The History of Debt in America - Colonial Times to the Present Day

Colonial Times - 1799

Before the Revolution - Our English Heritage

The American system of debt and debt collection was modeled after, to no one's surprise, the British legal system. This led to some colorful laws. The first bankruptcy law occurred in English law in 1543 and allowed the imprisonment of debtors. Later statutes in 1571, 1604, and 1623 allowed for punishment of those who aided bankrupts. All bankrupts were presumed dishonest and fraudulent and could be forced to repay or be hung. However imprisonment was far more common and occurred in England for over three hundred years. Although severe by modern standards imprisonment for debt was not a British invention as the Greeks and Romans had condemned debtors to slavery.

In the seventeenth century when the commercial market in England was expanding the concept of bankrupts as honest but unfortunate started to circulate. This gave birth to the thought that creditors could oppress debtors as well as debtors oppress creditors. In 1706 a new bankruptcy statute recognized differences by offering absolution to honest bankrupts while retaining criminal punishment for dishonest ones. Eventually the public view of debtors began to change. This was in large part due to the 1760 Depression that happened after the end of the Seven Years War. Then even prominent merchants failed and it became harder to stigmatize insolvency as moral failure.

Debt in Colonial America

Debtors abounded in the Colonial era but failing in business was not as socially reprehensible as was falling from grace. While laws concerning debtors and debt collection revolved around moral obligations as well as financial responsibility there was a much more defined line between financial failure and personal character than we have today. That said the penalties for debt were by today's standards quite harsh.

In the Colonies a 1639 Maryland statute required insolvent debtors to assign their property to their creditors in proportion to their debts. Debtors had to work off unpaid balances as indentured servants, bound successively to each creditor in declining order of the amount of their debt until every debt had been paid in full.

The other option for a debtor was insolvency. Insolvency was a way to be released from prison or a way to avoid arrest but it was not without a high price. Debtors emerged from insolvency proceedings stripped of their substance but not their debts.

Early records show imprisonment for debt happening in Salem Massachusetts in 1678. In the 1760s a debtor was imprisoned for failing to pay an arbitration award. Debtors prison continued to operate in America until almost 1850.

Bankruptcy laws in Colonial America contained harsh punishments in hopes of providing an incentive for bankrupts to avoid court proceedings. The Pennsylvania Bankruptcy Act of 1785 allowed convicted bankrupts to flogged and have an ear nailed to a pillory. In order to make the punishment permanent the ear was then cut off. In early colonial New York, bankrupts were branded on the thumb with a "T" for "thief."

Financing Freedom

American public debt pre-dated the Revolution with every colony using it to finance public obligations. But the war itself led to the first large-scale public debt with the issuance of direct loans and script. By the end of the war Congress had issued some $200,000,000 in Continental currency, sold about $60-70,000,000 in loan certificates to investors and borrowed perhaps $12,000.000 from European sources.

Born in Guinea in 1791 and sold into slavery, Prince Jenks fought in the Revolutionary War. Captured and later released Jenks helped America win its independence but in doing so lost one of his legs. Peg-legged and indebted he took to sea until his army pension kicked in on March 4, 1789 the day the U.S. Constitution took effect. Homeless and unable to vote Jenks did enjoy one benefit of freedom, the ability to enter into contracts and therefore the ability to get into debt. This led him to the position of needing to pay off a creditor and he did so by granting permission to garnish his pension.

The Morality of Debt

The concept of debt as a moral issue has played a central part in the formation of laws, public opinion, and personal conduct throughout American history. It still does. From the sixteenth century English judge who believed that if the debtor couldn't provide food for himself he should be allowed to starve to death, to the bankruptcy bill of 2005, there has been a strong argument that the creditor's rights are paramount.

In 1716 Cotton Mather, the minister of Boston's Old North church, invoked the debtor's plea "Have patience with me and I will pay thee all." But Mather recognized the occasional necessity of debt saying "People must not be in debt unto another, any further than what is unavoidable." He also recognized that debt was an integral part of business expansion.

In the mid-nineteenth century as more and more people met with financial failures that had nothing to do with bad character, judgment, or money management the public perception of debt began to change. It was then that laws recognizing that both the creditor and the debtor hoped to profit from the exchange were created. As such there was a shared responsibility when the debt couldn't be repaid. This new concept was the foundation for standardization of debt collection laws that led to the end of debtors prison in 1849.

Financial Panics, Crashes, Recessions, & Depressions (The Business Cycle?)

