AUSTRALIAN ALMANAC Vol.3 No23

The Credit System vs. Speculation:

Nicholas Biddle and the Second Bank of the United States

4 July2012
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Part 4 of 4

The Uniqueness of America

The credit system of the 1820s and 30s was a uniquely American experience and uniquely a product of the government's regulation of the currency, to channel all the available surpluses from the productive economy into an increased availability to generate more productive surpluses, through the means of the national bank.

The most fundamental concept of a credit system is the operation of a physical system on the basis of the future productive wealth to be generated by that system, which will exceed the physical capital initially invested into that system. The credit system fundamentally meant that any citizen, beginning with nothing but a moral character could compete with a wealthy capitalist; that it was the right of anyone with a spirit of enterprise to receive the capability to increase productivity.

In settling and cultivating new lands, families, without stores of gold or stock in companies, took with them little more than their clothing, furniture, agricultural implements, and a small stock of domestic cattle. In a few years the fertility of the soil enabled them to send a surplus of agricultural produce to exchange for European products at the stores of the country traders in the nearest towns; who in their turn transmitted the produce to the sea coast, for consumption in the more thickly settled portions of the country, or for exportation. While they were in the process of generating this new wealth, these various classes obtained the necessaries of life to a great extent from the merchants in the interior, upon a credit founded on the expected returns of their industry, when they would be able to repay from the profits of their business, be it a few months from the tradesman, a year from the manufacturer, or when the farmer's crops are sold.

"Active trade is kept between seaports and interior, and those in the interior stand in need of various articles, which for many years they require on credit to be paid for from the next years harvest, it follows that the interior is invariably in debt to the merchants on the sea board. *These debts they are enabled to discharge by their cultivation and the advance of prosperity in the improvement of the country; and contrary to a received maxim in other countries, they grow rich although they continue in debt:* that is, they are constantly augmenting the value of their farms, and each year they are enabled to enjoy some additional comfort or luxury, which they do not hesitate to purchase on credit, because they are in general certain of being better able to pay for it before the lapse of another year."[29][emphasis added]

They were able to purchase on credit, because of the operations of the Bank of the United States, which guaranteed payments for goods and wages for laborers, or made loans of bank notes available.

"The merchant in the country obtains his credit to the usual amount from the merchant in the city, and he in turn has his accommodations from the United States Bank, the great center and source of the active capital of the country. Thus the accommodation and credit originally obtained from the bank is extended from the one to the other, in a beneficial course, until it reaches, in some useful degree, to every workshop and every cottage; and those acquainted with the operations of business, know that these benefits have been extensively enjoyed, although, in a manner silent and imperceptible, until a derangement of the course made us to feel and to perceive the injurious cause."[30] The credit system was the system of transactions outside of the immediate exchange of goods, based on a means of future payment. Credit and money are not comparable; money is a direct conversion of goods, whereas credit lies outside the goods, and was the means to avoid such push and pull mechanisms. The Bank coordinated and balanced the debts and credits between the parties involved, allowing payment for commodities to be separated from the immediate transaction at hand, setting it off based on a separate debt, not involved in the transaction. The role of the branches of the national bank, in taking such a great role in the domestic and foreign exchange market, was to coordinate these debts and credits with the least expense and greatest facility for the whole economy, as well as to directly loan. Numerous transactions to settle debts, such as these bills of exchange between various branches, were handled so as not to involve any gold and silver in the operations, so as to allow the rest of the capital generated to be absorbed into further productive growth.

Biddle's statement in a letter to John Quincy Adams rings clear: "In truth the banks are but the mere agents of [the] community. They have no funds not already lent out to the people, of whose property and industry they are the representatives. They are only other names for the farms, the commerce, the factories, and the internal improvements of the country..."[31] The Bank of the United States was not an object, but a means through which the powers of government and production operated.

