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What Alexander Hamilton Would

Think of Today's National Debt

The man who argued for national debt, and who created it, might be horrified

BY RICHARD SYLLA

AS THE

first secretary of the Treasury, Alexander Hamilton helped establish the credit of the U.S. government, making it a trusted borrower at home and abroad.

What we've done with that trust might appall him.

Over two centuries, the money we borrowed funded many of the biggest developments in our nation's history. But we stopped paying it back and kept borrowing more, with no workable plan in place for repaying it. Our federal debt now stands at \$37 trillion, with no end in sight.

(1)

As our unpaid bills keep piling up, long-term interest rates rise, and the dollar loses value in domestic and international markets, our financial system is looking shaky. We should pay attention to what Hamilton tried to teach us about borrowing responsibly before it is too late.

Planning for the worst

I believe Hamilton would be disgusted at our current situation, but he wouldn't be entirely surprised. Racking up huge debts, he wrote, was "perhaps the NATURAL DISEASE of all governments; and it is not easy to conceive anything more likely than this to lead to great & convulsive revolutions."

Hamilton realized the instinct to borrow runs deep, as people clamor for more government spending while clamoring against any new taxes to pay for it. "These contradictions are in human nature," he wrote. As a consequence, "the public Debt swells 'till its magnitude becomes enormous, and the Burthens [burdens] of the people gradually increase 'till their weight becomes intolerable." Clearly, "there can be no more sacred obligation, then, on the public Agents of a Nation than to guard against so mischievous a result."

Little wonder that Hamilton's work is full of warnings about borrowing heavily—and how to avoid the disasters that come with it.

His strategy was seemingly simple and obvious: Any time the government authorized more borrowing, he argued, it should also institute tax increases to pay the interest on the money borrowed (at very least). If we kept to this discipline, our federal government's credit in domestic and international markets would be sustained forever. Public credit would be, as Hamilton termed it, "immortal."

Setting up a new model

In fact, establishing public credit became the linchpin of Hamilton's plan to modernize the U.S. financial system.

He was working with a congressional mandate. Lawmakers had tasked him with rescuing the country from bankruptcy and devising a national currency. The previous Confederation Congress and many states had not paid their debts incurred during the War of Independence, or even the interest on them. States had also issued their own depreciating fiat currencies.

In 1790 and early 1791, Hamilton produced strategies to remake—if not create from scratch—the nation's financial infrastructure. Consider this: In 1789, the U.S. had essentially no banking system to create credit, no national currency that held its value and no securities markets. By the time Hamilton left office in 1795, the nation had all of those and more.

For one, Hamilton recommended restructuring the old, unpaid debts, including war debts of the states, into new issues of Treasury bonds. Tax revenue would give the U.S. government the means to pay the interest, and possibly even the principal. He also pledged that federal creditors would get priority in government spending.

Congress enacted the essence of Hamilton's plan in the summer of 1790. By the following year, the main issues of federal debt were selling above their face value— and the modern Treasury-bond market was born.

Hamilton next asked Congress to establish a national bank, aiding public finance and creating a national banknote currency. Hamilton had the federal government take a 20% ownership interest in the bank, saying it would become a profitable investment (it did). The new U.S. dollar was defined by specific weights of silver and gold. The currency held its longterm value well into the 20th century, when its ties to precious metals were severed.

Building the system

State governments and private actors, responding to Hamilton's initiatives, completed the financial system. Starting in the 1790s, legislatures began to charter more banks, often taking equity stakes in them, while private entrepreneurs applied for corporate charters. Some of them also organized securities markets to give liquidity to all the new federal,

state and corporate securities. One famous example: In 1792, New York brokers met under a buttonwood tree in Wall Street to found the forerunner of the New York Stock Exchange.

All of these changes enabled U.S. economic growth and helped make us the richest and most powerful nation in history. Thanks to Hamilton's financial revolution, the federal government always had access to credit required to finance America's wars and its territorial acquisitions, starting with the Louisiana Purchase in 1803. State and local governments could raise the credit required to finance urban and rural infrastructure, among other things.

In the private sector, American businesses were able to tap bank, bond and equity financing to fund transportation, industrial and digital revolutions. And in time individual Americans gained access to the credit they needed to finance homes, cars, college educations and so on.

For almost two centuries, it worked. Over U.S. history, the rapid growth of the economy generated enough increases in tax revenue to cover peacetime government spending and devote excess revenue to pay down the national debt. Then, late in the last century, we took a disastrous turn: In the 1980s, we boosted spending immensely—but refused to raise taxes to match.

By 1981, federal debt reached \$1 trillion for the first time, but that was only 31% of GDP. By 1990, the debt tripled, rising to 54% of GDP. Now the debt is \$36 trillion higher, and the ratio is around 120%.

It is a miracle that we stayed so responsible for so long. We didn't always follow Hamilton's maxims exactly, but we were disciplined enough to avoid longlasting damage. Now, of course, we have drifted off with no evident signs of changing course. And, as Hamilton predicted, alarm bells are ringing.

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