Throughout American history there have been times when turmoil and panics brought financial devastation to the country. Interestingly enough they seem to occur on a regular basis at least once every generation. The exception to this was the periods immediately after World War II.

I've heard these occurrences described as the business cycle as though they were a naturally occurring event. But from what I've discovered they occurred because of human actions, most often investment speculation funded with credit. The sad thing is that I see this happening again today so be aware of the state of business when making personal financial decisions. Here are some of the past financial panics.

The major upheavals started in 1792, with another wave of failures in 1797. They continued in the next century with panics in 1819, 1837, 1857, the Great Depression (the first one) of 1873-1878, the farm mortgage crisis of the 1880s, financial downturn in 1884, and another panic in 1893. The pattern continued with a panic in 1907, T he Dpression of 1921, The Great Depression (the second one) of 1929-1942, recessions in 1943, 1957, 1960 & 1969, the inflationary period in the late 1970s, the savings and loan crisis of the 1980s, the Wall Street crash of 1987. We escorted in the current century with the 2001 recession.

The Panic of 1792

The Panic of 1792 was triggered by the collapse of William Duer's speculative empire. Duer was a delegate to the Continental Congress was one of the largest contractors supplying the Continental army. Investing in paper assets, stocks, government warrants, state securities, and currencies and securities on the consolidated national debt, he hoped to take over the Bank of New York and perhaps the Bank of the United States. But when stock prices fell his high interest loans and leveraged purchases defaulted. Duer died in debtors prison in 1799.

1776-1799

Suspicion about the motives of creditors has been around as long as the country. Thomas Jefferson believed that British tobacco merchants conspired to enslave Virginia tobacco farmers into generations of servitude by getting then to buy supplies on credit and when their debt was sufficient lowering the price of tobacco to snare them in the trap.

Commerce between the Colonies and England was extensive before the war so naturally debt was too. The peace treaty that ended the Revolutionary War had a provision to allow British creditors to pursue their pre-war debts in American courts without hindrance and with no suspension of interest for the years of hostility.

Because the law gave creditors the right to have absolute power over their debtor's life and liberty many debtors scoffed at the idea of independence. Creditors could at their discretion have debtors arrested and their property seized. One debtor's will included instructions to sell his body's remains to surgeons. He wanted the proceeds of the sale to be lent with interest in order that it could generate ongoing money to pay his debts. There was one problem however, his creditors owned and controlled his body.

After the Revolution English merchants flooded the American market with their higher quality, lower priced goods. Exports fell, imports grew, income and wealth declined. This brought on a postwar depression that flooded the courts with debt collection lawsuits and crammed the jails full of imprisoned debtors.

But American merchants had their share of tricks too. Post-war merchants used advertising to create demand and used a stair-step approach to profits. By first advertising goods at enticingly low prices for cash and then in exchange for various commodities and finally, on credit at seemingly affordable terms they blurred the distinction between luxuries and necessities.

In the 1780s & 90s debt was a great incentive to migrate west. So many debtors fled the east to live in less-expensive Kentucky that the mere absence of a debtor raised the speculation that he had “gone to Kentucky.”

It was in the 1790s that criminal codes were updated eliminating whipping, ear-cropping, and branding. They also instituted prison sentences of specified lengths. This left only debtors to serve an indefinite prison term.

This led to an interesting situation. If you robbed a bank of $1,000 and were caught you would be sent to prison for a specific amount of time where you’d be fed, clothed, and kept warm. But if you borrowed $1,000 from a bank and couldn’t repay your loan you could be imprisoned for an indefinite period, and if you couldn’t pay for your own food, clothing or heat you would be left to die.

Bankruptcy Easier Said than Done

The right to bankruptcy protection is so fundamental that is was written into the U.S. Constitution. Article 1 Section 8 states, “To establish a uniform rule of naturalization, and uniform laws on the subject of bankruptcies throughout the United States.” Even though this article is unambiguous the first permanent national bankruptcy law didn’t go into effect until 1898.

Debtors protested the lack of bankruptcy protection as far back as 1798 using July 4th as a day to highlight their lost independence. Their protests led to a short-lived bankruptcy bill but the moral argument against debt relief prevailed for another 100 years despite the Constitution.

Early Forms of Debt

In eighteenth century America the most common from of debt was the book account. Generally a book account was a listing of goods purchased and payments received from a particular customer. Although there was no interest charged and no specific promise to pay the implied promise to pay made them easily enforceable. But even then debtors had the right to present evidence that challenged the accuracy of the account. And although the creditor could sue to collect they were subject to the statute of limitations that hadn’t yet been applied to written debts.

