic assessment

- Government pays off $1.2 million of the public debt by selling off much of its Bank stock. Thereafter, the debt is repaid gradually.

- Bank lasts for 20 years and the charter is not renewed during the Madison administration.

- By then, the U.S. has a well established financial system that developed in a remarkably fast manner.

- The First Bank is integral part of that development.

- Some of that is due to its tremendous size. Capitalized at $10 million, which dwarfs the total capital of the $3 million of the five banks already in existence.

- When it closed in 1811, it had as much specie in its vaults as all the other 89 banks combined.

- While not a full fledged central bank, the First Bank takes on responsibilities that are associated with central banking.

- Hamilton’s blue print for the economy turns out to be extraordinarily successful.
The political economy of the First Bank
RECONSTRUCTING
THE
NATIONAL
BANK
CONTROVERSY

POLITICS & LAW
IN THE
EARLY AMERICAN
REPUBLIC

ERIC LOMAZOFF
Opposition to the First Bank

- The argument for the Bank was hotly contested on economic and constitutional grounds.

- Thus, in 1811, the Bank does not have enough allies to renew its chart.

- Southerners in general oppose it:
  
  1. They consider the bank is anti-agrarian, with farmers at the mercy of city institutions.
  2. Ability to issue notes spark fears of inflation.
  3. Also, southerners are worried about its size and, hence, potential monopoly power.

- Madison, Jefferson, and Randolph oppose it on constitutional grounds as well.

- Constitution does not grant the government the power to incorporate a bank: they argue Constitution is document establishing a limited government.
Enumerated vs. general powers

- In the U.S. Constitution, there are:
  
  1. **Enumerated** powers: those powers expressly listed.
  
  2. **General** powers: those given to the government to serve the general welfare of the people.

---

**General Welfare Clause, Article I, Section 8**

“The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defence and general Welfare of the United States;”

---

**The Necessary and Proper Clause, Article I, Section 8**

“The Congress shall have Power... To make all Laws which shall be necessary and proper for carrying into Execution the foregoing Powers, and all other Powers vested by this Constitution in the Government of the United States, or in any Department or Officer thereof.”
Jefferson’s arguments

- Jefferson dislikes all corporations.
- Also, he argues:

**Opinion on the Constitutionality of a National Bank, 1791**

“...the foundations of the Constitution [was] laid on this ground that ‘all powers not delegated to the US by the Constitution, nor prohibited by it to the states are reserved for the states or the people.’ [10th amendment]. To take a single step beyond the boundaries drawn around the powers of Congress, is to take possession of a boundless field of power no longer susceptible of any definition.”

- Radically opposed to the idea: suggests to governor Henry Lee of Virginia (the father of Robert E. Lee) that anyone recognized the Bank in Virginia is guilty of high treason and should suffer death.
Madison’s arguments, I

- Madison insists that Hamilton wants to use the government to establish the national bank as a corporation, a power that falls outside of Article 1, Section 8, as a power granted directly to Congress.

- Attorney General Randolph tells President Washington that he agrees with Madison’s reasoning.

- Thus, Washington asks Madison to draft a veto in case he decides against the Bank.
  
  - Madison bases it on the Constitution not warranting the Act: the Constitution is a grant of particular powers and the “necessary and proper” clause should not be considered as granting powers other than those consistent with “the incidentality to an express authority.”
  
  - “necessary and proper” can not mean unlimited discretion. At a minimum, a measure that comes within the meaning of a clause and “to means necessary to the end and incidental to the nature of specified powers.”
  
  - The Bank bill is not a borrowing of money or a levy of taxes, but the exercise of a power not enumerated.
  
