The Credit System vs. Speculation:

Nicholas Biddle and the Second Bank of the United States

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Part 2 of 4

1. Speculators Take Over

Unfortunately, the vast majority of Congressmen who were ignorant of the relation of the Bank to their districts were, as Mathew Carey put it, *"liable to be bewildered and led astray—to be instrumental in dashing the bark of public credit upon rocks and quicksands—and producing an awful scene of destruction."*, they rushed headlong into the trap set for them, and the effects of which Biddle, Carey, and others had warned, of letting the Bank expire, were as bad as predicted.

The removal of a massive amount of credit was replaced with numerous other state banks lending more than prudence allowed, and, aided by outright speculation, a situation ripened where a nation abounding in patriotism during the war, and full of resources, had a government that was bankrupt, for the want of an institution that would facilitate government loans and other Treasury operations.

The American Founders designed the Bank of the United States to manage the Constitutional credit system. The Second Bank of the U.S. (above) was chartered by Congress in 1816.

By attempting to supply the enormous vacuum created by the lack of the Bank and simply profiting from lack of regulation, the state banks augmented the total circulation of paper by over one half during and after the war with Great Britain, which diminished the value of the circulation by more than one third. While many banks attempted to curtail loans to prevent the inability to provide specie for those seeking to redeem their notes, in the summer of 1814, all the banks south and west of New England finally suspended the payment of specie as the only mode of keeping their circulation at an amount at all proportional to the demands of their customers.

The failure of numerous banks which had been puffed into a factitious credit without any substantial basis to redeem their bills, was later commented on by a merchant in Charleston: "If we look back to what took place... we shall see the grossest impositions committed by banks, commencing with a few thousand dollars in specie... and after getting their bills into circulation, blowing up, and leaving the unsuspecting planter and farmer victims of a fraud, by which they were deprived of the hard earnings of years of honest industry."

In addition to the general depreciation of the currency due to an over issuance of state bank paper, without a unified national currency of Bank of United States notes, there was also a *relative* depreciation of different currencies of the states ranging from 5-25%.

A merchant doing business between states was compelled to resort to a money broker to exchange his depreciated currency for available funds in another currency, and since state bank notes were held in less confidence outside of each state or region, the holder of western and southern notes was compelled to allow a discount[7] when he purchased in eastern markets. The broker took into consideration the solvency of the bank, the distance, and the time which would elapse before he could turn this depreciated paper into available funds, a discount augmented when the capital was small, making it less worthwhile to transmit for redemption, making it even more of a tax on those just beginning their ventures. By 1816, the depreciated currency led merchants to pay a 15% increase for a bill of exchange[8] drawn on a debtor in New York, due to the risk of loss on western money. The merchants engaging in a bill of exchange with the broker would then pass on this expense to the farmers. In other words, the various brokers taking advantage of the situation were taxing all trade for a cost 10-20% higher than it had been through the Bank of the United States.

The state currencies imposed extravagant premiums upon the Treasury for the mere act of transferring government revenue collected at one point to another, and reduced government revenues overall. In the fall of 1814 the notes of the Baltimore banks were, for the greater part of the time, depreciated by 20%, those of New York by 10% , while those of Boston at par. Since state bank notes were received by the revenue officers at those places in payment of duties, the importer at Baltimore paid one-fifth, and at New York one-tenth less than the importer at Boston. These varying depreciations at the points of importation drew imports to the cities where the depreciation was the greatest and diverted them from elsewhere, and the importers paying duties were then encouraged to bring their goods to those ports where currency was most depreciated, encouraging each state to degrade its own currency to attract foreign commerce. While the government was receiving consequently less than it should for duties, it was also apparent to all that this situation made it impossible to discharge the power of Congress which states that all taxes collected "shall be uniform throughout the United States," and that "No preference shall be given by any regulation of commerce, or *revenue,* to the ports of one state over those of another," as this would be a discrimination in favor of the lower value, proportioned to the depreciation of the local currency which is 20 percent below value of another. Notwithstanding this clear practical violation of the Constitution, this inequality continued for two years.