Bills obligatory and promissory notes were also common forms of debt. They both set the terms of payment with bills obligatory generally used when merchandise was purchased and promissory notes used for simple cash loans. Bills of exchange were precursors to modern checks. Like today’s checks they instructed a second party, a bank or other entity, to pay a third party. Also like today’s checks non-payment carried penalties in addition to the face value. They included interest charges and collection costs.

Written debt instruments had provisions that books accounts and oral debts didn’t. They incurred interest whether by agreement in the contract or by statute. Statute established maximum interest rates above which lay the forbidden realm of usury. But the most valuable part of the written debt was its transferability. As such the written debt could be used to conduct commerce as if it was cash or the debt could be bought and sold as a commodity.

Early Globalization

In the 1790s Benjamin Franklin Bache published a newspaper called the Aurora. In it he wrote that the merchants of the day were “men who know no country but that where they can make money,” who “carry their capitals ships and our sailors to the country which will encourage them.”

Bache also attacked the “clan of Land Jobbers” the have “monopolized” the public lands because “our people are loaded with debts for the purchase of land which will plunge multitudes in distress and ruin.”

Early Debt Collection

William Samuel Johnson was a delegate to the Constitutional Convention and president of Columbia College. But before the Revolution he was a creditor’s lawyer, one of America’s first debt collectors. Because the process of legal debt collection could take years Johnson often recommended to his clients that they accept a negotiated settlement rather than engage in lengthy litigation. But this didn’t stop him from employing a tactic that is still effective today, the threat of a lawsuit. The threat of a suit worked for two reasons one being fear and the other ignorance. Like today most debtors didn't know the law gave them considerable legal rights. This fact gave Johnson one of his most powerful weapons, the bluff.

If the debtor was knowledgeable of the legal procedures and wasn't scared by the word lawsuit then convincing the creditor to negotiate was Johnson's best tactic. However it wasn't always successful so lawsuits often occurred.

There is one major difference between the legal process then and now. Then the common way to begin was by a writ of attachment. The attachment required a debtor to provide security sufficient to satisfy the debt. If the debtor had property it could be used but if not his body became the security. If the debtor's body was attached he needed to secure the services of a bondsman or sympathetic friend or relative. The alternative was imprisonment. Not designed as punishment but as a way to guarantee a court appearance the imprisonment never-the-less imposed punitive sanctions, jail.

Even then debtors with steady nerves and a good grasp of the law often responded to the threat of jail with indifference or defiance. For being imprisoned may have helped them delay a payment they were required and able to make or been a way to avoid a negative credit report. Of course there were two good ways to avoid the writ of attachment one being stay in your home where you were exempt from being served, which some did for years, or flee and hide.

As today, even a victory in court didn't produce immediate payment. Instead a writ of execution was implemented. In simple terms it directed the sheriff to attach the debtor's property. But the debtor could avoid the attachment of property the same way they could avoid the initial attachment, by fleeing or hiding. Even when property was attached there were loopholes and complications. Only non-exempt property could be attached which allowed debtors to keep basic necessities and in Southern state plantation land was off limits. Even today Florida and Texas retain this exemption.

Even when land could be attached problems often ensued. Often mortgages or other liens were given precedent and even when the property could be seized and sold the lack of buyers and cash often netted the creditor only a fraction of the stated value. And the attachment of last resort, imprisonment, may have given the creditor a sense of justice but it provided him with no money. These complications being known provided incentive for the creditor to negotiate rather than sue. And in the absence of a settlement lawyers often advised creditors to consider the debt lost rather than incur the time and expense of suing.

As early as 1788 Samuel Barrett, a Boston justice of the peace, used printed forms to notify debtors that he would sue them unless they paid. It had blanks left for the names of the creditors and debtor, their places of residence, the form and amount of the debt and the length of the remaining grace period before the filled suit. By 1799 newspapers were running ads for debt collection services.

Who was in Debt?

Thomas Jefferson had a life long habit of purchasing fine wine and foreign luxuries on credit. With the failure of a friend whose note he had endorsed Jefferson was brought to virtual bankruptcy. He wound up more than $107,000 in debt. When he died in 1826, his large estate and all his possessions, including 130 slaves, were auctioned off to pay his creditors.

