

Primary Investigative Question

How has fiscal policy strengthened or weakened a country as it tries to compete in a global economy?

Contextual Essay

How will the US Government respond to our current economic struggles? What fiscal policies will future generations examine and deem successful or as failures in helping us emerge once again as a major player in the world economy? Investing in business here and abroad, tax increases or reductions all have opponents and proponents. When individual governments make fiscal policy decisions in a global economy, implications are both national and international. Changes may occur that impact the economic welfare of the citizens of the country making the decision and the citizens of a country half way around the world. People often talk about the economy and government spending as if it was a 20th century problem but the US government has almost always operated with some debt, and consequently, tried to find ways to raise money. In fact, more than fifty five thousand dollars of the current national debt can be traced back to the Revolutionary War and has been merged under “old debt.” (Anderson, page 63). The fiscal policy decisions made by our founding fathers in response to the Revolutionary War Debt during the 1780s and 90s have implications for how our current leaders should respond to our debt today.

The United States of America has been borrowing, taxing and investing for quite a long time, all three revenue producing methods have risks associated. Risks and rewards of investing can be seen in the case of colonization of the America’s prior to

the Revolution. Some European countries were widely successful, some devastatingly unsuccessful. Scotland's attempt at colonization in 1699 is an example of an unsuccessful investment and the consequences that followed demonstrate how a country may be forced to respond in the wake of unimaginable economic disaster. Events in our history have demanded much debt accrual, others minimal. In either case, how the US or any country responds to debt has consequences nationally and internationally.

At the time of the ratification of the constitution, the debt accrued by the US in waging the war for independence was more than 54 million dollars. (Alexander Hamilton, Report on the National Credit, 1790). This debt or financing of the war had been carried on by two levels of government, state and national. The debt itself was the result of money borrowed by states and the national government from private citizens and foreign countries.

Although a major concern of the founders, payment of the debt was impossible because of the limitations the confederate system of government initially designed. The financial climate during the 1780's in the new country was one of chaos and uncertainty. For example, the state debts were for a time, absorbed by Congress. Congress however, was soon unable to pay the soldiers, and was humiliated when the states began paying back debt clearly their responsibility. It was not until Alexander Hamilton's complicated fiscal plan passed through Congress that the federal government assumed the state's war debts once and for all.

There was still the issue of the foreign debt. Congress had no money and suspended its payments on loans to Spain and France. The Articles of Confederation denied the power of direct taxation, "all charges of war and all other expenses that shall

be incurred for the common defense or general welfare” were to be “defrayed out of a common treasury, which shall be supplied by the several states, in proportion to the value of the land within each state” and could be “laid and levied by the authority and direction of the legislatures of the several states. (A Companion to the American Revolution, Becker, pg 389). This flaw within the Articles was something many nationalists (advocates of a strong national government) believed would have to be remedied if the new country was to emerge on the global scene a strong, financially independent country. Nationalist Robert Morris, a wealthy Philadelphia merchant, was chosen by Congress to run the new Department of Finance. Morris argued that the only way the destitute states and federal government could repay the national debt would be to give Congress the power of taxation. In 1783, he helped propose an amendment to the Articles that altered the method for calculating each states share of the national expenses from the value of the land formula to apportionment based on population. With the war now over, the states no longer had a common goal of defeating the British, thus the state legislatures failed to ratify the amendment..

Alexander Hamilton, another leading nationalist at this time, was a bit more radical in his approach to increasing the central governments power of taxation. He proposed a convention to draft a new framework for a national government. In 1780, in a letter to James Duane, he espouses on what he believes to be the problems of the current system and writes

“The confederation too gives the power of the purse too entirely to the state legislatures. It should provide perpetual funds in the disposal of Congress--by a land tax, poll tax, or the like. All imposts upon commerce ought to be laid by

Congress and appropriated to their use, for without certain revenues, a government can have no power; that power, which holds the purse strings absolutely, must rule. This seems to be a medium, which without making Congress altogether independent will tend to give reality to its authority.(
<http://press-pubs.uchicago.edu/founders/documents/v1ch5s2.html> Letter from Hamilton to Duane, 1780).

