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Annotation:

The most pressing problems facing the new government were economic. As a result of the Revolution, the federal government had acquired a huge debt: \$54 million including interest. The states owed another \$25 million. Foreign credit was unavailable.

Ten days after Alexander Hamilton (1754-1804) became Secretary of the Treasury, Congress asked him to report on ways to solve the nation's financial problems. Hamilton immediately realized that he had an opportunity to create a financial program that would embody his political principles. Born in the West Indies, Hamilton never developed the intense loyalty to a state that was common among Americans of the time. He intended to use government fiscal policies to strengthen federal power at the expense of the states and "make it in the immediate interest of the moneyed men to co-operate with government in its support." Such an alliance, in his view, was indispensable for the survival and growth of the United States.

In his "Report on Public Credit," Hamilton proposed that the government assume the entire indebtedness of both the federal government and the states, and retire the old depreciated obligations by borrowing new money at a lower interest rate. This proposal ignited a firestorm of controversy since the states of Maryland, Pennsylvania, North Carolina, and Virginia had already paid off their war debts and saw no reason why they should be taxed to pay off other states' debts. Others opposed the scheme because it would provide profits to speculators who had bought bonds from revolutionary war veterans for as little as 10 or 15 cents on the dollar.

For six months, bitter debate raged in Congress, before Hamilton approached Thomas Jefferson with a compromise proposal. In exchange for southern votes on his debt plan, Hamilton promised his support for locating the future national capital on the banks of the Potomac River, the border between two southern states, Maryland and Virginia.

In the following letter Roger Sherman (1721-1793), a member of Congress from Connecticut and the author of "the Connecticut Compromise" at the Constitutional Convention, explains why he supports Hamilton's policy on the debt and outlines the ideal relationship between federal and state governments.

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The report of the Secretary [Hamilton] has been under consideration for some time respecting a provision for the national debt. There has been a long debate respecting a discrimination between the Securities in the hands of the original creditors and those which have been transferred [i.e., bought up by speculators]--but it was finally decided by a large majority against a discrimination, the motives were that the Securities were by government made transferrable, & payable to the bearer, and therefore the transfer vested the whole property in the purchaser, if there were no fraud or compulsion.... No common market price could be fixed without great inequality & injustice in many instances, and a particular inquiry into the circumstances of every case would be impracticable; besides the public faith had been pledged after the transfers in most of the cases of speculation by issuing new securities to the purchasers in their own names. It was therefore concluded that government could do nothing to impair or alter the contracts consistent with good faith. The assumption of the debts of the several states incurred for the common defense during the late war, is now under consideration. The Secretary of the Treasury has been directed to report what funds can be provided for them in case they should be assumed. His report is contained in one of the enclosed papers. He supposed that sufficient provision may be made for the whole debt, without resorting to direct taxation, if so I think it must be an advantage to all the states, as well as to the creditors. Some have suggested that it will tend to increase the power of the federal government & lessen the importance of the state governments, but I don't see how it can operate in that manner, the constitutions are so framed that the government of the United States & those of the particular states are friendly, & not hostile, to each other, their jurisdictions being distinct, & respecting different objects, & both standing upon the broad basis of the people, will act for their benefit in their respective spheres without any interference. And the more strength each have to attain the ends of their Institutions the better for both, and for the people at large.

I have ever been of opinion that the governments of particular States ought to be supported in their full vigour, as the security of the civil & domestic rights of the people more immediately depend on them, that their local interests & customs can be best regulated and supported by their own laws; and the principal advantages of the federal government is to protect the several States in their enjoyment of those rights, against foreign invasion, and to preserve peace, and a beneficial intercourse between each other, and to protect & regulate their commerce with foreign nations.

Source: Gilder Lehrman Institute