Some banks reaped the reward of loaning under the general depreciation of the currency, taking nearly twice the amount of property from the people for the debts which had been originally contracted, when the depreciated currency was contracted by suspending their loans and taken out of circulation later on. Also, intentional, abrupt curtailments of loans would reduce prices, obliging the debtors of the banks to sacrifice their wealth at low prices to the speculators, retaining the property of the poor classes, till the prices rise. Reviewing this period later on, Congressman McDuffie wrote in 1830:

"When banks have the power of suspending specie payments, and of arbitrarily contracting and expanding their issues, without any general control... In such a state of things, every man in the community holds his property at the mercy of money-making corporations which have a decided interest to abuse their power... By a course of liberal discounts and excessive issues for a few years, followed by a sudden calling in of their debts, and contraction of their issues, they would have the power of transferring the property of their debtors to themselves, almost without limit.[9]"

Some of them had allowed their money capital earlier as stock of the national bank to be lent productively, but now speculated upon the distresses of the community, having nothing better to do with their large surpluses of money.

Without the agency of a bank established by federal government authority, the Congress had no control whatsoever over that which fills up the channels of pecuniary circulation. In the absence of a bank, the state banks become effectually the regulators of the public currency, without regulation. In such a condition, it was vain for Congress to regulate value of coin, when the circulating paper currency of local banks had no relation to this value. In essence, the individual state banking corporations had taken this power from Congress, with the strongest motives for abusing it for profits.

The state legislatures were never designed to be the exclusive suppliers of the national currency; long before any state had a bank, there was a national bank, whose powers the Constitution outlined.[10] It was the intention to vest in the Federal Government the exclusive control over the currency by prohibitions of states in coining money and emitting bills of credit. The constitutional power vested in Congress over the legal currency was one of its very highest powers, and its exercise of this power was one of the strongest bonds of the union of the States. This power must be exercised by Congress; or one of its powers affecting all the daily operations of society would remain dormant.[11]

George McDuffie (August 10, 1790 – March 11, 1851) was the 55th Governor of South Carolina and a member of the United States Senate.

A Charter Doesn't Make the Bank

Consequent to this experience, President James Madison, who had himself been in favor of recharter in 1811, after reviewing various proposals for a new bank, accepted a design for a charter almost identical to Hamilton's original and signed it into law in 1816, with overwhelming support from all sides.

Madison delivered the following message on December 16th, 1816: "For the interests of the community at large, as well as for the purposes of the Treasury, it is essential that the nation should possess a currency of equal value, credit, and use wherever it may circulate. The Constitution has entrusted Congress exclusively with the power of creating and regulating a currency of that description, and the measures which were taken during the last session in execution of the power give every promise of success. The Bank of the United States has been organized under auspices the most favorable, and can not fail to be an important auxiliary to those measures."

The unified patriotism in the wake of the War of 1812 led to great recognition for the need of internal improvements and domestic manufactures, led by West Point's army engineers. The Erie Canal was begun that year, and designs and plans for canals in Virginia, North Carolina, Georgia, were being put forward by the government, while industries of all kinds started up.[12] However, the resumption of a national currency and credit system able to facilitate this plan was not guaranteed with the mere existence of a Bank of the United States. The Bank faced an unprecedented army of unregulated state banks, and the government had taken out a loan for the war at 20% interest which it was to pay back in a currency of twice the value, a situation requiring a director with the full national interest in mind and with the resolution of an Alexander Hamilton to handle the fragile situation. Instead of such a president, there now occurred two administrations of the Bank that did not fulfill its function.[13]

