American Money, Part III: Store Credit, Installments, and Shadow Lending - Arsenal For Democracy Ep. 397 [Bill/Rachel/Kelley]

Part III: Store Credit, Installments, and Shadow Lending [Bill/Rachel/Kelley] (ep.397)
[Bill] Intro: Arsenal for Democracy this week continues our mini-series on money in the 19th Century United States. What was it? Was it something physical with a “real” value, or more of an abstraction? How did people understand it at the time vs how we understand money today? What were the economic, political, and socio-cultural implications of the 19th century version of American money?

In parts I and II of this series, we looked at currency and forms of paper money in the Antebellum, Civil War, and Reconstruction period, and we emphasized the chronic shortages of money in circulation within the United States (particularly rural areas). In part III today, we want to talk about the situation after the end of Reconstruction as the money circulation tightened again and we want to examine the coping mechanisms people used during this period, both in rural areas and in the growing industrial cities.

In both places, to a greater or lesser degree, money ended up existing as a kind of Unit of Account on a ledger somewhere more than any physical object or paper in circulation. This was most true in the rural areas, especially the West, with institutions like the General Store selling on credit between harvests and eventually payment plans for farm equipment. But this version of money experienced primarily as a Unit of Account was also the case in some urban contexts, such as door-to-door peddlers offering payment plans, which we first discussed on our episode about Singer sewing machines. However, many urban workers found that they were not given the same opportunities for delaying or spreading out payment for purchases, even while they themselves were paid intermittently and unreliably, and so they often needed to be able to access physical money more quickly. This led to the shadowy world of gray-market and black-market lending institutions and high-interest loan sharks that were the forerunners of today’s payday loans and pawn shops still serving a similar niche.

(As a side note: Listeners might also be wondering about other unsavory forms of compensation, credit, and exchange in this period such as “company scrip” and Southern share-cropping credit. But we’re not going to get into that here because I would argue that those both functioned almost explicitly as a method of enslaving people without legally being considered slavery and so these forms of “payment” were intended to be so narrowly useful to the recipients that they do not really qualify as genuine expressions of financial credit or as as money circulation substitutes like we talked about with Antebellum bank notes. While a shady urban lender might be effectively chaining the borrower to a job and a paycheck, this was not slavery in the way that company stores and sharecropping were, and there was real cash involved in those lending transactions. These institutions were there to make a profit filling a need, not to avoid spending money on labor.)

So, this week we’ll be talking about frontier store credit, early payment plans, and shadow credit markets in American cities. We’ll be drawing this episode most heavily from “Financing the American Dream: A Cultural History of Consumer Credit” by Lendol Calder, published in 1999.

Later in the series we’ll talk about the political battles that arose in the post-Reconstruction period over US monetary policy, such as William Jennings Bryan and the Cross of Gold, and then we’ll return to the question of credit for ordinary people with the transformation from simple store credit, early installment plans, small-dollar lenders, and pawn shops to more sophisticated “consumer credit” finance plans that evolved into the 20th century US economy of home mortgages, auto loans, credit cards, and more. By the 1920s, consumer credit alone was already a multi-billion-dollar industry (Calder p.9) and home mortgages had been well into the trillions since the 1890s, when estimates began to be compiled (Calder p.40).

But the seeds of that transformation were planted and starting to grow quietly in the era and institutions we’re talking about this week, because those later developments were only possible with a cultural shift in how people understood money, their uses for it, and the appropriateness of borrowing. As usual, the notes for this episode will be available at ArsenalForDemocracy.com in a PDF, and with that let’s get into it. [end intro]

[I’m debating reading into the episode pages 78 & 79 which we didn’t read last week but sort of recap the major points of parts I & II]

As the Second Industrial Revolution took off, there were quickly a lot more things for consumers to buy, but not necessarily the money in circulation or on hand with which to buy it. So, how did they buy things?

<u>Peddler Installment Plans, Retail Installments, and Farm Equipment Installments</u> (starts p.55, continues p. 156 in Chapter 4) [Rachel]

