American Money, Part V: Epilogue - Personal Finance - Arsenal For Democracy Ep. 399 [Bill/Rachel] (Oct 10, 2021)

[Bill] Intro: So far on this miniseries, we've focused on answering fundamental and philosophical questions about the nature of money in the United States in the second half of the 19th century, and especially during the takeoff of the American mass consumer economy in the 1870s and 1880s after the Civil War experiments with national paper currency. Last week we focused on the death spiral of the sound money political battles between the gold and silver coinage factions, but the previous week we looked at the early credit economy and the shadow lending economy of American cities in this period. This episode serves as an epilogue by showing how all these trends and emerging forces resolved themselves into a more coherent system as the 1890s brought the century to a close and the 20th century arrived. Now that we've attempted to answer questions like "what is money," especially when there isn't enough circulating physically, we can examine how those monetary policy and emerging credit systems of the late 19th century turned into the iconic American consumption culture of the 20th century and how that in turn became the 21st century iteration upon that. This week we'll try to answer how Americans by the turn of the century started to become culturally comfortable with personal debt to make purchases, how this unlocked the full power of the 20th century American consumer economy, and how the new modes of personal finance from the turn of the last century unleashed the all-consuming 21st century monster of monthly payment plans bundled by the millions as secondary and tertiary investment vehicles that are too big to be allowed to fail…

This week, as in part III of this miniseries, we'll be drawing most heavily on the 1999 economic cultural history book "Financing the American Dream: A Cultural History of Consumer Credit" by Lendol Calder, but of course when we cross past 1999 for the epilogue to our epilogue, we'll be drawing our own conclusions. The Calder content we will draw on today also heavily overlaps with "The Rise and Fall of American Growth" by Robert J. Gordon, published in 2016. So, with that, let's get into the final episode of our miniseries.

The Ideology of Credit

[Bill] One of the big features of Calder's book is the author's research into the evolution of American cultural views on personal finances in the second half of the 19th century and the first couple decades of the 20th century. For the rise of consumer finance to occur, there needed to not only be a demand for it and a supply of it, but also an ideological propaganda campaign to break the hostility widespread in the American mind on the subject.

Since the country's founding, the official line in American culture, setting aside practical realities, had been that you should live within your means and that there are two types of borrowing: productive borrowing, which is worthy and noble, and consumptive borrowing which is profligate and evil. A productive loan would be a business loan, for example. You borrow money on your good name and reputation, your credit, and you make a business investment, such as opening a store or buying a piece of machinery for your company, that you hope will generate so much profit that you can repay your loan and then earn an income for yourself. A consumptive loan, on the other hand, would be borrowing money to cover personal expenses, such as food, clothing, shelter, gambling debts, and other vices. The line between necessity and disreputable prodigality was often blurred, so that borrowing money to replace an essential item of clothing was regarded as equally evil to borrowing money for a fancy dress or necklace as a frivolous and vain indulgence.

Obviously we've talked already about how desperation with shortages of money in circulation on the frontier and unstable compensation cycles in both frontier towns and American cities had pushed many businesses to extend consumer credit for basics like food and textiles and many

customers to take out emergency loans or pawn property to make ends meet during the course of an ordinary week. And as we've discussed, there were already starting to be opportunities to purchase furniture and clothing on payment plans to help maintain or build the lifestyles of those on the economic and cultural edge of working class and middle class as the latter began to gain a distinct identity. So to some extent, the pump was primed for a cultural shift because deep down many people knew it wasn't realistic to say you should live within your means.

But there still needed to be a sustained ideological war to make borrowing and credit for consumer goods not only culturally acceptable but essential and expected. As we talked about in the last couple episodes, had this shift not occurred, the American consumer economy after the American Civil War would have floundered and died with a vast overproduction of all manner of new goods with nobody to buy them and no money to buy them with.