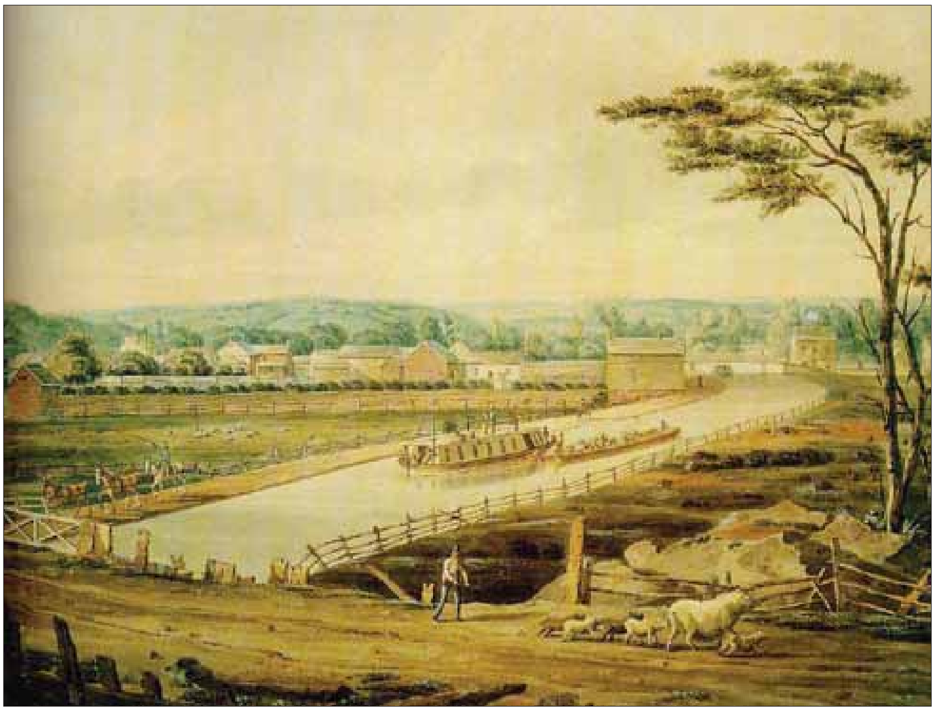
William Jones, the first president, was unqualified for the post and elected for political reasons. After many years of freedom of lending without regard to their specie, the enforced policy of resuming specie payments brought pressure on their borrowers, causing great protest in the interior of the country. Also, speculators were not absent in their opposition to the bank. Jones succumbed, and to silence the protest in the interior, he supplanted the state bank bubble with loans from the regional branches, without limit or relation to the capital stock of the Bank. The notes issued from the western branches were accepted in the east, and therefore capital and resources of the Bank were being transferred from the east where valid debts were being paid, to the interior, where speculators in land and stocks were taking advantage of loose credit. Meanwhile, Jones was involved in fraudulent banking practices in the East.

When other directors of the bank finally began to exert its influence in July 1818, its forced curtailment of loans put pressure on merchants and speculators and state banks, and led to mass bankruptcy. The Bank was overextended, and drained of much of its specie. Jones was thrown out for mismanagement and fraud, and in January 1819, Monroe appointed Langdon Cheves as the new President of the Bank, and Nicholas Biddle as one of the government directors. Biddle had refused to serve as a director under Jones' administration.

John Quincy Adams provided the sharpest global strategic thinking for the new nationalists, combined with a passionate commitment to industrial and scientific progress.

Cheves ordered the interior branches to cease issuing notes, and to forward a large amount of their specie and two-thirds of their government deposits back east, while demanding complete settlement with state banks. As stated, a chief cause of the over extension was issuance of currency in the interior states and the eventual demand for specie redemption of the notes at branches in the east for duty payments. He therefore suspended the part of the bank charter which said that all the notes given out by the Bank and its branches would be receivable at any branch, i.e. a national currency. John Quincy Adams, as Secretary of State, describes the state of affairs in his memoirs in 1819-1820 from his discussions with Treasury Secretary Crawford and President Monroe. On April 5th, 1819, he wrote, "The bank is so drained of its specie that it is hardly conceivable that they can go to the month of June without stopping payment. The measure which Cheves now represents as indispensable is the *refusal to receive in payments for public account the bills of the several branches of the bank at any other branch than that from which they issued.*"

Cheves' action burst all of the speculative lending in the country which Jones had allowed. Beginning in the summer of 1818 and continuing through 1819



The New York Erie Canal (shown here in a painting by John William Hill, 1829), joined with the Ohio Erie Canal, to complete the first water route from the Atlantic to the Mississippi River system. The Ohio cities of Cleveland, Columbus and Toledo grew up along the canals.

all real estate and products of labor collapsed in value. Multitudes of farmers and manufacturers who had established themselves from the credit supplied by the first Bank, and had invested their money in the state banks which had taken its place, now were left penniless, when these banks were finally made to adhere to the proper regulation. John Quincy Adams continued to discuss the situation with his fellow Cabinet members, in May 1819.

"I had also some conversation with [Treasury Secretary] Crawford on the present situation and prospects of the country, which are alarming. The banking bubbles are breaking. The staple productions of the soil, constituting our principal articles of export, are falling to half and less than half the prices which they have lately borne, the merchants are crumbling to ruin, the manufactures perishing, agriculture stagnating, and distress universal in every part of the country...

The house of Smith and Buchanan, which has been these thirty years one of the greatest commercial establishments in the United States, broke last week with a crash which staggered the whole city of Baltimore and will extend no one knows how far.