  - It is not possible to discover within the Constitution a power to incorporate a Bank. Indeed the power of incorporation was rejected at the Convention.
Madison’s arguments, II

- Madison worries particularly that a Bank bill is a usurpation destroying the main characteristic of the Constitution:

“To borrow money is made the end and the accumulation of capitals implied as the means. The accumulation of capital is then the end and a bank implied as the means. The bank is then the end and a charter of incorporation, a monopoly implied as the means. If implications thus remote and multiplied can be linked together, a chain may be formed that will reach every object of legislation, every object within the whole compass of political economy.”

- The argument appears different from Madison’s own writings in Federalist 44, where he strenuously defends the necessary and proper clause.
The SIXTH and last class consists of the several powers and provisions by which efficacy is given to all the rest.

1. Of these the first is, the “power to make all laws which shall be necessary and proper for carrying into execution the foregoing powers, and all other powers vested by this Constitution in the government of the United States, or in any department or officer thereof.”

Few parts of the Constitution have been assailed with more intemperance than this; yet on a fair investigation of it, no part can appear more completely invulnerable. Without the SUBSTANCE of this power, the whole Constitution would be a dead letter. Those who object to the article, therefore, as a part of the Constitution, can only mean that the FORM of the provision is improper. But have they considered whether a better form could have been substituted? There are four other possible methods which the Constitution might have taken on this subject. They might have copied the second article of the existing Confederation, which would have prohibited the exercise of any power not EXPRESSLY delegated; they might have attempted a positive enumeration of the powers comprehended under the general terms “necessary and proper”; they might have attempted a negative enumeration of them, by specifying the powers excepted from the general definition; they might have been altogether silent on the subject, leaving these necessary and proper powers to construction and inference.
Had the convention taken the first method of adopting the second article of Confederation, it is evident that the new Congress would be continually exposed, as their predecessors have been, to the alternative of construing the term “EXPRESSLY” with so much rigor, as to disarm the government of all real authority whatever, or with so much latitude as to destroy altogether the force of the restriction. It would be easy to show, if it were necessary, that no important power, delegated by the articles of Confederation, has been or can be executed by Congress, without recurring more or less to the doctrine of CONSTRUCTION or IMPLICATION. As the powers delegated under the new system are more extensive, the government which is to administer it would find itself still more distressed with the alternative of betraying the public interests by doing nothing, or of violating the Constitution by exercising powers indispensably necessary and proper, but, at the same time, not EXPRESSLY granted.

Had the convention attempted a positive enumeration of the powers necessary and proper for carrying their other powers into effect, the attempt would have involved a complete digest of laws on every subject to which the Constitution relates; accommodated too, not only to the existing state of things, but to all the possible changes which futurity may produce; for in every new application of a general power, the PARTICULAR POWERS, which are the means of attaining the OBJECT of the general power, must always necessarily vary with that object, and be often properly varied whilst the object remains the same.
Had they attempted to enumerate the particular powers or means not necessary or proper for carrying the general powers into execution, the task would have been no less chimerical; and would have been liable to this further objection, that every defect in the enumeration would have been equivalent to a positive grant of authority. If, to avoid this consequence, they had attempted a partial enumeration of the exceptions, and described the residue by the general terms, NOT NECESSARY OR PROPER, it must have happened that the enumeration would comprehend a few of the excepted powers only; that these would be such as would be least likely to be assumed or tolerated, because the enumeration would of course select such as would be least necessary or proper; and that the unnecessary and improper powers included in the residuum, would be less forcibly excepted, than if no partial enumeration had been made. Had the Constitution been silent on this head, there can be no doubt that all the particular powers requisite as means of executing the general powers would have resulted to the government, by unavoidable implication.
No axiom is more clearly established in law, or in reason, than that wherever the end is required, the means are authorized; wherever a general power to do a thing is given, every particular power necessary for doing it is included. Had this last method, therefore, been pursued by the convention, every objection now urged against their plan would remain in all its plausibility; and the real inconveniency would be incurred of not removing a pretext which may be seized on critical occasions for drawing into question the essential powers of the Union. If it be asked what is to be the consequence, in case the Congress shall misconstrue this part of the Constitution, and exercise powers not warranted by its true meaning, I answer, the same as if they should misconstrue or enlarge any other power vested in them; as if the general power had been reduced to particulars, and any one of these were to be violated; the same, in short, as if the State legislatures should violate the irrespective constitutional authorities. In the first instance, the success of the usurpation will depend on the executive and judiciary departments, which are to expound and give effect to the legislative acts; and in the last resort a remedy must be obtained from the people who can, by the election of more faithful representatives, annul the acts of the usurpers.
The truth is, that this ultimate redress may be more confided in against unconstitutional acts of the federal than of the State legislatures, for this plain reason, that as every such act of the former will be an invasion of the rights of the latter, these will be ever ready to mark the innovation, to sound the alarm to the people, and to exert their local influence in effecting a change of federal representatives. There being no such intermediate body between the State legislatures and the people interested in watching the conduct of the former, violations of the State constitutions are more likely to remain unnoticed and unredressed.
Hamilton’s reply, I