Calder's book charts the transformation of even the terminology itself from "consumptive" borrowing to "consumer credit." Then, as today, lifestyle was the foot jammed into the crack in the door to force it open. As the Second Industrial Revolution got under way, a non-mercantile middle class was emerging as cheap industrial paper, the typewriter, and the telegraph suddenly came together to allow and enable corporations to form bigger and more complex consolidations around the country that required an army of white-collar clerks and administrators constantly doing paperwork all day. These men (and by extension their wives and children) were not rich industrial titans of the big bourgeoisie with their ownership of large capital formations, nor were they the shopkeepers and small business owners of the little or petit bourgeoisie, and they certainly were not performing hard labor for unreliable wages. They were simply modestly educated men on reliable salaries with surplus time in the day and a little bit, but not a lot, of surplus cash. The post-Civil War corporations churning out canned food from wartime food factories and mass-produced shoes and ready-to-wear clothes from wartime uniform factories, in conjunction with their newly created partners in the emerging field of consumer advertising, were all about creating new demand for their products and that meant crafting a narrative around a lifestyle. The new middle class could furnish an apartment or a house and keep up with the latest fashions by buying or renting these things on payment plans. And if you were a successful laborer with a steadier job than most and looking for some cultural upward mobility, then you could do the same and enter the ranks of the new middle class too. People were already used to purchasing on a tic at the ledger of the local grocer or the general store with accounts to be settled up later. The principle could be extended to payment plans. And most importantly of all: A consumer credit plan was, after all, really just a kind of productive borrowing, because what could be more of an investment than investing in yourself to keep up appearances? If you host the boss for dinner with your stylishly financed furniture and chinaware, you might get a promotion and move up in the world.

The real coup, however, in the propaganda war to normalize and disguise consumer borrowing as being something distinct from the bad old "consumptive borrowing" was convincing everyone that the truly fiscally responsible man was not the man free of personal lifestyle debt and scrupulously saving up for purchases later, but rather the man and wife who could religiously make all their payments on time through careful household budgeting and little cost-cuttings here and there – and improve his lifestyle today. The dour old Protestants of the antebellum United States and colonial America had always warned sternly against borrowing for personal use and held that it was only morally righteous to save money and deny one's desires and vanities. The new Protestant man of the end of the 19th century understood that the truly moral fiscal rectitude and self-discipline was to shackle one's self to a world of monthly payment plans very precisely based on projected household incomes over time and to scrimp and save to make every single payment on time, not to scrimp and save to put money aside for some

unknowable future. Published surveys frequently sought to demonstrate that people budgeting to live slightly beyond their means through credit were actually more careful and self-disciplined with household finances than those who did not borrow or engage in credit-based consumption. Therefore the paradigm was flipped on its head where hedonistic consumption became viewed as the noble, difficult, personal responsibility characteristic.

Meanwhile, every company involved in this kind of "Buy Now Pay Later" consumer financing was quickly discovering that offering these credit plans didn't just enable more consumption but was actually quite lucrative in its own right. In the past, as we've discussed, when it had been done as a necessity in the cash-poor United States or to smooth out harvest revenue cycles in farm country, extending credit at a store was an expensive proposition in terms of delaying cashflows to pay back institutional creditors and thus carried high-markups on prices for the end-consumers. But eventually, as consumer financing began to emerge in its own right, it became much more obvious to institutions that people's willingness to pay much more for a good over time could itself be turned into profit. No longer was the debate between cheap, cash-only retail and marked-up purchases to be settled up later. Now a vendor with access to longer-term loans at reasonable rates from a patient financier could charge a lot more for a good by spreading out the payments over time. All you needed was patience and you would make much more profit per unit than if you had demanded lump sums or quicker payment in full. Putting up the investments to credit-based business activities went from a high-risk venture to a highly-profitable business activity in its own right.

This ideological transformation around people's understanding of credit and its place in lifestyles and moral righteousness, as well as the economic transformation around understanding how lending into the consumer sphere could itself be a legitimate and lucrative sector, laid the groundwork for the 20th century consumer economy and also the 21st century economy of infinite loans and not production of goods and services themselves as the center of gravity in business. In the era we've been covering, this financialization was still a supporting sideshow to the main event, but as we'll return to later in the episode, the foundations of the current balance of power are clearly becoming visible even at this early date.