- Peddlers were middlemen hired by retailers to bring in immigrant consumers and introduce them to American consumption. The peddlers were given retail experience that could lead to jobs in-store, and the stores had access to a new demographic. Peddlers used their connection to immigrant communities to build relationships between consumers and the stores. They literally brought customers into department stores and helped them navigate the confusing world of American consumerism. They helped with language barriers and matters of American purchasing etiquette. This turned a formerly fraught experience into a positive one, and created loyal customers.
- Peddlers would sell goods on installment and then visit consumers’ homes to collect the payments. Over time, the peddlers became trusted family friends. One example from Calder tells a story of the peddler who sold a sewing machine to a family. He came to the family’s house every week for 25-cent payments over a period of 18 years.
- Once department stores saw how successful the peddler installment scheme was, they started offering installment plans in-store. Stores quickly adopted this scheme, and a new form of store appeared, aggressively selling low-quality, overpriced goods to low- and middle-income households on installment. These stores were called “borax stores”, in that they “cleaned a person out.” These stores hurt the credibility of installment buying among middle-income consumers. These borax stores were primarily furniture and clothing stores. In 1899 Boston, half of the city’s furniture stores sold mainly on installment.
- Although there were some less-than-credible retailers aggressively marketing to families without much money, these low-income families were able to afford goods that were previously unavailable to them. Pianos and other musical instruments were now attainable, and these households were able to own a piece of culture, which I see as a net good.
- Installment credit, including the rent-to-own model, became popular in the late 18th century. Calder tells a tale of a countess who wanted to outfit her house in the Parisian fashion with fancy furniture sets. The countess included in the payment agreement that she wanted to retain the option to buy the furniture. She told all her friends to outfit their houses in this manner.

- Installment credit exploded in the mid-19th century, with the rise of machines (eg. household appliances such as sewing machines and record players, which we've talked about in previous episodes, and farm equipment, which we will talk about shortly). While they made work significantly easier, they were also a significant expense for workers. So significant, in fact, that many workers were hesitant to buy them, even with traditional credit instruments. Installment credit helped to overcome that hesitancy.
- [Kelley] Farm Equipment (pp.159-161): At the beginning of the 19th century, farmers actually owned very few things as there had been few technological advancements since biblical times and farmers lived simply with a few pieces of furniture and clothes. However, as more efficient farm equipment was developed and produced, producers needed a way to make this expensive equipment affordable to farmers. The equipment was often so expensive that it could not be paid off in a season or two and more long-term plans were necessary. For example, a McCormick reaper was $100, but annual income for a farmer was only $300. So McCormick introduced the installment plan, with a small downpayment and the balance due after the crop. This put a drain on McCormick's own finances, so we went on to introduce a generous discount for up front payment, but ⅔ of purchasers still preferred to buy using the payment plan. Farmers were reluctant to sign formal agreements, and competition forced sellers to continue to reduce down payment prices, leading to significant losses. Generally speaking, farmers did pay when they could, but repayment often took more than a year.
- [Bill] Farm equipment and the credit financing it had a profound effect on the entire United States, not just in how it brought mechanical capital to agriculture but also how its associated debts and production levels ended up contributing to a sector collapse for several years that brought much of the American population to the brink of starvation for a few years in the 1890s, which is when soup kitchens and community garden campaigns first appear, before things balanced back out. I want to recap a point we made on our July 2020 episode on The Long Depression: *The 1890s was also notably distinct from (and put an end to) the earlier period because there was a wide-scale exit from agricultural production by farmers who had been struggling for the two previous decades with capital debts, mounting prices for shipping and storage of grain in the rail industry, and falling grain prices due to vast over-production (and the arrival of significant industrial mechanization in the 1870s especially after wartime labor shortages had spurred mechanical innovation -- the total value of all farm machinery nationwide rose by nearly a quarter-billion dollars from 1860-1890 -- by 1889, American manufacturers were producing $81 million worth of farm machinery annually compared to $17 million per year in 1859 before the Civil War [all Census Bureau data from a 1927 Congressional Research Service report])*

(As mentioned earlier, we will talk about the rise of auto loans later in this series, which is the ultimate culmination of consumer credit and capital equipment installment plans.)

<u>Book Credit and Running Accounts</u> (starts p.59, continues p.70) [Bill]
- This had been before the Civil War and remained after paper money was de-emphasized after Reconstruction the only way of grappling with the severe shortages of "specie" (precious metal coinage from the government) in circulation almost everywhere in the United States.
- Urban and rural, middle class and working class
- In rural areas, the "general store" ledger; in urban areas, every specialized shop (grocer, butcher, baker, etc.) had a ledger and people would "buy on tic"
- Declined in relative terms for a while as the new post-Civil War urban department store industry attempted to force cash-only purchasing (offering the incentive of significantly

cheaper prices) but eventually even these companies bowed to the pressure to offer charge account options

- Open Book Credit had a major drawback for the vendors which was that if a customer in debt actually went bankrupt, their retail creditors were treated the same as any other creditor and probably didn't get paid back or only got a fraction of the money owed. By contrast, installment plans meant that the store had already probably recouped a lot of the price of the item sold, as opposed to waiting weeks, months, or years for the customer to have enough cash on hand to settle up. (p.276)
- Cultural question: Did people think of this as money or borrowing? It was that, but maybe they didn't understand it as such.

