CHAPTER 1

A New Merchant Class

Self-Made Businessmen

From America's Independence to about 1840, the United States experienced a period of substantial economic growth. Economic historian Richard Sylla has called it the beginning of 'modern economic growth'. He argues that from 1650 to 1900, the United States had a relatively sustained total product growth of three to four percent per year. Before 1776 the rate was often the result of population increases, which were around three percent per year with a growth of 0.3 to 0.5 percent in product per person. After 1840, population growth was at two percent with a 1.5 to 1.6 percent product growth per person per year. By 1840, the gross national product per capita in the United States was 40 to 65 percent larger than that of European countries such as France and approaching that of Great Britain. Between 1776 and 1840 changes happened that radically transformed the economic landscape of the country. Old colonial institutions were replaced with new ones, paving the way to as Sylla calls it, a 'modernized financial system.'

Historian Robert E. Wright considers the economic changes happening between 1787 and 1800 a 'financial revolution'. Much of the development was a result of Alexander Hamilton's fiscal and financial policies that were optimized to support America's business community. According to Wright, entrepreneurs found themselves struggling with a variety of obstacles during colonial times. A high fluctuation of money supply, a shortage of specie and volatile interest rates, as well as information asymmetries made it difficult for merchants to pursue stable business enterprises. As there were almost no formal financial intermediaries, it was close to impossible for smaller merchants, who could not

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2 Sylla, 'Financial Innovation and Adaptation', p. 231.
As Secretary of Treasury, Hamilton pursued financial and fiscal reforms in the 1790s that helped to create economic stability. These reforms were the fixing of the national debt, the establishment of a national bank, and the diversification of the economy. Hamilton, whose background had acquainted him with international trade, regarded the stimulation of commerce as a prime motor for the nation’s well-being. He favored a diversified economy that was not only based on agriculture but also to a large extent based on manufacturing and global trade.\(^7\)

Hamilton made three reports to Congress in the 1790s, which illustrate that the stimulation of commerce was his prime objective to achieve economic prosperity. In the First Report on Public Credit of 1790, he detailed his plan to restructure the nation’s debt by issuing long-term, interest paying, and negotiable government bonds. The bonds, thought Hamilton, would create an atmosphere of security and reliability for the country’s business community, which was in desperate need of a steady capital supply. The establishment of the national bank, expressed in the Second Report on Public Credit in 1790, helped consolidate the debt plan by facilitating the circulation of government funds. It introduced a financial service sector to the public replacing the dependence on informal intermediaries for credit supply and served as a source for the government to obtain money in case of emergencies. After convincing President Washington of the constitutionality of such a bank, Hamilton saw the First Bank of the United States chartered in 1791. In his third report in 1791, Hamilton laid out his vision of a diversified economy based on agriculture and manufacturing in opposition to Thomas Jefferson’s agrarian economy. The report lists the benefits that manufacturing provided society by way of increasing employment and stimulating commodity exchange. The advancement of manufacturing, Hamilton argued, should be achieved through government encouragement like bounties to industry and moderate tariffs. Hamilton favored a strong national government whose policies could encourage and facilitate national commerce. In his understanding, economic prosperity and political stability were dependent on each other. Hamilton’s plans were successful; by 1800 the United States had a single national money supply that was based on a specie standard. A broad class of people invested in joint stock companies that

\(^6\) Wright, *Hamilton Unbound*, p. 36.