The banks are breaking all over the country; some in a sneaking and some in an impudent manner; some with sophisticating evasions and others with the front of highwaymen. Our greatest real evil is the question between debtor and creditor, into which the banks have plunged us deeper than would have been possible without them. "

Unfortunately, while Cheves restored the soundness of the bank, he greatly over-corrected, and numerous debtors who were legitimate businessman and purchasers of land were stuck with the same fate as the speculators. Shoring up the eastern banks with funds from the interior, and canceling loans and purchases of bills of exchange led to a reduction of business activity and forced the state banks, which were already being pressed for payment, to do the same.

Consequently, all bank notes were kept in their vaults, and bills of exchange were almost unsalable. Trade and commerce were almost wholly suspended, confidence between man and man was greatly impaired, the interest of money privately borrowed was extravagantly high, few men bought but what they could immediately sell, no dependence was placed on the collection of debts, and manufacturers were daily discharging their workmen, unable to raise money for their wages.

Mathew Carey wrote directly to the directors of the Bank on June 28th, 1819, calling on them to reverse the policy of austerity, outlining this state of affairs and its consequences. He concluded the letter by stating, "The system pursued by your immediate predecessors, invited applications for discounts, in consequence of which immense sums were borrowed, which were invested in trade, commerce, houses, and lands. Yours is the antipodes of theirs. But surely, in order to cure a plethora, arising from repletion, it cannot be necessary to starve the community to death," signing his letter "A Friend To Public Credit."

Despite this and similar encouragement from Biddle, Cheves firmly believed the only way to be able to resume issuance of notes at all branches was to hold more specie than notes issued, abandoning the idea of supplying a national currency; he even pushed for congressional alteration of its charter from this Hamiltonian design. Instead of its own notes, it reissued state bank notes as loans and discounts, especially in the interior regions; it was unwilling to issue its own because it might be compelled to pay at one of many places remote from the point of issuing them, when they showed up at a different branch.

The continuance of this situation would have defeated the object of establishing the bank, since by declining the issue of its notes, it could not furnish the circulating medium expected of it, and by re-issuing the notes of the state banks, it surrendered its most efficient means of control over the currency, which was to keep exchange rates to a minimum by regulating the state bank currencies, and providing a national currency. It couldn't press the state banks for payment of specie for its notes, when it wasn't even issuing its own notes and was sitting on a capital far beyond its currency issued. The state of affairs was fatal to its usefulness.

Footnotes

[7]Receiving less credit than the full value for a note, or receiving less in advance for the value of a bill of exchange. Discounting by banks is similar to a loan, except instead of the bank giving the full amount asked for and charging interest, the bank will give a lesser amount, and expect the full amount back. Simply said, getting a 20 percent discount from the bank is borrowing 80, and paying back 100.

[8]A bill of exchange can involve an inumerable number of parties, but usually three or four. Another example: Merchant A has a debt from Merchant C, but wants to buy goods from Merchant B, but presently does not have the funds on hand. Merchant A therefore purchases them on the credit of Merchant C who owes him an amount necessary to cover the purchase, by means of a bill "drawn on Merchant C"—i.e. to be eventually paid by Merchant C. Merchant B can now either use this bill of exchange as payment to another trader, who can then have it discounted by a bank or broker, receiving cash to pay a farmer or manufacturer for goods he wishes to buy.

[9]House of Representatives, Committee of Ways and Means, George McDuffie April 13th, 1830.

[10]See *NAWAPA XXI Special Report,* Section III. How NAWAPA XXI Will Restore the System of Public Credit, www.larouchepac.com/nawapaxxi

[11]Daniel Webster 1832, Speech on the Bank of the United States.

[12]Chaitkin, Anton, "The American Industrial Revolution That Andrew Jackson Sought to Destroy," EIR, vol. 39, no. 25, June 22, 2012.

[13]It is crucial to look closely at this period of bad management, because it was later used fraudulently by the Jackson gang to attack the Bank long after Biddle had reversed and entirely corrected these errors. See also, Report of Mr. Adams, May 14th 1832, Committee Investigation of the Bank of the United States, 22nd Congress, 1st session.

[14]For the development of Hamilton's concept of the Bank of the United States, see the NAWAPA XXI Special Report, p.57-67, http://larouchepac.com/files/20120403-nawapaxxi-forweb_0.pdf