Michel Chevalier, a Frenchman touring the United States in 1834, made a number of observations on the uniqueness of the situation created by the Bank of the United States from 1823-1834 in contrast to Europe and France in particular:

"The great extension of credit, which resulted from the great number of banks, and from the absence of all restraint on their proceedings, has been beneficial to all classes, to the farmers and mechanics not less than to the merchants. The banks have served the Americans as a lever to transfer to their soil, to the general profit, the agriculture and manufactures of Europe, and to cover their country with roads, canals, factories, schools, churches, and, in a word, with every thing that goes to make up civilization. Without the banks, the cultivator could not have had the first advances, nor the implements necessary for the cultivation of his farm... The credit system has... also enabled him, although indirectly, to buy at the rate of one, two, or three dollars an acre, and to cultivate lands, which are now, in his hands, worth tenfold or a hundred fold their first cost. The mechanics... owe to it that growth of manufacturing industry, which has raised their wages from one dollar to two dollars a day... it furnishes the means by which many of their number raise themselves to competence or wealth; for in this country every enterprising man, of a respectable character, is sure of obtaining credit, and thenceforth his fortune depends upon his own exertions."[32]

It was only by this system that the opening of new lands was possible, and that the spirit of invention could take hold of any man without the exercise being in vain. Chevalier pointed out that this was not the case in Europe, where, on the other hand, manufacturers, smiths, masons, canal engineers, etc., who possessed the ample capital to construct a project for their community, that is, the necessary labor, skill, and workforce, etc., kept their designs on paper, since they had *no means of raising on their lands and houses the ready money to serve as currency between the commodities to be exchanged*.."[33]

Without the Bank, the tradesman was unable to sell his wares, the laborer was unable to use his hands, and the canal engineer unable to pay his workers, and this was exactly the case in most places in Europe at the time, which lacked this system of credit, and nearly all such projects and industrial growth which required large investment, stood idle, as only those with large stores of wealth had the ability to undertake them.

Loaning on interest was the proper use of superfluous capital to those who would generate more wealth far beyond the original use of the capital. While in Europe, credit from nobles was largely unavailable, for lack of confidence in loaning their capital out for use, and tended to accumulate as stores of metal currency, in America, anyone who wanted to get a loan was able to be industrious.

"It was never the intention of equal rights, that the man qualified for commercial pursuits should not embark in them on capital obtained for an equivalent interest secured to the lender. It was never designed that the man of skill in the manufacturing arts should not have that scope given to his enterprise and usefulness which a confidence established between him and the money lender is so well calculated to carry out into the community; nor was it ever contemplated that the farmer, who stands first in the important train of interests... should not strive to become the owner of the soil he cultivates by a purchase upon credit, depending upon the products of his labors to discharge the debt.[34] It was never designed by the laws which regulate and protect the rights of well ordered communities that none but capitalists should engage in the active pursuits of civilized life."

The success and possibility of this system of credit was based on the character of confidence of man in his fellow man which existed in America, and particularly so, once the government had made proper use of its powers. *"Conscious of the ability to meet his own engagements, each was willing to repose confidence in those of his neighbor; and that confidence had been so fully and honorably redeemed as to have given to credit a firmness and extent which threw wide open to industry and enterprise the avenues to competence and wealth."*[35] Since good conduct of a worker could ensure his ability to obtain the aid of capital, rendering his labor more productive and his condition improved, there were an increasingly large number of incentives for Americans to apply their property productively and accumulate real wealth. The tendency to moral improvement increased, while interest for borrowing capital decreased.

The situation opened up by this established system of credit led to the greatest prosperity throughout the union in its history. "Enterprise had encouraged industry; competence

Michel Chevalier painting by Leon Cogniet.

had rewarded labor; commerce had carried our produce to a ready, profitable, and fair market; and mutual confidence had extended, without weakening credit; that the constant occupation given to our mechanical and laboring classes, and ready payments made to them, had enabled them, equally with the more wealthy, to obtain those articles necessary to their wants or their comfort, which our commercial intercourse with the largest cities in our Union had introduced amongst us."[36]

Chevalier pointed out that this confidence and security made the difference in Europe.

"In France... it would be difficult to teach them to look upon a scrap of paper, although redeemable at sight with coin, as equivalent to the metals. A metallic currency, has, in our notions, a superiority to any other representative of value, which to an American... is quite incomprehensible; to our peasants, it is the object of a mysterious feeling, a real worship; and, in this respect we are all of us more or less peasants.