Morris, Hamilton and their contemporaries understood that payment of the debt was essential for the new country's future. After all, what nation would loan money or engage in trade with the US if it reduced or did not pay its current debt? The solution to financing this important revolution turned out to be the product of another, secret revolution. The founders met, in secret, to revise the Articles of Confederation, and instead, wrote The United States Constitution. The first power given to Congress in Article I is the power of direct taxation, taxes to be collected to pay the debt and ultimately solidify our place on the world economic scene.

Alexander Hamilton, now our first Secretary of Treasury, saw the national debt as a "national Blessing" since it created a group of powerful people, public creditors, that now had a vested interest in seeing the new government succeed. (Ferguson, page 60). Thomas Jefferson opposed this view and believed the national debt should be paid immediately. Ultimately, it was the disagreement about the national debt that led Jefferson and Hamilton's other political enemies to unite and form a new political party, one to be later known as the Democratic Party. All things considered, the Constitution was written in part as a result of the new country's need to be able to tax and raise the money to pay back the debt incurred by the Revolution. The founding fathers needed to

raise revenue to pay the national debt, they could not borrow. The way they choose to make this happen was to increase the power of the national government, allowing for direct taxation.

Investment is another way to increasing government revenue. Between 1500 and 1800, the Kingdoms of Spain, Portugal, Great Britain and France as well as the Dutch Republic each sought to accumulate wealth through advantageous overseas trading arrangements and colonies, while thwarting the ambitions of their rivals to do the same. (AOTWS, Shammass page 3) The Kings and Queens of these countries risked the money of their subjects and reaped the rewards as their wealth, empire and power grew. The Company of Scotland trading to Africa and the Indies owed its origin to the desire of the Scots to enjoy economic advantages similar to those possessed by other nations of Europe. (the Darien Scheme, The University of Glasgow, Spencer collection). Private and government investors invested in the company which was to make Scotland rich.

The first ship set sail for the Ithumus of Panama in July of 1689. Initially, the settlers made a smooth start and began establishing their colony with little problems. William Patterson, the successful London banker in charge of the company, wrote to the Board of Directors asking for second ship with additional supplies be sent. Just before the second ship departed, rumors about trouble in the colony began to circulate. The summer season met the colonists at Darien, disease and starvation took their toll. At the same time, The King of England ordered the English colonists not to assist the Scots at all. A Proclamation issued by the governor of Jamaica is the only one that still exists, however all the governors were known to have been sent the message. With natural forces working against them as well as conflict with unfriendly neighbors, the Darien

colony was abandoned by the original settlers. When the second ship landed they found none of the original settlers, their worst fears were realized. No official record remains of how many original Darien settlers made it back to England, one account estimates less than 30. The shock of failure stung the people of Scotland. Between one between a quarter and a sixth of the nation's capital had been sunk in the venture (Darien and The Union, National Library of Scotland, Scotland pages (<http://www.nls.uk/scotlandspages/timeline/1700.html>). The debt was viewed as too large to overcome by the Scottish Parliament and convinced large numbers of Scotsmen, who had resisted marriage with England for over a century, that the only way for the country to prosper would be to join. The Darien Scheme is seen as a contributing factor in the Union of Parliaments, the joining of the British and Scottish Parliaments in 1707 and the formation of the United Kingdom.

America became a strong, financially independent country as a consequence of being able to tax its citizens and pay back its debt; the result of the fiscal policies of the time was our emergence on the world stage as a strong, economic partner in commerce. The exact opposite is true of the fiscal policy decisions made by Scotland after the failure of Dairen. Both countries, at a crossroads in their national history, decide on two different fiscal strategies as the major component of their fiscal policy, with two drastically different results. Scotland lost its national identity after a bad investment and emerged as part of the Untied Kingdom. History teaches us to look back and learn from the fortunes and misfortunes of the past. What can the United States learn about fiscal policy and responding to debt from these two case studies? Should the government make a risky investment or raise taxes? Whichever path the US takes in her fiscal policy

decisions, one thing the past has taught us will be certain, the ramifications will be both domestic and global.