Alexander Macomb, one of New York's richest and most prominent citizens, wound up on debtors prison because of his partnership with William Duer.

Robert Morris signer of the Declaration of Independence and the U.S. Constitution was considered the financier of the America Revolution. He profited so hugely from government contracts, many of them obtained while he himself was serving as Superintendent of Finances that he emerged as the richest man in America. He bought large tracts of land on credit hoping to resell them quickly to other speculators. He used bills of exchange drawn on British accounts as a source of credit but when war broke out in Europe his notes were not honored. This led him to debtors prison where he remained until released because of the short-lived bankruptcy law of 1800.

James Wilson, Associate Justice of the United States Supreme Court, was briefly jailed in debtors prison in 1796.

1800-1849

The period of 1800 to 1849 was one with two financial panics, pleas for bankruptcy laws and continued imprisonment for debt. It was stated that in the 1800s only 3 in 100 businessmen achieved financial independence. A handbill of 1812 declared bankrupts "politically dead,' 'no longer recognized as a citizen of the community…doomed to slavery, misery, and bondage for life." The personal toll debt played on Americans was highlighted in 1829 when failed Bostonians reportedly "preferred death, by their own hands, to a life of misery and disgrace." And again when Ralph Waldo Emerson said of the panic of 1837 "the land stinks of suicide."

In 1800 nineteen of twenty Americans lived on farms and economic exchange operated as it had for centuries with virtually no money passing hands for weeks or months at a time. Exchange was done with commodities, tobacco, corn, and furs being among the most popular.

The Bankruptcy Act of 1800

Even though Bankruptcy was written into the U.S. Constitution a debate over the morality of it kept a comprehensive bill off the books until 1800. Even when the proponents of bankruptcy mustered enough votes to get a bill passed they couldn't keep it on the books for long. The first national bankruptcy bill was passed in 1800 but it had significant restrictions.

The bankruptcy law of 1800 made the proceedings involuntary; it could only be initiated by a creditor. And it was could not be declared unless the debtor engaged in certain commercial occupations, amassed debts in excess of a large amount and committed statutorily defined acts of bankruptcy.

After a large number of debtors actually had their debts cleared the Republican dominated Congress repealed the bankruptcy act in 1803 eighteen months before it would have expired on its own. The bankruptcy bill of 1841 fared no better lasting barely a year.

Pawnbrokers

Pawnbrokers were first legally recognized by New York City in the 1802 charter and were first regulated by city ordinance in 1812. While "usury" was considered to be any rate of interest above 6 percent a year, interest on pawn loans could reach as high as 300 percent.

During this time poverty remained a fact of life for most working-class families. Most lived on the knife-edge of poverty where any financial disturbance whether brought on by illness, unemployment, or injury sent families on a desperate search for money. For many borrowing, from any possible source, was the only way to survive. This generally involved a trip to the pawnbroker. A local journalist estimated that almost the entire population of the Bowery New York had at least one pawn ticket at all times.

The Panic of 1819

In the summer of 1818 the Second Bank of the United States called in loans and hard money, panic ensued. Banks throughout the country failed; mortgages were foreclosed, forcing people out of their homes and off their farms. Falling prices impaired agriculture and manufacturing, triggering widespread unemployment. Conditions were exacerbated by the influx of large quantities of foreign goods into the American market and the slumping cotton market in the South. A depression ebbed and swelled throughout the 1820s. The cry of the time was "Hard Times."

The Panic of 1837

Before the Panic of 1837 people from all walks of life had been investing in schemes they knew nothing about. Workers who weren't able to invest during the pre-panic boom times fell behind because wages didn't keep up with rising prices and rents. Investors, as well as most state governments, preferred to hoard specie (gold and silver) and to pay off their debts with paper bank notes. President Jackson became alarmed by the growing influx of state bank notes being used to pay for public land purchases and, in 1836, ordered the Treasury to no longer accept paper notes as payment for such sales. Banks suspended specie payments and started to restrict credit and called in loans.

Soon many of the Tappan brothers' (Lewis Tappan was the founder of the first credit reporting agency) customers began defaulting on their payments. Soon the brothers were faced with more than $1,000,000 in debts. Their default helped spark the Panic of 1837 that led to thousands of business failures.

Unemployment soon touched every part of the nation and food riots occurred in a number of large cities. Construction companies were unable to meet their obligations, sparking the failure of railroad and canal projects, and bringing about the ruin of thousands of land speculators. During this time the number of commercial failures was unprecedented. Banks and some states defaulted on their debts. Prices fell by 20 percent. The impact of the depression lingered until 1843.