"The Americans, on the other hand, have a firm faith in paper; and it is not a blind faith... they have had their continental money, and they need not go far back in their history to find a record of the failure of the banks in a body. Their confidence is founded in reason, their courage is a matter of reflexion... it will be a long time before we shall be in a condition, in France, to enjoy such a system of credit as exists in the United States or England; in this respect we are yet in a state of barbarism..."[37]

The ability to have an entire economy accept future payment for productive investment was, and still is a revolution. In 1790, it allowed two-thirds of the surplus productivity to be immediately absorbed into further productive investment, rather than used to generate a metallic currency. But it is important to understand, it is the ability to engage and embark on long term investments on the basis of their future completion which determines whether an economy is operating under a credit system, not what is exchanging hands. By removing the credit system, Americans suffered, and must always suffer a sick irony, that with a banner of equal rights waving over our heads, the demand to pay on the basis of past wealth imprisons enterprise, disabling the ability of a man to increase the power of his labor.

Beating the Monetary System

Various regulations were taken to protect the internal economy, which was based increasingly on this credit system, from the influence of the system of speculation, which continuously threatened the delicate structure of future payment. The process of growth described in this period of 1823-1832, was only possible by constantly regulating and maintaining the whole financial system within the time scale of the credit system, and preventing the old system of money of Europe from the financial system into its destructive rules, which insist on immediate payment in cash.

As stated above, while the currency was fixed to specie in order to give it uniform value, and trade deficits were settled with specie, it was completely possible to engage in most transactions internally, on the basis on future productivity, credit, and not metal, since most transactions were in fact of such a nature. On the other hand, trade deficits with foreign nations were settled and arranged on the basis of specie, and therefore foreign merchants had to be paid in coin for imports, not with bank notes, the nationally accepted representation of coin. This necessity further augmented the importance of operating domestically on a credit system, as all of the metal coin which would otherwise be locked up for interior circulation is released for foreign trade. However, if an over-abundance of such payments occurred, it caused shocks to the internal currency, since a removal of coin from banks had a multiplier effect on credit, reducing the total amount of safe lending by banks.

Biddle describes the regulation capability in an essay in 1828, paraphrased here. The increase of too many bank notes increases the prices of domestic goods. While foreigners see a market for their goods in these conditions, they do not take home an equal amount due to the increased price of our goods. This trade deficit must settled by coin, and soon the specie reserves in the bank becomes too little to support excessive paper issues and the banks fail. To prevent failure, the Bank could therefore initiate a cutoff to merchants from borrowing coin to purchase foreign goods when sensing a drain on specie. When the regulated banking system can curtail loans, domestic goods now fall in price, with less notes in the hands of merchants. Debtors now want the scarce notes and therefore sell goods ever cheaper to obtain them. Foreigners export no more because of the cheap prices for which they would have to sell their goods, money being scarce, and Americans import no more since the market for foreign goods becomes poor. The remaining coin within the country seeks cheaper domestic goods instead, and foreigners find it more worthwhile to return the coin they took away by purchasing domestic goods. The coin will then stay until a superabundance of paper occurs again.[3] Time is thus gained until the arrival of the internal southern exchange market which will supply the demand without the aid of coin and then everything resumes its accustomed course.

We will now detail this and other important regulatory functions which Biddle performed as President of the Bank, and then comment on the central feature of his method.

Biddle coordinated payments of war debt in such a way as to avoid a mass of funds being taken out of availability all at once on the anticipated dates, by inviting creditors to borrow money ahead of time gradually, protecting the economy from losing its customary credit facilities due to a mass of government funds being unavailable for lending.[39]

In 1825-1826, even in the midst of a government debt payment, Biddle protected the American economy from one of the greatest speculative waves of the century centered in London, by taking numerous measures to prevent all branches of the Bank from engaging in the excessive lending beyond the actual needs of the economy, and keeping the bank in a position to prevent bank panic due to the London market. When all state banks had closed their doors and a general panic was threatening the country, his Bank prevented interstate specie drains by coordinating through its branches, initiating a gradual supply of credit, even in the midst of 104 banks closing in London, and companies going bankrupt all throughout Latin America. The Bank however was in sound condition since it's primary motive was convenience and stability for the economy as a whole.[40]

