

European issues
n°566
07th July 2020

Dinner at Jefferson's

(or how the US created the federal public debt)

Jean-Guy GIRAUD

As negotiations on the European Union's future economic recovery plan continue, many references are being made to Europe's "Hamiltonian moment". For the first time, the European Union could supplement its budgetary resources with funds raised on the capital markets to finance grants and loans to countries affected by the crisis. Jean Guy Giraud returns in this text to the 1790 agreement between Alexander Hamilton and Thomas Jefferson on public borrowing, which helped transform the United States into a true political federation. The text contains an introductory statement by Alain Lamassoure.

Introductory words

FROM WASHINGTON TO BRUSSELS?

From day one, the constitutional history of the United States of America has fascinated the promoters of European unity. From Victor Hugo to Winston Churchill, via Altiero Spinelli imprisoned in Ventotene, the formula of the "United States of Europe" had become commonplace long before Robert Schuman's founding speech. In 2002, Valéry Giscard d'Estaing, who had been asked to preside over the "Convention on the Future of Europe", proposed to the Convention members that they take the Philadelphia Convention as a reference. Alas - or fortunately? - the road to a European political union proved to be longer and more winding than that leading to the American federation. How could the best minds in a territory then scarcely more populated than present-day Lithuania conceive of a system of government so firmly rooted in its principles and adaptable to a post-industrial superpower of 300 million inhabitants?

Without in any way diminishing the merit of the *founding fathers* of the New World, a more refined analysis leads us to put the European project back into the perspective of the long term, removing at least one inferiority complex. Contrary to Epinal's image of an ideal federation in place since 1787, despite the national unity acquired from the outset in the war of independence and despite the historical genius of the wise men of Philadelphia, it was another three quarters of a century before the United

States acquired a single currency comparable to the euro, a real Central Bank, a standing army embryo and a federal budget capable of having a macro-economic effect. In the meantime, the conditions of temperature and pressure that made it possible to move towards a truly complete federation had been met: a twenty-fold increase in population, the conquest of the West, the industrial revolution and the dreadful Civil War, from which the American Union never fully recovered.

And yet, there are sometimes striking similarities in these very different historical experiences. Jean-Guy Giraud recalls here how, as early as 1790, the very first federal budget was born out of the need to repay the debt that the thirteen impecunious States had been forced to mutualise. As a nod to history, it now appears that it is the same need to support a huge common debt after the pandemic crisis that will force Europe to finance its budget with new own resources, independent of national budgets.

A former senior official of the European Parliament, Jean-Guy Giraud remains the infallible compass of the Community's magnetic pole. A tireless watchdog, from his Occitan hideout, he measures the ebb and flow of the European wave, passes texts through his legal scanner, dissects acts that contradict the speeches, and encourages the strongest believers when the time comes for doubt. With a fine sense of staging, he helps us to feel when the wind of history is blowing. Is it a wind from old America that is coming, blowing in the opposite direction, which is suddenly shaking up a young Europe?

ALAIN LAMASSOURE

DINNER AT JEFFERSON'S (or how the US created the federal public debt)

It is 3:00 p.m. in New York City (provisional seat of Congress) on 20 June 1790. At his residence on Maiden Lane, Thomas Jefferson (*Secretary of State*) chooses the wines - French - that he will offer his guests for the most famous dinner in the history of the American federation. At 4:00 pm sharp, his only two guests introduce themselves: James Madison ("*floor leader*" of the Democratic-Republican Congress Party...) and Alexander Hamilton (*Secretary of the Treasury*). The invitation had been issued the day before during a brief unannounced meeting between Jefferson and Hamilton in front of President George Washington's residence on Broadway, a meeting recounted by Jefferson as follows: "*Going to the President's, I met Hamilton as I approached the door. His look was somber, haggard ... He asked to speak with me ... We stood in the street near the door. He opened the subject of the assumption of the States debt, the necessity of it in the general fiscal arrangement and its indispensable necessity towards the preservation of the Union ...*".[1]

The dinner and the topics of debate

The three men knew exactly which topics - seemingly unrelated to each other –the focus of their conversation would be:

- the Congress's consent to the *assumption* of state debts by the new Federal Government ("*the assumption plan*"),
- the choice of the federal capital's definitive seat.