The Morality of Debt – The Businessman

In 1842 writer John N. Bellows advanced the idea that the creditor was not just doing the debtor a favor by selling now and allowing him to pay later because the creditor was as much interested to sell as the debtor was to buy and thus must bear his share of the risk inherent to a credit economy.

During this time the struggle to balance the early concepts of debt morality with the modern business practices was played out in state legislatures and publications throughout the country. They struggled with questions like: Were men always at fault for their failures? Did a man's moral responsibility to pay his contracted debts persist even if the law let him off the hook?

The saying, "Nobody fails who ought not to fail," was still held onto by many staunch advocates of a strict interpretation. This was especially applied to merchants. Moralists warned that the new title of "Business Man" (usually in two words) that came into the common usage in the 1830s, reduced men to mere creatures of ambition.

"Every man thinks himself qualified to be a merchant," a U.S. Circuit Court judge remarked in 1839. "A man but says, 'I will be a merchant,' and he is a merchant. The creation of light was scarcely more instantaneous." The ambition of the times led Alexis de Tocquerville to give a name to this emerging spirit: individualism.

The new business class had some tough learning to do. Even though they were free to succeed they were also free to fail. The fact that failure was intrinsic, not antithetical, to the culture of business was often a hard lesson to learn, but learn they did.

The Bankruptcy Act of 1841

The Bankruptcy Bill of 1841 still allowed for involuntary proceedings but unlike previous laws allowed the debtor to declare voluntary bankruptcy. It provided for an automatic discharge unless fifty percent of creditors in filed a written dissent. While allowing large numbers of debtors to gain financial relief the Act immediately became highly unpopular with creditors. It was repealed in 1843 after only thirteen months on the books.

Who was is Debt?

Thomas Dawes, a judge on the Massachusetts Supreme Judicial Court, declared bankruptcy in 1801.

Debtors Prison

Debtors in New York's New Gaol debtors prison established a very sophisticated legal system to deal with fellow prisoners. Based on the relatively new U. S. legal system it included a constitution that required consent of the governed, a legal system that had well defined procedures, and prescribed punishments for offenders

In some state prisoners could gain release by taking the "Poor Debtor's Oath," swearing that no fraud had been committed. But first the debtor had to pass cross-examination.

Unlike criminals debtors had to supply their own clothing, food, and fuel. The tone of the imprisonment was set by a sixteenth century English judge who believed that if the debtor couldn't provide food for himself he should rely on the charity of others or simple be allowed to starve to death.

Conditions in the debtor's prisons were so harsh that relief organizations were formed to help the debtors. In New York the Humane Society distributed donated food and clothing to the prisoners.

In 1791 Pennsylvania Governor Thomas Mifflin inspected a prison and was struck by the painful differences in treatment between debtors and criminals. While debtors were without clothing and food criminals had their basic needs well cared for. He concluded that being a debtor seemed to be more offensive to society that being a vicious criminal. Although he urged legislation to provide for debtor's basic needs none was passed into law.

Who Served Time in Debtors Prison?

The collapse of large-scale speculation schemes in the 1790s lead for the fist time to imprisonment of large numbers of "wealthy debtors."

James Wilson associate justice of the United States Supreme Court was briefly jailed in debtors' prison in 1796.

Thomas Rodney an officer in the Revolution, a member of the Constitutional Congress, and a judge of the Supreme Court of Delaware was in debtor's prison for fourteen months in the early 1790s.

Revolutionary War figures William Duer and Robert Morris both went to debtors prison.

Richard Crowninshield was a successful merchant and ship owner with net assets of almost $200,000 in 1811 but a year later he was in debtors prison.

Standardized Debt Collection Laws

In 1846 Hunt's Merchant Magazine proposed the total dissolution of creditor rights. It proposed attachment remedies be used instead so that lenders would only lend what they were sure they could recover and borrowers would only borrow what they could absolutely afford to pay back. In cases of error it suggested that the borrower write off the loss and the borrower be denied further credit. The later aspects of their proposal are to a large extent in effect today.

As the legal system for debt collection evolved and became more standardized the need for debtors' prison lessened. More loans become secured and the system of garnishment allowed for easier collection of small debts. This led to the end of debtors prison just before 1850.