The Bank's regulation capability prevented an internal collapse in the winter of 1827-1828, which prevented an internal collapse of the economy. A flood of imports, combined with a collapse of American exports, created a perfect storm for the export of specie, as American planters were not supplying funds to purchase bills of exchange for imports, which continued to increase; a crisis which if allowed to correct itself, would have been a mirror of London's 1825 banking collapse. Biddle declined loans to brokers exporting specie, and sold assets to collect state bank notes, which aided but didn't prevent the speculative frenzy for imported goods. He then allowed time to slowly bring government tax payments into its branches in the form of state bank notes, and immediately demanded specie from the state banks, until the pressure to reduce their loans reined them in.

In these and similar situations of correction and intervention by the Bank, time was the essential factor during every period of strain and pressure, since every merchant, banker, and producer operated on credit;what was crucial was to provide the time for adjustment to keep all assets involved in long term investment and growth, not sitting idle in banks or in treasury department boxes.

No one could call in debts and pay for the production that had not yet been produced, without reducing the power of the economy, not because real capital doesn't exist among the merchants inside the credit system, but because the operation of the internal economy based on a credit system increasingly invests its surplus in the active capital of technological and productive progress, and cannot turn their active capital into the demanded payment of gold and silver, which the monetary system imposes. Valid debts are never immediately collectible in a credit system, as they only present themselves as a continual stream of benefit in the progress of wealth creation, never an object of money.

Biddle's principle was to maintain the economy's operations within the credit system, rather than dipping into an existence of the money system of metallic currency, by preventing the use of coin except to balance trade deficits (and even then as little as possible). Thus, internal economy was able to grow in relation to its productive power, on credit, rather than artificial controls. By these means, he was able to protect the credit system, upon which an increasingly number of all transactions were based, as the freedom and security of one's property was more and more established, and as confidence in one's neighbor and government increased.

The government used the Bank of the United States to protect the real economy from the speculative markets, unlike what later would occur in 1837 when Jackson had destroyed the Bank. This fact, and this fulfillment of a system of true equal rights of man makes a mockery of any analysis of economy from the standpoint of "the market" to explain the growth of the economy.

Conclusion: The People's Bank

After a few years of Biddle's reorganization of the bank, the confidence of the people that the bank of the United States would now be the dependable means for economic investment, gave the impetus to enterprise which led to the great expansion of canals and industries, encouraging thousands of industrious, honest, and capable men to commence operations as merchants, manufacturers, and farmers, without sufficient capital to support their enterprise, leaning for aid upon the credit system. They were fully invested into that future investment system.

With Jackson's attempted replacement of the credit system with a pure metallic system, the entire class of citizens who depended on credit—the poorest, yet most enterprising, farmers, manufacturers, and masons—were crushed, while the citizens of the states already bearing a tax for the internal improvements had ripped from their hands the vision of the future. Van Buren mocked the nation as President in the midst of the intentional contraction of the economy by fifty percent, following Jackson's actions with respect to the bank and currency, saying to the people and state governments, that they were in debt because they had spent too much money and must now live within their means; that the collapse was due to interference in the "free market" by the bank of the United States, and remnants of a currency not solely of gold and silver. Biddle and others attempted in vain, though righteously, to continue the facilities provided by the credit system without the government's role, preventing a complete contraction of the economy through the continued operations of Biddle's United States Bank of Pennsylvania, and nearly single-handedly aided the states in completing canals and creating America's railroads. The American attempt to break free from the monetary system of the British Empire by defeating them in foreign exchange war was thwarted by the destruction of the Bank, and in the years after, the specie was sucked out of the country into England. The U.S. reverted to near colonial status until Lincoln's forces, those patriots waiting in the wings, struck forward with an approximation of the system implemented under President John Quincy Adams, Nicholas Biddle, Mathew Carey, and others.