On the second issue, Thomas Jefferson and James Madison were the plaintiffs. Since independence (1776), the seat of the Confederation's government - then of the Union (1789) – had remained provisional. The first US Congress sat in Philadelphia before moving (driven out by a mutiny of soldiers from the War of Independence claiming back pay arrears) to Princeton (NJ), Annapolis (MD), Trenton (NJ) then New York where it still sat in June 1790.

To put an end to this wandering, Jefferson and Madison wanted - pursuant to Article I, Section 8, paragraph 17 of the Constitution - to establish quickly the definitive seat of the capital on the banks of the Potomac and

near Mount Vernon, the family residence in Washington. To do so, they needed the support of the Northern States, represented by Alexander Hamilton, an elected representative of the State of New York, and grouped together in the "federalist" party of Congress.

The issue of "assumption"

Regarding the first issue – that of "*assumption*" – which is more of interest to us here, Alexander Hamilton was the plaintiff. This project - just as decisive for the future of the Federation as the choice of its capital - concerned the United States' "*public credit*". In short, the aim was to authorize the Federal Government to assume ("*assumption*" plan) the war debts of the States and the Confederation contracted with foreign government and American citizens - and to finance them with new loans taken out, this time, in the name of the new Federation resulting from the 1787 Constitution (of which James Madison and Alexander Hamilton were the main inspirers in Philadelphia).

In Hamilton's view, it was first of all necessary to remedy, as a matter of urgency, the catastrophic state of the finances of several States and of the Federation which threatened the very unity of the young Republic (and in particular the solidarity between the States of the North and the South of the Union) and to restore the indispensable political and financial credit of the Union vis-à-vis its European backers (banks and governments of England, the Netherlands and France).

But the idea was also to provide for the basis of a broad federal financial structure - the foundation of the national government's monetary and fiscal system - designed to "cement the Union" through the existence of a permanent and controlled public debt and to become "a financial tool for the development of agriculture, industry and trade" in the United States.

For Madison and Jefferson, this plan presented the risk of accelerating the creation of a powerful central administration (a "Treasury") for the main benefit of the trading and industrializing states of the North. Madison's fervent constitutional federalism made him reluctant to take steps towards the centralized organization of a federal financial power. Jefferson, on the other hand,

[1] *Diner at Jefferson's, three men, five wines and the evening that changed America* - Charles A. Cerami - Wiley - 2008

saw it as confirmation of his long-standing fears of an English style "*big government*" at the service of private interests: His scepticism was, however, tempered by his sense of responsibility towards a Government and a State of which he was - as *Secretary of State* - the third figure.

But let's get back to the dinner...

The guests arrive together and early: Madison because it has been his habit since the Convention in Philadelphia and Hamilton because he takes to heart what will be the great affair of his (short) ministerial career. Table service is provided by discreet "servants" who guarantee the confidentiality of the conversation. The menu is worthy of the reputation of Jefferson's table, whose *Francophilia* (criticized by his political opponents) and taste for French gastronomy (unanimously appreciated) are well known to American high society. The scheduling of the meal is moreover supervised by André Petit, the maître d'hôtel that Jefferson brought back from Paris as part of his retinue.

After the salads - accompanied with Château Carbonnieux blanc 1786 - a capon stuffed with Virginia ham and chestnut purée, seasoned with Calvados is served, together with a Montepulciano from Tuscany because a French wine "would have dulled the sauce". Then came a New York version of "*boeuf à la mode*", served with a Chambertin. The desserts (meringues and macaroons) are followed by a "vanilla ice cream *en croûte*", enjoyed with a precious "champagne without bubbles" of which Jefferson boasted that he was the only one to import in the "new world".