1850-1899

The period of 1850-1899 was again one of turmoil and financial panics. It included panics in 1857, 1873, 1893, the farm mortgage crisis of the 1880s, not to mention the Civil War.

One economist noted that in the period before the Civil War period almost everyone was in debt but because there was no money the debts went unpaid. There was more money in large urban centers but even there the supply was not sufficient to fill all the economic needs. Outside the cities, where most people lived, the system of personalized credit, generally from merchant to local customer, and barter remained by necessity the norm well into the early twentieth century.

In 1861 half to 2/3 of San Francisco merchants failed. 240 of 256 N.Y. Dry Goods dealers went broke – almost 7,000 firms owed more than $5,000. Between 1873 and the end of the century one-third of all the railroads failed.

The Panic of 1857

The Panic of 1857 abruptly ended the boom times that followed the Mexican-American War. It was triggered by a number of factors that included the ending of the Crimean war. This caused European demand for American grain plunged. Massive embezzlement in the New York branch of The Ohio Life Insurance and Trust Company caused it to go broke. This in addition to the steamer Central America sinking with $2 million in California gold sent ripples though the financial world.

When British investors began to remove funds from American banks questions were raised about the overall soundness of the economy. Then widespread railroad failures caused manufactured goods to pile up in warehouses and massive layoffs to occur. Land speculation programs collapsed ruining thousands of investors.

Eventually the panic and depression spread to Europe, South America and the Far East. No recovery was evident in the United States for a year and a half and the full impact did not dissipate until the Civil War.

The Ethics of Debt

The Victorian attitude towards debt started with a strict adherence towards avoiding debt. But it often strayed from there. Acknowledging that in a money economy credit and debt were sometimes not only unavoidable but desirable the strict avoidance of debt flexed. But the morality of debt varied only slightly.

As far back as the 1710s Cotton Mather preached against debt but also conceded to its inevitability by advising to "Come into (debt) with the pace of a Tortoise, and to get out of it, with the flight on an Eagle." In the late nineteenth century the emphasis was put on the borrower's character. If money could be borrowed without effecting self-control, or even reinforcing self-control, it could be used as a positive. But going into debt just to falsely raise one's perceived standard of living was still forcefully argued against. This was the beginning of the concept of good debt/bad debt.

There were really three categories of debt. The one good one was to use the borrowed money for a cause that would produce income or appreciating assets that would make the borrower more money then he borrowed. If one went into business and the business turned a profit then the loan, principle and interest, could be paid back while leaving the borrower in a better financial state. If a home mortgage was taken out and paid off the homes increasing value, no to mention its value as shelter, was considered a wise use of credit. Investment speculations for quick profits were, on the other hand, thought of in a different light. Akin to gambling it was considered bad debt. As was borrowing for immediate consumption.

There were two exceptions to the rule of borrowing for consumption as bad credit. One was for the very unfortunate, like the unemployed, who had very little or no choice and the other was for those of sufficient financial resources and control as to be able to pay their tabs in full on a regular basis. The later came with a warning that applies today. Beware running a tab for the everyday expense because of the tendency to spend more with credit than with cash.

The Moral Judgments on Debt Continued

Before the Civil War the word "failure" meant "breaking in business" – going broke. This meant that failure was as incident not an identity. That started to change when financial circumstances evolved into personal identity. This was in large part due to the creation of credit reporting bureaus in the 1850s. They helped bring terms like loser, into the American lexicon.

But it was not until the eve of the Civil War that Americans labeled being an insolvent as a personal failure. In fact during the Civil War the Union Army branded court-martialed soldiers with a variety of letters including W which stood for worthless.

In 1864 a physician reviewed the previous forty years: "Everyone is tugging, trying scheming to advance – to get ahead. It is a great scramble in which all are troubled and none is satisfied."

The Credit Report

The first comprehensive credit reporting agency was the Mercantile Agency. It was founded by Lewis Tappan in 1841. Tappan was a failed businessman. In 1827 he went broke milling textiles so he took a job as the credit manger for his brother Arthur, a silk importer.

The Tappan brothers, great-grandnephews of Benjamin Franklin, were active social reformers promoting prohibition and Sabbath laws. In 1822 they co-founded the American Anti-Slavery Society. A year later they organized Oberlin College to promote interracial education. But in that same year mobs of anti-Tappan protester sacked the brothers' business and burned Lewis' home.