The credit system is a system of commerce where the intention and confidence in the future is the medium of exchange, not the past production or stores of wealth built up. It is a system where growth itself is the currency, not the products of growth. The merchants may be exchanging the same goods that they would with hard money, but the saving is made possible by a nation-wide regulation system and government control, which makes all the transactions on credit possible. Without the regulation and national banking structure, growth on credit and long term investment is not possible. Without the regulated exchange rates which the Bank of the United States created through its national power, there was no long-term assurance in investment, and everything included usurious taxes by private banks and brokers.

The credit system makes possible not merely more, but more of higher quality, and allows an economy to be related to confidence, allows it to be commensurable with the spirit of Man, the spirit of enterprise; it allows the economy to be related to moral incentive.

In addition to a re-establishment of a Bank of the United States, what is needed today is a group of statesmen in industry, agriculture, science, and technology to be the main drivers and directors of branches of a national banking system; men and women of the fiber of Mathew Carey, Nicholas Biddle, and Charles Carroll, who have a vision of what the country and world should look like, and work with their associates in government and businessmen to invest the nation's and the world's resources to that end.

Such a team of statesmen must immediately move to replace the bankrupt and rotten financial system now, instead of continuing more destruction with one based on speculation, led by those derivatives to be wiped out under Glass-Steagall, derivatives whose creation was as equal a violation of the Constitution as that which usurped the Congress's control of the currency in 1811-1816, and was compounded by the treasonous destruction of the Bank by Jackson in 1832-1836.

Footnotes

[29]"The Bank Question, Report on the Currency," by a Committee of the New York Convention of the Friends for Domestic Industry, *The American Quarterly Review Vol. XI, March & June 1832*.

[30]Mr. Barnitz May 19, 1834, House of Representatives, Speech on the Removal of the Deposits from the Bank of the United States.

[31]Letter to John Quincy Adams on the Specie Circular April 5th, 1838.

[32]Michael Chevalier, Letters on North America, 1834-1836.

[33]Chevalier, op. cit.

[34]Two Hundred and Fifty Three Citizens of Northumberland County, PA, "For the restoration of the Deposits, and renewal of the charter of the Bank of the United States." May 1st, 1834

[35]Senate Documents, 23d Congress, 1st Session, Citizens of Essex County, NJ "Against the removal of the Deposits, and in favor of the recharter of the Bank of the United States" May, 13th, 1834.

[36]Senate Documents, 23d Congress, 1st Session, People of Bristol County, Rhode Island, For the restoration of the Deposits, and recharter of the Bank of the United States, March 29th, 1834.

[37]Chevalier, op. cit.

[38]Essay of Biddle on Banking in April 1828.

[39]"In large payments of the principal of the debt...it avoids the inconvenience of too great an accumulation of money in the vaults of deposit used by the Government, and of the vacuum that would succeed its too sudden distribution. It does this by anticipating, as the periods of payment approach, the disbursement of a considerable portion of the stock, in the form of discounts in favor of those who are to be paid off; thereby enabling them otherwise to employ their capital, as opportunities may offer, beforehand. In this manner heavy payments of the debt are...made gradually, instead of the whole mass being thrown at once upon the money market, which might produce injurious shocks. So prudently this, and other respects, does the bank aid in the operation of paying off the debt, that the community hardly has a consciousness that it is going on." —Secretary Treasury Richard Rush, Report of the Treasury 1828.

[40]Another key function Biddle initiated that year was to prevent a drain of specie contributed to the ability to weather the global storm. Instead of allowing an annual shock to the economy when merchants trading with China and India would pull a large amount of specie from the banks to trade with, Biddle sold bills of exchange drawn on London, as payment instead, which were equally or even more valuable in the Pacific than specie, since they had debts there to settle, which could be done faster this way through American ship-owners, than sending the coin. "This advantage the bank has secured to the community by confining within prudent limits its issues of paper, whereby a restraint has been imposed upon excessive importations, which are thus kept more within the true wants and capacity of the country. Sometimes judiciously varying its course, it enlarges its issues, to relieve scarcity, as under the disastrous speculations of 1825."—Treasury Secretary Richard Rush, 1828.