[Rachel] One interesting point that Calder brought up is that the word "consumption" was a euphemism referring to TB at the time (as readers of period literature probably already know and as Bill constantly references in casual conversation), and it was definitely a dirty word in regards to spending as well. There were editorial illustrations of waifish and gaunt figures pawning their furniture for whiskey and skeletal dandies wearing fine watch chains, demonstrating the differences between terrible consumptive debt and moral and right productive debt.

<u>Homeownership Financing Takes a Turn</u>

[Rachel] One "good" form of debt was housing mortgages. In the late 1800s, it was customary to save for a house, and then pay for it to be built when the money was raised. Because saving for the house was a practice in patience and frugality, it was a moral endeavor. However, by the 1870s, the price of a house - say, $1500 - would take an average white-collar salary worker earning $1000/year 15 years of saving 10% of their income. Most people didn't want to save that long and delay home-buying for such a long time.

In the early days of housing financing, prospective home-buyers were still expected to contribute a significant down payment, about half the price. One example from Calder (and also cited by Gordon, pp.300-302) was the purchase of a lot and the cost of building a house, equaling $3000. The buyer would save $1500, which would then be split into $500 for a

payment on the lot and $1000 for materials and labor to build the house. The balance of $1500 would be obtained through two separate mortgages. One mortgage of $1200 would be from a savings bank, or from a private small investor; this would have an interest rate of 5-6% and would have priority over all other debts. When the house was almost complete, a second mortgage for $300 at 6-8% would be obtained from a real-estate professional. These mortgages, again totalling $1500, would be paid back in a manner that looks weird to modern borrowers. Buyers were required to pay interest payments semiannually for the next 3-8 years, and then the principal would be paid off in a lump sum at the end of the loan term. This is what's known as a "balloon-payment mortgage". (This lump sum repayment was also the same system farmers had used to purchase farm equipment, rather than installment plans. [Gordon p.291])

There were a diversity of methods of home financing at this time. One strategy even included taking out four loans from three different sources to build one house: buying supplies and hardware on credit, taking out two loans from a loan office to pay for the supplies, and then securing a mortgage from a building and loan association. There were many sources for financing, from the aforementioned loan offices, savings banks, and building and loan associations, to individual savers who happened to have money they were willing to lend at interest.

Building and loan associations were an important source of funding for home buyers. They were cooperative societies designed to make homes affordable to families with modest means. They operated as banks without vaults, and oftentimes without offices or salaried officials. Prospective home buyers invested their savings as shares in an association, with the goal of borrowing against those shares to finance a house at a low rate of interest. Borrowers were required to subscribe for an amount of stock equal to the loan they wished to borrow. Along with a membership fee and a premium paid for the loan (which was determined by auction), the borrower paid monthly interest on the loan at 6% and monthly installments on the shares. When the shares were paid up, the loan was effectively liquidated. Calder gives an example of how this worked: a borrower wanting a $1400 loan would buy ten shares in an association, at one dollar each. As a member of the association, he would be allowed to bid for the privilege of receiving a loan for $2000, which could be obtained at a 30% premium. Making the bid, he received an actual loan of $1400 to pay for the labor of building the house. The house and the borrower's shares were mortgaged to the association. Repayment of the loan occurred gradually as the borrower paid monthly dues on his 10 shares and interest on the loan to the association. In 8-9 years the debt was declared paid and the mortgage released. As quoted in the book, "the contract was crude and very few people understood it." However, this type of mortgage was instrumental to our current method of home financing. In this scheme, both interest and principal were paid off concurrently, unlike with the balloon-payment mortgage. This style of amortized loan structure didn't become popular in the 1920s. Amortization made loans much safer for both borrower and lender, but the complicated loan structure was slow to take off. Banks were risk-averse to these long-term loans versus 30- and 60-day notes that could be called in quickly. And, until 1916, national banks were prevented by law from making real-estate mortgage loans.