The conversation is brilliant between these three highest figures of the Republic (after, of course, the American "Commander, George Washington). It is mainly led by the ebullient Hamilton, imbued as usual by the soundness of his cause and anxious to convince his interlocutors. Madison played the role of the calm, cautious, meticulous negotiator that he had played at the Convention, which helped him rally Hamilton to his cause. The master of the house speaks little - except to comment skilfully on his culinary choices - anxious to maintain the equanimity of the remarks, but above all

aware that it would ultimately be up to him to decide the outcome of the negotiations (subject to the President's agreement) and to bear the main responsibility for this as the government's leading figure.

The topic of debate

It was positive and can be summarised as follows:

- the seat of the capital would be established on the splendid, but wild site planned on the banks of the Potomac, at the end of a period of ten years necessary for its development; in the meantime, the seat would be transferred from New York to Philadelphia (the original capital and most populous city of the United States at the time);
- regarding the "*assumption plan*", Jefferson and Madison undertook to pass through Congress the text of the "First Report on the public debt", taking into account the situation of certain states (including Virginia) which had already paid most of their debts.

The agreement was rapidly implemented:

- The "residence bill" was passed by Congress on July 10, 1790, three weeks after the "dinner". As planned, ten years later, the capital was moved from Philadelphia to the District of Columbia (DC) bordering Virginia and Maryland and incorporating the small town of Georgetown;
- the "*assumption bill*" was passed on July 18, 1790. Its adoption reassured European bankers as to the political consolidation of the young federation and its solvency. This law allowed the United States to obtain the foreign capital necessary for its development, but also to finance, in 1803, the purchase of "Louisiana" (representing in fact more than half of the current territory of the United States) sold off by Napoleon! Internally, this law ensured the development of the "Treasury Department", not without many vicissitudes due to the persistent opposition of the supporters of the States against those of the Federation, an opposition which still underlies American political life today.

DINNER AT JEFFERSON'S (or how the US created the federal public debt)

By way of conclusion, we will let the reader imagine the conversation that our three protagonists might have if they were to meet again, 220 years later, at another dinner in Washington! The current financial power of the Federation - and in particular the use of its "debt" both internally and internationally - would certainly leave them dreaming! Hence the importance of dinners in town ...

"United States then, Europe now"

In a speech delivered to the Stockholm Academy on December 8, 2011 entitled "*United States then, Europe now*"[2], American Nobel prize winner Thomas J. Sargent endeavoured to recall the main features of the creation of the United States Tax Union and to draw a parallel, if not an anachronistic comparison by nature, between the American experience at the time and the present situation in Europe[3] a parallel which became topical (again) on the occasion of the Recovery Plan launched by the Commission in spring 2020. One of the components of this plan aims to enable the launch of a major European loan to finance the economic recovery of the European Union, which has been severely affected by the consequences of the COVID health crisis.

Many references have been made to the European Union's "Hamiltonian moment". For the first time, the EU is considering supplementing its traditional budgetary resources with funds raised on the capital markets to finance grants and loans to economic operators particularly affected by the crisis. This borrowing and lending would be carried out directly by and for the European Union and managed by the Commission. The European budget would act as a guarantee and service the repayments, which would be financed by new tax revenues. However, without going into the details of the American and European mechanisms, we would like to outline some particular characteristics of the former while leaving the reader free to draw possible analogies with the latter.

"A plan, not a plot"

First of all, it should be noted that Hamilton's initiative actually had a greater purpose: that of enabling "the

concentration of governmental authority and the industrialisation of the United States"[4]. This vision and plan was based more on rational economic reasoning than on some kind of political scheme to ensure the supremacy of federal power. The restoration of "*public credit*" through the centralisation of financial resources was mainly intended to enable the subsidisation of the economic recovery and then the development of the American Union - according to a plan also devised by Hamilton : the "*Report on Manufactures*" which - although initially postponed by the Congress in 1791 - was finally implemented at a later date.