Another fire soon started to burn. In 1837 many of the Tappan brothers' customers began defaulting on their payments. Soon the brothers were faced with more than $1,000,000 in debts. Their default helped spark the Panic of 1837 that led to thousands of business failures. It also sparked Lewis' desire to tame the credit market by collecting reliable information about businessmen and making it available, for a fee, to potential creditors.

Tappan's goals for the agency went beyond providing information; he wanted to bring "moral regulation" to the business community. That's why the Mercantile Agency's reports were more than just a financial record. They included morals, talents, past financial performances, economic potential, and a summary judgment of character.

Their system institutionalized moral judgments – making such judgment a vital business tool. As example a credit report in 1854 stated, "The kind of credit that can get our recommendation must consist much more in a man's virtue & general character than a few thousand in property that may be easily transferred."

The early reporting lacked numerical characterization but relied on colorful commentaries. Phrases like, "be sure & never trust him, will always be worthless," or "there is a strong possibility of his failure," related a person's business worthiness. But not stopping there the reports often challenged the character of the businessman. Reporting, "...don't think he will succeed, he is unpopular. He is rather of an unhappy disposition," allowed the fixation of moral blame upon a potential failure.

The Bankruptcy Act of 1867

In 1864 a political movement started to call for a new bankruptcy law. It was in March that The National Bankruptcy

Association began recruiting. Also in 1864 U.S. Representative Thomas A. Jenckes urged “emancipation” for all Union soldiers who wore a mantle of oppression under their blue tunics. He was not speaking of the behalf of the Union’s Negro soldiers but of the white soldier who was shackled by “the bondage of debt.” His plea became the first comprehensive bankruptcy law in American history in 1867. It included both voluntary and involuntary bankruptcy filings.

Previous to the 1867 Bankruptcy Act debtors had only been allowed to keep the most basic necessities, including clothes, bedding and tools of their trade. But now the exemptions were controlled by state law. This prompted Texas to establish a generous homestead exemption for real property in hopes of attracting new settlers. Mississippi allowed an exemption of 240 acres of land plus $4,000 in personal property and Florida granted a 160 acre exemption.

The Act was amended in 68, 72, & 74. The 1874 Amendments abandoned the 50 percent requirement applicable to involuntary cases thereby preventing creditors from blocking the discharge in these cases.

One of the major problems with the Bankruptcy bill of 1867 was the fees involved with carrying it out. There were filing fees, administrative fees, and Marshall’s fees. In many cases after the exemptions were made and the fees paid there was nothing left for the creditor.

But it did offer help for many debtors. George Lyman Cannon, founder of the National Bankrupt Association used the 1867 bankruptcy law to relieve himself of $30,000 in debts and went on to found and run the prosperous Colorado Chemical Company.

The bankruptcy law of 1867 lasted far longer than its predecessors but was finally repealed in 1878.

The Expansion of Failure

In the 1800s the meaning of failure took on a significantly different definition. Failure was initially defined as a business failure. If one was in business and it didn’t succeed you had a business failure. But with business being done in expanded territories where credit was being extended to strangers a new entity took on preeminent importance. The 1850s saw the rise of the credit bureau.

Because they were expected to not only keep a financial record but to make a moral judgment credit bureaus needed to create a system of character definition. Not yet at the place to assign a numerical judgment colorful descriptions were used.

It was during this time that the word failure took on a new definition. No longer an event failure became an identity. Now if a business failed the owner did not have a failure he became one.

At this time there were no bankruptcy laws to give a second chance and credit reports were permanent lasting until you died. Once you became a failure you stayed a failure. This led to failure becoming a personal identity.

Because of the great expansion of business and the rise of individualism failure took on yet another added dimension. Now if one wasn’t actively moving ahead they were put on the “sinking list.” Failure was not just doing poorly it was not making progress.

By 1890 failure was a broad category of identity not simply the financial ruin of an entrepreneur, it meant as much dissatisfaction as disaster.

The Panic of 1873

The period of 1873-1878 was known as The Great Depression, at least until The Great Depression of the 1920s and 30s came along. Starting in Europe the economic reversal hit the United States when the country’s preeminent investment bank failed.

Jay Cooke and Company was the principal Bacher of the Northern Pacific Railroad and had handled most of the government’s wartime loans. Its failure sparked a series of events that touched the entire nation.

Investors rushed to sell stocks in order to protect their capital. As stocks on the New York exchanges sunk lower the New York Stock Exchange closed for 10 days. Credit dried up, causing businessmen, many of whom had borrowed money to expand their operations during boom times, to release workers. Foreclosures and banks failures were common; factories closed their doors and most major railroads failed. Thousands of workers lost their jobs.