<u>Loan Sharks, Pawn Shops, Small-Dollar Lenders</u> (starts p. 116) [Bill]

- High-interest not only for exploitation but also due to the high overhead costs of the business relative to the size of the loan being made
- Usury laws were still on the books and often enforced in many parts of the United States during this period, unlike in Europe. These laws were avoided by making an interest-free loan and then charging a whole bunch of "fees." However, Calder argues that the continued existence of usury laws until reforms in the early 20th century did make enough of the industry unprofitable except by illegal activity that unsavory loan sharks became an essential source of financing in many ordinary people's lives. Many desperate poor people in American cities ended up paying huge sums to illegal lenders.
- Small-loan lenders emerge as a direct outgrowth of industrialization and the rise of industrial wage labor in the 18th and 19th century. Paychecks might be more frequent than agricultural harvests but they were still unreliable and subject to sudden firings, plant closures, strikes, horrific injuries, illness, etc. Where pre-industrial farmers might subsist and meet most of their needs within their own farm, the industrial laborer's entire life was dominated by the need to earn and spend money on everything: food, housing, clothing to say nothing of little luxuries. They needed cash on hand, not necessarily at convenient times, and their life was completely precarious. Into that breach stepped the small-dollar lenders, especially in the second half of the 19th century. People could pawn their property for various lengths of time, sometimes quite briefly like less than a week, or they could sign away the rights to their future earnings on a relatively steady paycheck for a discounted lump sum in the present. Newspapers were filled with ads for pawn shops. "Wage assignment" businesses were often illegal and did not advertise.
- There were some fairly unsuccessful attempts to serve the poor's need for short-term, small-dollar finance through various "charity shops" and philanthropically-subsidized lower-cost lenders. These mostly didn't really go anywhere.
- The chattel lending or pawn shop industry was interesting in this period because some families would pawn property during the week and retrieve it for the weekends, hoping the shop didn't burn down with all the inventory in the meantime. All of this seems terribly inefficient and expensive.
- This is the part of the book that I learned the most from because it was totally new info to me and it was also filled with lots of anecdotes and research (some by other academics) that would be hard for us to summarize here, so listeners might want to try to find a copy of "Financing the American Dream" by Lendol Calder (1999) to read it for themselves. I was especially surprised to read about how many of these small-dollar lenders apparently employed women, not just big muscle men, as enforcers. They gambled that using women to collect on late payments and enforce unpleasant fees was a) somewhat less likely to provoke debtors to physical violence and b) could publicly embarrass and shame a debtor in front of his family and friends if necessary.

Credit Reporting [Kelley]

- How did those providing credit know who to loan to and who was likely to pay them back? Equifax, one of the "big three" of modern credit reporting was born in 1899, and by 1920 had offices across the country and millions of index cards with newspaper clippings of promotions, arrests, etc to determine one's credit worthiness. However, there were systems that predated them. In 1864 the Mercantile Agency, which would later become R.G. Dunn and Company created a formal system for ranking the credit worthiness of companies.

- A central and fascinating figure at the Mercantile Agency was its founder, Lewis Tappan. Tappan was a strict Calvanist who insisted on cash transactions for the first part of his career, as the bible warned against lending money and charging interest. https://www.pbs.org/wgbh/theymadeamerica/whomade/tappan_hi.html

  In 1830, the Tappans met a young abolitionist agitator named William Lloyd Garrison, whom Arthur offered financial support. Soon, the brothers were part of a nationwide network opposing slavery. Their new crusade made them the hated targets of many merchants and white laborers, who believed ending slavery would destroy the cotton export business and allow freed slaves to take scarce jobs. By 1834, mobs were storming Lewis' home and Arthur's store. Faced with a boycott and lost business, the Tappans were forced to extend credit for the first time. Then, in the panic of 1837, the business was wiped out. By 1839, Arthur had repaid all his creditors and the business was shakily back on its feet.

  Lewis hated credit, but he realized offering it to customers was becoming the only way to make a sale. How could a merchant gauge his customer's trustworthiness, and assess whether he'd ever get paid? Tappan began keeping files on customers, reviewing their characters and their credit-worthiness. Pretty soon, other merchants were turning to Tappan for advice. Exploiting his abolitionist connections across the country, Tappan created a network of correspondents to offer up-to-date and comprehensive credit information about people in their communities

  By 1841 they had 280 clients, and by 1859 they had over 2000 correspondents across the country. Tappan retired wealthy and spent retirement continuing to fight slavery; he died 10 years after the emancipation proclomation.

- Still, the use of credit reporting was not used like it is today. Research has found that even when information was available, it wasn't accessed until something had gone wrong - either a system wide or individual event that called credit worthiness into account.

  First, subscribers only acquired a fraction of the reports that the agency supplied, even though the information was inexpensive and easily available to subscribers. Second, when they did access credit reports, subscribers were more likely to do so after an adverse shock to the aggregate economy or the individual borrower. Finally, subscribers were more likely to acquire information about a borrower if one of the subscriber's other borrowers defaulted.
  https://www.fdic.gov/analysis/cfr/working-papers/2016/2016-04.pdf

[Closing discussions]