

Bankruptcy Reorganization For a Credit System

The application of the concept of creating sovereign credit, in the face of seemingly unpayable debts, was pioneered by the U.S. First Treasury Secretary Alexander Hamilton. While his debt restructuring differed significantly from the total program required today—since he was dealing only with honorable war debts of the nation, not speculative looting by private banks—the principles involved hold valuable lessons to be learned.

The following description comes from the article “Alexander Hamilton’s Economics Created Our Constitution,” by Nancy Spannaus, which appeared in the Dec. 10, 2010 edition of EIR.

President Washington appointed his former aide-de-camp as his Secretary of the Treasury in September 1789, and Hamilton went to work immediately. The bankruptcy of the nation was near total. Much of the agricultural land had been heavily damaged by the war, the British were interfering with the use of the fisheries, and commerce had been choked by the British as well. There was no national currency worthy of the name, just coins of various other nations circulating. The use of barter was increasing, even for such transactions as payment of taxes.

On top of the collapse of the physical economy, there an enormous amount of debt.

There were three categories of debt, plus arrears in interest on debts. The largest amount was money owed by the Confederation to individuals, including Army veterans, or states, amounting to approximately \$40 million. This debt had been taken over by the Federal government, as prescribed in the Constitution. The second-largest category of debt was that owed by the states, incurred for their expenses during the war, approximately \$25 million. The third category was foreign loans, approximately \$10 million—an amount also assumed by the incoming government. Interest on this debt—with rates at 4-6%—was several million dollars in arrears.

To service this debt, Hamilton figured, would cost over \$1 million a year—more than the revenue projected to be available to the Federal government from the one major source, the tariff that had been passed two months before.

So, what did Hamilton propose? He proposed to *add* to the debt owed by the Federal government, by assuming the debts of the states—and then to turn that debt, in the form of bonds, into a pool of capital for a National Bank, which would provide the basis for beginning to build up the physical economy of the nation! That, he emphasized in his first *Report on Public Credit*, would be the means of securing the public credit of the bankrupt country. His second *Report* went into the particulars of the formation of the National Bank, and the benefits that it would accrue to the nation.

Hamilton’s first *Report* proceeds from the first principle, of course, that the debt from the war is a moral obligation of the nation (“the price of liberty”), and must be repaid. But to do that, there are certain urgent measures that had to be taken to support public credit. He summarized the objectives as follows:

“To justify and preserve their confidence; to promote the encreasing respectability of the American name; to answer the calls of justice; to restore landed property to its due value; to furnish new resources both to agriculture and commerce; to cement more closely the union of the states; to add to their security against foreign attack; to establish public order on the basis of an upright and liberal policy. These are the great and invaluable ends to be secured, by a proper and adequate provision, at the present period, for the support of public credit.”

Yet this could obviously only be done by increasing the productivity of the nation! Thus the debt—most of which fortunately did not include any due date for the principal—had to be turned into annuities, or bonds, monetized, in such a way that it provide funds for real, physical-economic development. This funding of the

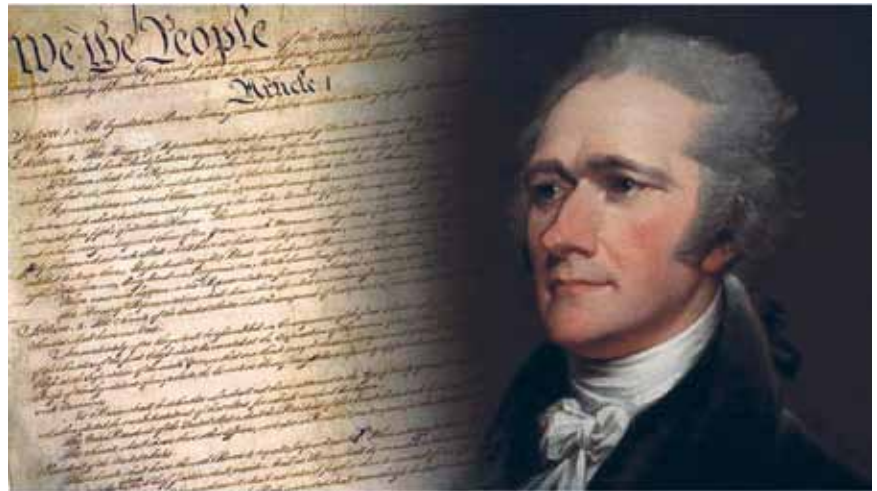
debt would provide for regular interest payments, but turn the debt into capital.

To kick off the implementation of his plan, he needed (and got) another loan from France. He also opened subscriptions for a new loan to cover the domestic debt, but at 4% interest rather than the going rate of 6%, sweetening the deal with additional options, including a certain amount of public land. He also increased revenues by an increase in excise taxes on liquor, and created a sinking fund which would perform the functions of a national bank until that could be established.

Hamilton outlined in detail the benefits which would accrue upon his plan to fund the debt. It would extend trade, by making available greater capital, promote agriculture and manufactures, and reduce the interest on money, by putting more into circulation. It would also be a blow against speculators, who were counting on the depressed values of land and overall instability in the economy, to profit at the expense of the nation.

The response to Hamilton's first proposal was an uproar. To a large degree, that uproar focussed on his plan to assume the state debts. Some of the states had already paid off their debts, while others were in great arrears—a situation which led the richer states to resist assumption, on the alleged grounds of inequity. More seriously, the representatives of those states, especially New York and Virginia, saw clearly that increasing the size of the national debt, and funding it, would increase the power of the Federal government, and its ability to advance the aims of industrial and technological development—rather than the plantation system (Virginia) or largely commercial system (New York)—an outcome which Hamilton, Washington, and their collaborators were clearly driving for.