The Auto Loan Revolution

[Bill] The British podcast Trashfuture, which we on this show listen to and greatly admire, has a recurring joke that is also an accurate observation of the economy that major American automakers like GM are banks that happen to make cars, because the lending part of the company is so huge. It's a joke we've referenced many times in the course of our own episodes on economic history. While that show is talking about present-day structures of car companies and the joke is commenting on the totalizing financialization of every business in the 21st

century global economy – a point we'll be circling back to before the end of this episode – there is one slight misconception contained within the joke and that is the idea that this balance in the relationship between making cars and selling cars via financial instruments is a new one. In fact, we were surprised to learn in the process of researching this episode, both from the Lendol Calder book and from a passing sentence in Robert J. Gordon's 2016 tome "The Rise and Fall of American Growth," that actually the real story of the American auto industry from the beginning isn't really about assembly lines or mass production but rather about auto loans. General Motors itself was formed in 1908 and by 1919, 11 years later had established the General Motors Acceptance Corporation (or GMAC), its in-house auto loans financing division. These loan arrangements with convenient monthly payments over a short fixed term, initially provided by local banks in conjunction with franchise dealers before GM pioneered the in-house strategy, were absolutely critical to the success of the nascent auto industry, just as late 19th century farm machinery manufacturers had discovered, as covered in prior episodes. Without this financing option, the customer base for personal automobiles would have remained small and rich. The enormous profits to be gained through mass production required mass consumption and paying cash up front was simply not an option for almost anyone in the United States in the 1910s. Mass production also only worked if demand for purchases was year-round, which didn't work without credit to bridge the lean months, especially in rural markets. (Gordon) Automakers like Ford that tried to reject a credit-based system of auto purchases found themselves so quickly out-competed in the market that they eventually had to yield. All of these car companies within a short period of time were entirely dependent on the business of offering auto loans to American customers, and because these cars became so ubiquitous, the auto loans themselves opened the cultural door that final distance to make consumer finance and monthly payments a perfectly acceptable way of living life. Without auto loans taking off when they did, it's difficult to imagine electric home refrigerators and other appliances like washing machines, dryers, and dishwashers becoming so omnipresent. It's also hard to imagine the planned obsolescence cycles of new models every few years being widely feasible without the short terms of these financing plans.

And it's important to note that auto loans in the United States were indeed loans. They were similar to, but marked a distinct departure from, the financing methods we've talked about previously, like Singer sewing machines paid for each week over a decade or two, or player pianos in middle class homes.

[Rachel] When a customer was ready to buy, the dealer sat down with the buyer to explain the transaction, fill out a credit application and sign a contract detailing the terms of the deal. Initially auto loans required a hefty down payment, about one-third of the price of the car, and the balance paid out monthly for 6-12 months. This short repayment period was pretty important to the finance companies. Repair bills after the first year ran so high that the finance companies were afraid that borrowers would be reluctant or unable to pay their remaining balance. After the paperwork to buy the car was completed, the dealer would call his sales finance company over the phone, a credit check would be completed (taking a few hours), and the deal would either go through or be denied. To make sure the dealer screened applicants with care, rather than rubber stamping all sales, risk was distributed between the finance company and the dealer through various risk-sharing arrangements.

However, competition was fierce and there was a race towards liberalization of these contracts. (Gordon p.298) 12-month payment schedules were lengthened to two years or longer, and dealers were enticed with offers that relieved them of all risk when selling a car on credit. Also, many manufacturers quietly awarded subsidies to the major finance companies for contracts on the manufacturer's cars. Although the banks tried to encourage conservative lending methods

through the formation of the National Association of Finance Companies in 1924, they were largely ignored. This is very reminiscent of today's car financing, where credit flows freely.