Thus, the "*assumption*" of debts was only the first step in a broader process: the Federation had to acquire a borrowing capacity to repay its debts and assume new ones, which implied successively the creation of a federal "Treasury" to manage them, a central tax system to ensure their financing, the creation of a common national denomination (currency), a Central Bank to regulate this currency, etc. The Federation was also obliged to create an "*assumption*" of debts, which was the first step in a broader process. All these steps were finally taken only after great difficulty and rather belatedly, especially after the end of the Civil War. In fact, the progressive construction of the Fiscal Union was not a long, quiet process.

More specifically with regard to the Federation's borrowing capacity, it should be recalled that the new Constitution prohibited the states from taking on debt (which later led them to impose a rule of annual budget balance) - but did not formally allow the Federation itself to take out loans. It took a Supreme Court ruling in 1837 to recognize that "*because the Congress had the power to pay debts, it could do so by any means not expressly prohibited by the Constitution ... included the power to issue obligations in any appropriate form*"[5].

"A regular and adequate supply of revenue"

Finally, Hamilton wanted a broad development of the Union's fiscal power far beyond the need to finance loans alone. Under the "Articles of the Confederation", the central power was only financed by contributions - uncertain and late - from the States. Hence, "*their right to question the propriety of the demand has*

[2] Sargent, Thomas J. 2012. *United States then, Europe now*. Nobel Prize Lecture.

[3] For a wider vision of the comparison between European and American federalism, see "*Des Etats-Unis d'Europe - réflexions imaginaires de James Madison*", Jean-Guy Giraud, 2013

[4] Miller John C.. *The Federalist Era 1789-1801*. Waveland Press, 1960, p.63

[5] Sargent, Thomas J. 2012 p.22. *United States then, Europe now*. Nobel Prize Lecture.

been constantly exercised and would continue to be so, as long as the revenues of the Confederacy should remain dependent on the intermediate agency of its members"[6].

For Hamilton, this dependence was incompatible with the proper functioning of the Federation: "A complete power to procure a regular and adequate supply of revenue, as far as the resources of the community will permit, may be regarded as an indispensable ingredient in every constitution" (5). Adding that the limitation of central fiscal power "would leave the general government in a kind of tutelage to the States governments, inconsistent with every idea of vigor and efficiency"[7]. For this reason, the new Constitution resulted in a tight limitation of the states' fiscal capacity and a considerable strengthening of the Federation's fiscal capacity. Thus, its Article I - Section 8 provided that "the Congress shall have power (...) to lay and collect taxes (...) to pay the debts and provide for the common defence and general welfare of the United States".

More specifically with regard to the Union's credit in the capital markets, Hamilton considered that "the power of creating new funds upon new objects of taxation by its own authority would enable the national government to borrow as far as its necessities would require". He added that "to depend upon a government that must itself depend upon thirteen governments for the means of fulfilling its contracts (...) would require a degree of credulity not often to be met with the pecuniary transactions of mankind[8]"

"It was all about power"

More generally, it should be noted that the "assumption plan" was only one element of a wider debate: that of seeking a new balance between the thirteen States and the new Federation: "It was all about power. Under the guise of doing the states a favor by assuming their debts, the federal government was implicitly, even coverly, assuming sovereign authority over the economies of all the states"[9]. A debate mainly opposing the

commercial and industrial states of the North to the agricultural states of the South. A division embodied by the two major parties represented in Congress ("Federalists" and "Democratic Republicans", also called "Nationalists") and personalized by the two great architects of the Constitution: the "Northerner" Hamilton and the "Southerner" Madison, supported by the other Southerner Jefferson.

"Necessary and proper"

Finally, it might be useful to recall two of the key provisions of the 1787 Constitution which finally allowed the "federalists" to gradually carry out their undertaking.

