The credit revolution

Reviewed by Robin Klay in the June 30, 1999 issue

> **Financing the American Dream: A Cultural History of Consumer Credit.**
> *By Lendol Calder. Princeton University Press, 377 pp.*

Everyone seems to agree that America's moral fabric is being undermined by the unwise proliferation of consumer credit. We readily believe those who claim that easy credit fuels rampant hedonism and leads many to bankruptcy. Wistfully, we compare ourselves to ancestors who supposedly controlled their spending and never went into debt. We believe that our present affluence is a bubble that will surely burst.

According to Lendol Calder, these fears and claims are either exaggerated or fundamentally wrong. Consumer credit is not an invention of the post-World War II period. Our 19th-century predecessors also borrowed money, even for consumption. The "credit revolution" occurred in the 1920s and '30s, not the '50s (and certainly not the '90s). Furthermore, the naysayers of pre-Depression days—including preachers, bankers, journalists and government officials—were proven wrong in their predictions that consumer credit would end in serial bankruptcy and national economic collapse.

Calder, a professor of history at Augustana College in Rock Island, Illinois, fills in the fascinating details behind our misperceptions by tracing the history of consumer credit. Although he emphasizes the "credit revolution" that occurred between 1915 and 1940, Calder takes his readers back to colonial days (and even to John Calvin) for an engaging documentation of our love-and-loathing affair with credit.

One of Calder's goals is to expose perennial claims of "lost economic virtues" as the erroneous "memories" of cultural romantics. He shows that, far from abandoning the traditional economic virtues of thrift, frugality, planning and living within one's means, early 20th-century consumers, who enjoyed vastly increased access to cash loans and installment credit, continued to practice these virtues, but in a changed environment. They showed themselves worthy of credit by making regular payments on the debt they had incurred to purchase homes, cars, furniture, encyclopedias, jewelry and even vacations.

Calder points out that the credit revolution did not lead most borrowers into lives of debauchery and bankruptcy. Indeed, the first Americans to receive credit through formal financial systems were those who were relatively well-off. Overwhelmingly, their loans were for tools and business starts. Throughout the 19th century, cultural leaders (exhibiting a certain class bias) proclaimed that loans for consumption and loans to the working class would be financially foolish and morally debilitating. Between the Civil War and the 1920s, an important new source of consumer credit, small-loan companies, democratized access to loans. Earlier, most working-class people in need of money could turn only to friends, family or pawnshops; now they had easy access to small amounts of cash. Interest rates were high—reflecting both the costly processing burden associated with even very small loans, and a premium to cover risk to lenders who were in violation of state usury laws. Often referred to as "loan sharks," these lenders were considered social parasites.

Disgust with the strong-arm tactics of some of these lenders led to the creation of "remedial loan associations," whose objective was to drive down the high interest rates charged by private lenders by offering lower-interest loans to needy borrowers. These benevolent and semibenevolent associations, however, were never able to acquire the necessary capital to compete with private lenders. Many sponsors of these organizations turned their energies to proposals for legal reform to regularize the small-loan market. Those efforts were unsuccessful until the small-loan industry itself got on board.

Lenders first formed professional associations for policing themselves. Then, seeking to improve their public image, those associations collaborated with their critics in support of laws to regulate the industry, resulting in passage of the Uniform Small Loan Law (1932). Referring to themselves as "financial physicians," members of the industry took on a new identity as "personal finance" companies.

The other major aspect of the credit revolution was the rise of installment selling. First, farm tools were financed this way. Then, home mortgages, serviced with monthly payments of interest and principle, were developed by building and loan associations as substitutes for the previous practice of requiring a single payment of principle at the end of the mortgage term. Sewing machines were the first consumer durable to be widely purchased on installment plans, followed by pianos and other furniture.

Not until the invention of the car, however, did installment buying lose its stigma. General Motors began the practice, followed later by a reluctant Ford. Calder points out that cars would not quickly have become mass-consumption items without the move to installment contracts. Thus, much of the credit for launching the automobile industry, usually given to inventors and to those who introduced assembly-line processes, should be shared with the credit industry.

The consumer credit industry and the whole idea of "consumers" was for many decades unfavorably identified with women. Women were blamed for lacking good sense about money, indulging in instant gratification, and being tempted to make vain purchases. When men started to use installment credit to purchase cars, the initial public reaction was suspicion that the male spirit of self-reliance was being undermined.

A famous 1927 study of consumer credit, by the economist E. R. A. Seligman, eventually changed public opinion. He was able to dispel many fears about the effects of cash loans and installment buying on American families. Even more important, his analysis led to a revision of previous distinctions between "productive" credit for business and "consumptive" credit for households. What matters, Seligman argued, is whether the loan is wise, given the costs and benefits to the borrower. "Consumers" are to be viewed as producers of value whenever they are thoughtfully engaged in buying, whether with cash or "on time."

Calder convincingly rebuts claims that the credit industry has corrupted Americans by tempting them to wanton materialism and the abandonment of vital economic virtues. Credit and installment buying make it possible to enjoy the use of something while spreading the pain of payment over a period of time. However, that very arrangement forces on borrowers the disciplines of reducing certain ongoing purchases and working hard for extra income.

Materialism has always been alive and robust in our culture. The "American dream" stimulated untold exertions and sacrifices long before the credit revolution or the widespread use of credit cards. Calder reminds us that the American dream too often confuses good "things" with the good life. Thus, neither the credit industry nor even capitalism deserves our easy moralism. Instead, the human heart, as always, is the most appropriate target for teaching and reform.

Beautifully written and well documented, Calder's book shows an unusually keen knowledge of economic institutions and a respectful insight into the financial decisions and dilemmas of ordinary Americans. Lively examples taken from advertising and personal diaries flesh out the study's striking numbers. Preachers are among the public voices Calder criticizes for their lack of economic knowledge. They, and many others, would be well served by encountering and reflecting on the ideas presented in *Financing the American Dream*.