Annotated Bibliography

Secondary Sources

Anderson, William, *The Price of Liberty: The Public Debt of the American Revolution* (UVA, 1983). Alderman HJ247 . A63 1983

This is a detailed account of how the federal and state governments during the revolution and post revolution borrowed and tried to pay back the national debt.

Taylor, Alan. *American Colonies* (Viking, 2001), especially chapter 13. Clemons E188. T35 2001.

The Darien Scheme. (1685). Glasgow University Library, The Spencer Collection. Retrieved from <http://special.lib.gla.ac.uk/exhibns/month/may2005.html> in [October 2009](#).

This is the title page for a special collection of original documents, books and pamphlets on the Darien Scheme. It gives a brief, concise history of the scheme and its consequences.

Becker, R. (2000). Currency, taxation and Finance, 1775-1787. In J. Greene and J.R.Poole (Ed)., *A Companion to the American Revolution* (pp-388-397). Massachusetts. Blackwell Publishers.

The chapter in this book that details the ideas to pay back the national debt after the American Revolution. Is clear on the fact that only taxation held the hope of really putting American on its feet and paying back the debt. Changing the AOC was essential to do this.

Kaplanoff, M. (2000). The Federal Convention and the Constitution. In J Greene and J.R. Poole (Ed)., *A Companion to the American Revolution* (pp- 471-480). Massachusetts. Blackwell Publishers.

This chapter uses the lens of finance and economic decision making to frame the decisions made at the Constitutional Convention. Background for Hamilton's ideas is also included. Other decisions of the convention are discussed.

Shammas, Carole. (2008). America, The Atlantic, and Global Consumer Demand, 1500-1800. Gary W. Reichard and Ted Dickson (Ed)., *America on the World Stage A Global Approach to U.S. History*. Chpt 3. University of Illinois Press, Chicago.

Primary Sources

Adams, John. (1783). *A letter from John Adams to Abigail Adams 7 September 1783*, Massachusetts Historical Society.
<http://www.masshist.org/digitaladams/aea/cfm/doc.cfm?id=L17830907ja&numrecs=20&archive=letter&hi=on&mode=&query=loan%20&queryid=&rec=11&start=11&tag=text#firstmatch>

This is a letter from John Adams to Abigail emphasizing the importance of securing a loan from Holland to help pay back the debt after the Revolution. It shows that the founding fathers were searching for other means of financing the war since there was no power of taxation in the Articles of Confederation.

Adams, John. 1781. *Founding Families: Digital Editions of the Papers of the Winthrops and the Adamses*, ed.C. James Taylor. Boston: Massachusetts Historical Society, 2007.
<http://www.masshist.org/ff/>

In this letter from Adams to the President of Congress, he is very discouraged to report back to Congress that he has been unable to secure a loan in Europe, in part because the countries do not want to appear on the opposite side of England. He also writes of our ability to pay back what has previously been borrowed. It is important because it shows that the US needed another method to raise money to pay back the war debt.

Adams, John. 1781. *Founding Families: Digital Editions of the Papers of the Winthrops and the Adamses*, ed.C. James Taylor. Boston: Massachusetts Historical Society, 2007.
<http://www.masshist.org/ff/>.

In this letter to Congress, Adam gives specifics on the loans and taxes he estimates will be needed to support the country and pay back the debt. It shows that the founding fathers were searching for other means of financing the war since there was no power of taxation in the Articles of Confederation.