- Hamilton writes a reply on the night of February 22, 1791 (at 79 3rd Street) based on necessary and proper clause: *Opinion as to the Constitutionality of the Bank of the United States*.

- Basis for a broad interpretation of government power under the Constitution by making the argument for implied powers of government.

- It is in concert with the writings in Federalist 44.

“If the end be clearly comprehended within any of the specified powers, and if the measure have an obvious relation to that end and is not forbidden by any particular provision of the Constitution, it may safely be deemed to come within the compass of the national authority...

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 include by force of the term, a right to employ all means requisite and fairly applicable to the attainment of the ends of such power;”
Hamilton bases his argument on the fiscal policy nature of the Bank; it will help with the collection of taxes through printing notes redeemable in specie and that can be used to pay taxes, it will help with the payment of the debt, and it will aid raising future debt when necessary.

“The power which can create the Supreme law of the land, in any case, is doubtless sovereign as to such case. This general & indisputable question puts at once an end to the abstract question – Whether the United States have power to erect a corporation.”

Basically, Hamilton is arguing that any power is available if not prohibited by the Constitution. This is a very elastic interpretation.

“It has been questioned by some, whether the Act of Congress, for establishing the Bank of the United States, is Constitutional; but if it is a useful means for carrying into effect any of the powers specifically vested in the government of the United States, and does not infringe the rights of any individual state or persons, on what principle can it be unconstitutional.”
Who was right?

- The dispute has an economic and a legal component.

- Giving a monopoly as the government’s fiscal agent would give the Bank an enormous advantage over competitors.

- The U.S. after Jackson and prior to the Federal Reserve Act has no national bank, yet has remarkable economic success and carries out its fiscal policies without significant difficulty.

- Southerners’ misgiving were, therefore, not totally unfounded.

- However, at the time there was not a sophisticated financial system in the U.S. so an institution like the First Bank would have been more useful than at later dates, when there existed a well developed private banking system.

- What about the constitutional issue?
Washington signs the bill on February, 25, only after being convinced it is constitutional.

Washington initially viewed the veto power as one to be used only when a law passed by Congress was unconstitutional, not for reasons concerning his agreement with the legislation.

Judicial review will not come to the fore until Marbury v. Madison (1803).

However, we can uncover how the Marshall Court would have ruled by looking at his decision in McCulloch v. Maryland (1819).
The Second Bank of the United States

- After the First Bank charts expires in 1811, a Second Bank of the United States is organized in 1816 as a government-sponsored enterprise.

- Due to experience of the War of 1812. In fact, two main proponents are southerners (Henry Clay and John C. Calhoun).

- Government gives it an exclusive charter and owns 20%. The President with the consent of the Senate appoints 5 of its 25 directors.

- Treasury keeps its deposits and specie at the Bank.

- Its notes are tender for payments to the U.S. government, which effectively makes them universally accepted.

- It also engages in commercial banking.
Maryland decides to tax the Second Bank of the United States’ notes.