Henry Ford so hated the idea of consumer debt for automobiles that he tried to implement an alternative method for purchasing cars: the Ford Weekly Purchase Plan. Under this plan, a prospective buyer selected a body style at his local Ford dealer, then began a savings plan with the dealer by making a nominal "down payment", which could be as little as $5. The dealer then opened up a savings account with a local bank in the purchaser's name, where it collected interest. The buyer would make weekly payments that would go straight into this savings account. The buyer was allowed to skip deposits, and could also withdraw money in case of emergencies, though this would delay the delivery of the car. When the purchase price of the car had been accumulated, the customer would receive the car. This was in stark contrast to the "buy now, pay later" offer that competing finance companies were hawking. Not surprisingly, it was a profound failure. In the first 18 months only 400,000 people enrolled in the program, and only 131,000 of them managed to receive their cars. According to one Ford dealer, "We often had to refund [deposits]. After people would get $50 or $75 they would want a vacation or something and they would withdraw it." Ford's beliefs in fiscal responsibility and thrift just did not resonate with car buyers. By 1919, independent financing not approved by Ford was involved in two-thirds of Ford sales. (Gordon.) This failure or slowness to adapt to consumer credit was also mirrored in the resistance of the Macy's department store to establishing any kind of charge accounts and an unsuccessful attempt to implement a prepaid depository account system with the store, which merely relieved someone of the inconvenience of carrying cash or making sure they had enough cash on hand for a purchase, but did not actually advance them any money they did not already have on deposit at Macy's. (Gordon and Calder both discuss this pre-1920s effort.)

<u>Epilogue to the Epilogue: The 21st Century</u>

[Bill] Today almost everything in the consumer economy is some kind of monthly payment plan or subscription service, but also much of the business world itself has come to revolve around the money flows of these consumer payments and in turn the resulting payments to each other settling up accounts payable with accounts receivable. And there are various financial innovations, some more legitimate or more scammy depending on the specifics, to smooth out payment cycles over time, offering both consumers and businesses access now now now to future earnings for easy terms of a higher payment here or a discounted receivable there. Finance, as a sector, is conceptually merely a means of economic time travel, promising to go to the future where all your money is waiting for you and bring it back to the present where you don't have money on hand but need it to do something, whether it is to buy a new shirt or a house or to build a new bridge or a factory. And they just make their money on facilitating that transaction and using their amassed wealth in the present to substitute for a time machine to your future.

Finance and capitalism, particularly Western capitalism, have always been inseparable conceptually. So, it can be a bit reductive to describe the 21st century economy thus far as being primarily dominated by financialization. But the thrust of this argument is that the role of finance itself, rather than production supported by finance, has swallowed up the global economy. And I would argue that we can faintly see the origins of this at the turn of the last century and on either side of it by 20 to 30 years. Today we are in a similarly deflationary period in the sense that the cost of many goods continues to drop. And in another sense, the stagnation or real decline of wages combined with certain costs like housing, childcare, and education continuing to rocket up has acted in an analogous pressure to what we talked about with the money circulation shortages and wage cuts of the late 19th century. There's not enough

money going around, especially at the bottom of the economy, to support the level of consumer demand the top of the economy has come to expect. Rather than flooding the market with dollars at the bottom and wage increases, once again finance is the solution, just as it was in the late 19th century when faced with a similar challenge. And companies don't view this as an unsustainable pit of unrepayable loans. Rather, they see the immense profits to be made through the act itself of making regular payments on a marked-up base price. The object itself is cheaper than ever to make and consumers are willing to pay many times its value over a long period of time for the convenience of not having to pay a lump sum in cash. This means that the entity financing this purchase is creating even more surplus value out of thin air than even the normal profit model does. To be sure, there have been stumbles for the industry, like the mortgage market collapse of the last recession, but mostly the institutional private-sector lenders have reconceptualized money so completely that they're thinking in terms entirely unmoored from traditional views of lending or borrowing. To them, the balance sheet flows of regular, predictable payments from other companies or from millions of consumers paying off their monthly cell phone purchase agreement or auto loan is something that looks great each quarter and can also be bundled and repackaged to sell in bulk to other companies looking for somewhere to park their money, thereby quickly recovering their own outlay with a modest discount off an imaginary marked-up value. With cash reserves accumulated so heavily at the top of the economy, that principle sitting around has to be invested somewhere and thus has no opportunity cost to not being available as cash on hand, and it might as well be loaned out in the form of some collateralized debt instrument that will come back over the long run, even the very long run, with handsome profits. Even if the thing itself being invested in is a failure, the mandatory regular payments in the meantime will have repaid the principle long ago.