By the United States Congress Assembled, February 17, 1783. Library of Congress.
[http://memory.loc.gov/cgi-bin/query/r?ammem/bdsbib:@field\(NUMBER+@od1\(bdsdcc+08501\)\)](http://memory.loc.gov/cgi-bin/query/r?ammem/bdsbib:@field(NUMBER+@od1(bdsdcc+08501)))

This is a broadside issued by the US Congress during the time of the Articles of Confederation. It announces the taxes of luxury products specifically the new

taxes on rum. It fits into the module because it illustrates an attempt by the government under the Articles of Confederation to raise money for the public debt after the Revolution.

Bingham, Hiram. Virginia Letters on the Scots Darien Colony, 1699. *The American Historical Review*, Vol. 10, No. 4 (Jul., 1905), pp. 812-815. American Historical Association
URL: <http://www.jstor.org/stable/1834477>

The King of England sent letters to all of the governors of the colonies in North America. The British colonists were ordered not to help the Scots settling in Darien. Without help from neighbors, the Darien Colony failed. The debt accumulated is viewed by many as the reason Parliaments of the two countries joined in 1707. It is important because it is evidence as to why Darien was a risky investment and illustrates one of the reasons it failed.

Burton, John H. (Ed.) *The Darien Papers: Being a Selection of Original Letters and Official Documents*. 1848. The Bannatyne Club. Retrieved from
<http://www.archive.org/stream/darienpapersbe9000compuoft#page/n9/mode/2up>

This collection of original papers contains letters from William Patterson, the architect of the Darien Scheme as well as detailed accounts of subscriptions and payments. It documents the entire scheme, from beginning to end. This was an invaluable source.

Hamilton, Alexander. U Harold C. Syrett et al (Ed). *The Papers of Alexander Hamilton*. Chapter 5, document 2, Deficiencies of the Confederation. University of Chicago Press. Retrieved from
<http://prespubs.uchicago.edu/founders/documents/v1ch5s2.html>

This excerpt is from a letter written by Alexander Hamilton to James Duane. In it, Hamilton is explaining what he believes are the weaknesses of the Articles of Confederation. He states that until the federal government should have the power of taxation, specifically Congress. It is important because it states that some were thinking that the Articles of Confederation would need to be rewritten.

Hamilton, Alexander. Syrett, Harold C (Ed). *First Report on the Public Credit, The Papers of Alexander Hamilton*, vol. 6, Columbia University Press. Retrieved from
http://www.wwnorton.com/college/history/archive/resources/documents/ch08_02.htm.

Alexander Hamilton's first report on the public credit was the first official account of the debt after the Constitution was written. This was the first part of his financial program that was adopted by Congress while he was Secretary of the Treasury. This is an official account of how much debt the US had at the end of the Revolutionary war.

Shields, Alexander. (1699). Letter from on board the Rising Sun in Calendonia Bay, The "Sheilds Letters", The National Library of Scotland. Wod.Qu.XXX, <http://www.nls.uk/scotlandspages/timeline/1699.htmlff.252-3>.

This is a letter from one of the passengers on the second expedition to Darien. It documents what the second ship found when they arrived at Darien, that the colony had been deserted. It is important because the students can use it to get a first hand account of how desperate the situation was for the Scottish people because of this crisis.

The Darien Scheme. (1685). Glasgow Univeristy Library, The Spencer Collection. Retrieved from <http://special.lib.gla.ac.uk/exhibns/month/may2005.html> in October 2009.

This is the title page for a special collection of original documents, books and pamphlets on the Darien Scheme. It gives a brief, concise history of the scheme and it's consequences. It is important because it tells the entire story of the scheme and it's aftermath.

R. G. Thwaites, R. G. *A Letter of Marshall to Jefferson, 1783* The American Historical Review, Vol. 10, No. 4 (Jul., 1905), pp. 815-817 Published by: American Historical Association <http://www.jstor.org/stable/1834478>

This is a letter from a British Politician, James Vernon, Secretary of State under William the III. He is explaining to the Governor of Maryland that the King William does not want any help or support given to the Scots who are trying to establish a colony in Darien, present day Panama. Similar letters were sent to all the colonial governors, Proclamations were issued in Jamaica and Barbados. The Scots later blame the failure of the venture on the King of England.