The first is that of the clause relating to implicit powers ("necessary and proper") of the Federation: article 1 section 8 of the Constitution provides that "the Congress shall have power (...) to make all Laws which shall be necessary and proper for carrying into execution (...) all powers vested by this Constitution in the Government of the United States".

This provision has been frequently used - under the control of the Supreme Court's interpretation - to strengthen federal competences and powers, in particular vis-à-vis the States. It has been a major tool of a constitutional nature in the development of the Union's financial capacities as mentioned and, ultimately, far beyond them.

The majority rule

But the clause "necessary and proper" has only been effectively exercised due to another basic rule established by the Constitution: that of majority decision within the federal power - in this case, Congress. Under the Articles of Confederation, the main decisions required the unanimous agreement of each State represented in the "Assembly of delegates" which therefore enjoyed a right of veto. This situation - which was a constant stumbling block - led Hamilton to note dryly that: "the concurrence of thirteen distinct sovereign wills is requisite under the Confederation to the complete execution of every important measure

[6] Federalist Papers. N°30.

[7] Ibid.

[8] Ibid.

[9] Ellis Joseph J. 2002 p.58. Founding Borthers. Random House.

DINNER AT JEFFERSON'S (or how the US created the federal public debt)

that proceeds from the Union. It has happened as was to have been foreseen: the measures of the Union have not been executed"[10].

On the contrary, the new Constitution abolished this right by providing that all decisions of the Congress would be taken by a majority of both Assemblies - a majority that was sometimes reinforced in certain cases. It also provided that the Constitution itself could be amended as it was adopted, i.e. by a reinforced majority of the member states (at the time nine out of thirteen). On this point, Hamilton notes that the abolition of the unanimity rule was, in fact, little contested during the Convention and ratification and he considers that this acceptance *"can only have proceeded from an irresistible conviction of the absurdity of subjecting the fate of twelve states to the perverseness or corruption of a thirteenth"*[11].

[10] *Federalist Papers*. N°15.

[11] *Federalist Papers*. N°40.

[12] *Preamble of the Lisbon Treaty*.

[13] *Letter from Benjamin Franklin to M. Grand, 22 October 1787. Documentary History of the Constitution of the United States, Department of State, IV (1905).*

In his 2011 article, Thomas J. Sargent - while insisting on the obvious differences in historical, social, political, etc. contexts between yesterday's American experiences and Europe's contemporary situation - believes, however, that it would be possible for Europe to *"to draw lessons from the story about how the US created a fiscal union"*. America's long quest *"for a*

more perfect economic Union" could indeed - beyond the financial issues - inspire European leaders in the crisis and the economic transition they have to assume together.

Although it is not certain that they can find such a visionary inspirational figure as Alexander Hamilton, let us hope that his thoughts and ideas - in the permanence of their logic - will help them to overcome this ordeal and this stage in the construction of the European economy of *"an ever closer Union among the peoples of Europe"*[12]. And that - *mutatis mutandis* - they at least bear in mind the remark made by Benjamin Franklin to one of his European correspondents at the time: *"I do not see why you might not in Europe carry the Project of good Henry the 4th into Execution, by forming a Federal Union and One Grand Republic of all the different States and Kingdoms by means of a like Convention, for we had many interests to reconcile"*[13]

Jean-Guy GIRAUD

Former President of the Union of
European Federalists - France.

You can read all of our publications on our site :
www.robert-schuman.eu

Publishing Director : Pascale JOANNIN

THE FONDATION ROBERT SCHUMAN, created in 1991 and acknowledged by State decree in 1992, is the main French research centre on Europe. It develops research on the European Union and its policies and promotes the content of these in France, Europe and abroad. It encourages, enriches and stimulates European debate thanks to its research, publications and the organisation of conferences. The Foundation is presided over by Mr. Jean-Dominique Giuliani.