The tool for agitating against Hamilton's plan was primarily the plight of the war veterans, who had been forced to sell the promissory notes (or "indents") from the government for their pay, at a cut rate, over the recent period of near-financial anarchy, and now would not benefit, while the individuals who bought them out would receive full value from the Federal government. Hamilton was not unsympathetic to those who lost out, but insisted that there could not be created two cate-



Alexander Hamilton

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ries of such paper. It would just be too chaotic and time-consuming.

The spokesmen for the opposition were primarily the Virginians, House of Representatives leader James Madison, and Secretary of State Thomas Jefferson. Both waged a propaganda campaign against Hamilton's plan, and it was only through a private bargain, in which Hamilton agreed to support moving the nation's capital from Philadelphia to the Maryland-Virginia border along the Potomac, creating the Federal District of Columbia, that they agreed to let the *Report on Public Credit* be adopted, although its provisions had to be passed in four different pieces of legislation. The whole process took until August 1790, a full eight months after it had been submitted.

But, even though the second *Report* was clearly an integral sequel to the first, Madison and Jefferson decided to oppose that report, known as the *Report on the National Bank*, as well.

Hamilton submitted his *Report on the National Bank* in December 1790. The Bank of the United States, as he dubbed it, was to be capitalized with \$10 million, making it a monolith compared to the three other existing banks in the country—the Bank of North America, the Bank of Massachusetts, and (Hamilton's) Bank of New York. Two million dollars of the initial capital was to come from the Federal government, and \$8 million by public subscriptions, which were payable one-quarter in specie, and three-quarters in 6% securities of the Federal government. Thus, these government securities (debt) formed the basis for extending credit.

The bank's income would come from interest on the

Federal securities, and its loans to what we would call today the “private sector,” for development of the physical economy.

While Hamilton did not make a point of differentiating his plan for a National Bank from the Bank of England, not only its intent—as outlined above—but its entire functioning was different. First, the Bank was not to deal with public debt—i.e., buy government bonds—after the initial funding. It could provide short-term loans to facilitate collection of tax revenues and be a depository for government funds, but its major function was to provide a money supply for financing the physical economy: agriculture and industry.

From this standpoint, it is not hard to understand why Hamilton specified that the Bank of the United States was to be run by private individuals, although it was responsible to report to the Federal government on its functioning, and was subject to the government’s regulations. Hamilton insisted upon tying the public credit to the growth of the nation, not to serve as a piggy bank for the Federal government, which he feared would be a source of corruption, just as it clearly was in England.

The Bank bill came to the Congress in January 1791—and a major war began. The bill passed the Senate easily, and even after some extensive Constitutional arguments by Madison, it passed the House. But then, Madison, backed by Jefferson and Attorney General Edmund Randolph (also a Virginian), despite the fact that the previous deal on the location of the national capital had been struck, decided to try to block Hamilton’s plan. The tack Madison took was that which we still hear today: the claim that the Constitution did not permit the Federal government to create a corporation, namely the Bank of the United States. The three Virginians launched a full-scale assault to get President Washington to veto the Bank bill.

Washington was in danger of being railroaded. The pressure on him was so great, that he actually had Madison, who was considered a Constitutional authority, draft a veto message. But, in fairness, Washington also sent a note to Hamilton, requesting his response to the challenge on the constitutionality, which had been written by Randolph. With the deadline for the veto looming, Hamilton penned what has become the nearly definitive document on the meaning of sovereignty under the U.S. Constitution, in his “Opinion on the Constitutionality of the National Bank.” The paper was extensive, but we will quote it in summary. The core argu-

ment is this response to the argument that the U.S. government cannot erect a corporation:

“Now it appears to the Secretary of the Treasury, that this *general principle* is *inherent* in the very *definition* of *Government* and *essential* to every step of the progress to be made by that of the United States: namely—that every power vested in a Government is in its nature *sovereign*, and includes by *force* of the *term*, a right to employ all the *means* requisite, and fairly *applicable* to the attainment of the *ends* of such power; and which are not precluded by restrictions & exceptions specified in the constitution; or not immoral, or not contrary to the essential ends of political society.”

Hamilton proved beyond the shadow of a doubt that the establishment of the Bank was *necessary* and *proper* for meeting the basic objectives of the U.S. government: creating a prosperous nation, with an efficient tax system, and with the institutions that would support its credit and the expansion of its future productive power, through its investments in agriculture and industry, all for the General Welfare. Washington was convinced, and the Bank bill was signed into law on Feb. 25, 1791.

The Supreme Court affirmed Hamilton’s view in its 1819 opinion upholding the constitutionality of the National Bank, *McCulloch vs. Maryland*, written by Hamilton’s collaborator, Chief Justice John Marshall. That decision has never been overturned, and thus, is part of our Constitutional law.

The National Bank was to survive for its chartered 20 years, and make substantial progress on its mission, despite the subversion of its aims by President Jefferson and his Treasury Secretary Albert Gallatin, who did their best to use it to pay off debt, rather than use the debt for capital formation. The vote to prevent its re-chartering, on the eve of the War of 1812—just like the killing of the Second National Bank by Andrew Jackson in the 1830s—was a deliberate, effectively treasonous act to subvert the economy, and even the existence, of the United States.

So far, however, such traitors have not succeeded. In fact, leading members of Jefferson’s own party, centered on Mathew Carey, recognized that Hamilton’s economic principles were indeed the principles enshrined in the Constitution, and required for the survival of the nation, and kept them alive into the 19th Century, where they eventually bore fruit in the administrations of patriots. There is still a vestigial institutional impulse toward the Hamiltonian approach, but it is waning fast.