There's an interesting argument made in David Graeber's 2011 book "Debt: The First 5,000 Years" which is probably debatable historically but is at least worth considering conceptually. He argues that there is a massive difference historically between Western European Capitalism and Islamic Capitalism in their incentives and thus their results because of the prohibition on interest-bearing loans in the latter. (As a side note: In the former, interest was also prohibited for a long time but Europeans kept finding loopholes and workarounds, in no small part due to the vast shortages of physical cash in Western Europe, as we discussed in part I. But even then, the loans tended to be for business ventures and not personal borrowing except among the high nobility and royalty.) But to get back to the point Graeber argued – he believed that Islamic capitalism favored investing in ventures on a profit-sharing model, instead of an interest-bearing loan-funded model, and that this made Islamic ventures more about building something for the future. By contrast, he believed that Western European Capitalism, with its dependence on interest-bearing loans to launch ventures, became by necessity more extractive, more destructive, and more violent, as he argued colonialism and the industrial revolution both demonstrated. Again, I can't speak to the historical accuracy of this comparison, but there's something there conceptually. A profit participant shares a significant amount of risk in a venture and only makes money if the venture is a success. If it is a failure, there is typically little recourse to get back the money. A lender, by contrast, faces some risk of default but generally has immense legal powers to recover the money owed, or at least a substantial amount of it. They also have the right to demand repayment, depending on the terms of the agreement, either all at once or in segments at fixed, predetermined intervals. The borrower has every incentive to rip as much money out of anywhere he can find it as fast as possible. Every day, that payment deadline is getting closer and the interest is climbing higher. The lender will be repaid, come hell or high water, even if it means getting blood out of a stone.

There is no economic model better suited to facilitating and profiting from a neoliberalized era of stagnant wages and underemployment than one completely based on lending for profit on

monthly repayment terms because that is the model best suited to getting blood out of a stone even after you think there's no more blood left to wring out of it. It's never about paying off the loans. It's just about making the little regular payments forever. That's where the real money is – and that's how they keep you chained to the grindstone by your own self-discipline and fear of legal consequences.

[Rachel] It's interesting how there has been a return to tying debt to morality. Dave Ramsey really epitomizes the odd mix of financial advisor and Evangelist that has sprung up in the past few decades. His view is somewhat extreme in that he views even "productive" debt as bad. I would argue that strict adherence to his tenets can be disadvantageous as credit and credit history have become necessities in today's world.

Conclusion

[Bill] That's the end of our miniseries on American money in the late 19th century and its aftermath. We have more episodes planned for the future drilling down into more of the specifics that we only briefly touched on, especially early design implications of things like home mortgages. But this series in five parts and four long episodes took us most of the summer of 2021 to research and prepare in between all our other regular episodes, and I am currently just a few weeks away from my next election as we record and release this episode, so it is now time for us to once again ask for your patience and bear with us for a brief hiatus of a few weeks. In the meantime we will continue unlocking fantastic bonus Patreon episodes from the first half of the year to play on the main feed. But we will need a few weeks before we produce another new episode, to catch our breath from this miniseries, and to plan for our 400th episode, since this is our 399th episode. My election is on November 2nd, and so you can expect the next new episode to be recorded and released after that at our earliest opportunity. We hope you'll catch us then. Rachel, thanks so much for being on this week to round out our miniseries on 19th century American money and to talk about the rise of Personal Finance.