Recall that the Second Bank is a fiscal agent of the Treasury.

Can a state tax an agency of the U.S. government?

Maryland argues yes because the laws to be authorized are to be “necessary and proper” for the purpose, not “necessary or proper”.

In Maryland’s view, convenience is not a justification, but must be “indispensably requisite.”

Maryland’s decision is ruled unconstitutional by the court 7-0 (only 7 justices at the time), with John Marshall’s writing the decision.
Marshall’s opinion is, in some places, almost word for word what Hamilton wrote almost 30 years prior.

Marshall rejects Maryland’s argument and indicates that convenience is a justification. Necessary implies that any means that accomplish the end are allowable. Does not mean absolutely necessary, a phrase that appears in Article 1, Section 10.

- The legislature must be able to “avail itself of experience, to exercise its reason, and to accommodate its legislation to circumstances.”
- Marshall fears that the national government will fail without being able to exert discretion, and that discretion will not undermine the enumerated powers as Madison had argued earlier.
He casually dismisses the notion that the discretion granted will jeopardize what everyone knows. “This government is acknowledged by all to be one of enumerated powers.”

In contrast to Madison who gave examples of enumerated powers that were not left to implication, he gives 3 examples of unenumerated powers: to carry mail between post offices, to punish any violations of its laws, and to require congressional oaths of office.

Of all these examples Madison would have found them easy to justify. There is a definite connection between means and ends in all of them. The power to carry mail is “incident to the nature” of enumerated powers in Article 1, Section 8, and defending its laws is incident to the ability to make them.
Marshall argues that the Bank is incidental to the furtherance of Congress’s fiscal operations.

“Let the end be legitimate, let it be within the scope of the Constitution and all means which are appropriate, which are plainly adopted to that end, which are not prohibited, but consist with the letter and spirit of the Constitution, are Constitutional.”

However, constitution is a document of enumerated powers, not enumerated restrictions.

Also, country does without a national bank from 1811-16 and from 1836-1914.
Current interpretations, 1

• How would some current originalists approach the reasoning in this decision?

• At the time “necessary” was defined as 1. needful; indispensably requisite. 2. Not free; fatal; impelled by fate. 3. Conclusive; decisive by inevitable consequence”.

• Maryland’s argument applies this meaning. It does not imply convenient or useful.

• But the Constitution also contains the term “absolutely necessary” perhaps implying that “necessary” does not imply indispensable when used by itself. As well in Article 11, Section 3 the words “necessary and expedient” are used further indicating that necessary is not synonymous with indispensable.

• But if necessary is synonymous with expedient, why use it all in necessary and expedient.
• George Mason introduces the article II language at the 11th hour with an amendment, so not a lot of thought was given to the phrase. It was also clear from earlier statements by Mason at the Convention that he equated necessary with indispensable.

• It is interesting that Madison himself rejected that necessary meant indispensably necessary because “very few acts of the legislature could be proved essentially necessary to the absolute existence of government.”

• Madison urged that the words be “understood so as to permit the adoption of measures the best calculated to attain the ends of government, and produce the greatest quantum of public utility.”

• Thus, as was argued by Hamilton, necessity should not be so strict that no statute can pass, nor so lenient that any statute can pass. An appropriate level of scrutiny is required.
Many current constitutional scholars may be interpreting Marshall’s opinion in too open ended a way. Certainly, his 1803 opinion in *United States v. Fisher* is open ended, but in *McCulloch* he is more circumspect.

- “The means chosen must be “plainly” adapted to the end, not merely conducive to it; tenuous connections to granted powers will not pass muster. It must in addition be “appropriate,” which implies some supervision of the reasonableness of the means...“

- It must not be a “mere pretext ... for the accomplishment of objects not entrusted to the government.” It must be consistent with the spirit as well as the letter of the Constitution.

However, in *McCulloch*, Marshall does make much effort to provide the scrutiny that would justify the Bank.