The volume of destitute people soon overwhelmed the abilities of charities to function.

The Victorian Way to Wealth

The Victorian principle of self-mastery applied equally to money. In fact the mastery of money was seen unapologetically as a way to build wealth. The two were seen as an inside outside approach. By mastering yourself and your money you would have a better spiritual and physical life.

Three principles of Victorian money management survive today. They are frugality, thrift, and planning. Although the definitions have changed over time the idea of planning a financial path that includes spending wisely and living within your means is the bedrock of economic advice.

The Meaning of Money

As more and more money started to circulate its power over the body and minds of Americans grew. It was in the late nineteenth century that money became the predominant indicator of class in society. Those who were able to attract and increase their supply of money were able to move through the ranks of society as never before.

This meant that money had definable power and the lure of its dominion over all material things placed it at the top of everyman's desires. With the belief that money could be managed in a moral way that would led to personal growth, it quickly lent itself to traditional Victorian values. This happened even as the concept of what money really was escaped most.

The subject of money became the topic of many novels, advice books, and newspaper columns. The desire to understand the concept of money and to cultivate good management skills led to its prominent place in the media as well as general discussion.

Helping speed the role of money to the forefront was the industrialization of business that led to greater numbers of people becoming wage earners. It was also during this period that the nature and concept of money changed. Until this time money had been a metal coin that had intrinsic value but now money was becoming just paper, itself almost worthless, with its value determined by agreement.

The creation of the Federal Reserve in 1913 helped bring currency into mainstream use but it still took time for its effect to become universal.

THE HOME MORTGAGE

In the late nineteenth century the home mortgage accounted for the largest single portion of household debt. In fact a Massachusetts businessman remarked that, "About everyone that live in what he calls his own house, is in debt!" At that time in Boston it was common for a potential home owner to save up half of the $3,000 needed to buy a lot and build a house. Then a first mortgage raised $1,200 at 5-6 percent interest with a second mortgage of $300 being added as the construction neared completion. Once living in the house the new "owner" was required to make semi-annual interest payments for three to eight years with the principle being due at the end of the term.

However in other areas homes were sold with either one or two straight mortgages and on a variety on installment contracts, some offering payments for twenty years. Nationwide the most common terms were 31% down with the remaining 69% being financed at 5-6 percent for five years.

It's a Wonderful Life

First organized in Philadelphia in 1831 one of the most popular methods of home financing was joining a building and loan association. Like the Bailey Building and Loan in the movie "It's a Wonderful Life" borrowers would buy shares in the associations. Then by using a complicated system that most of them didn't understand, they were able to finance their home using an amortized home mortgage. This allowed them to pay off the principle and the interest simultaneously.

In 1903 the Ladies Home Journal reported that 3 of 4 new home buyers used a mortgage to finance their purchase. While this allowed more people to own their homes the joys of home ownership also brought on struggle, toil, and labor in order to pay off the large debt. Many homeowners found themselves getting extra wear from their clothing and learning how to cut each others hair. Some found that the financial discipline their mortgage forced on them stayed long after the debt was paid. While credit was used to bring about the dream of home ownership, the regiment of the mortgage taught that debt could be a hard task master.

The Panic of 1893

The depression following the Panic of 1893 was the second worst in the country's history. When the Reading Railroad went into receivership the failures of hundreds of banks and businesses dependent upon it soon followed. The stock market reacted with a dramatic plunge and European investors began pulling their funds out of the United States.

Thousands of businesses were ruined and more than four million were left unemployed causing the unemployment rate to reach 18.4 percent. This along with an ongoing agricultural depression in the West and South spread additional misery to those regions.

President Cleveland believing like most people of both major parties, that the business cycle was a natural occurrence and should not be tampered with by politicians, did nothing. This lead to the poor to believe they had been ignored and left at the mercy of big business.

The Bankruptcy Bill of 1898

The 1898 law was brought about by a variety of forces; business, pro-debtor, and legal interests. But the forces that gave the final momentum were the Republican lawmakers who supported pro-business debt collection groups that wanted a uniform statute to replace a myriad of state debt collection laws. In 1890 creditor groups commissioned a St. Louis attorney to write a bankruptcy law. That bill passed the House but bogged down in the Senate. In 1897 the House again passed a version of the creditor bill with the Senate passing its own debtor friendly version. Compromise arrived and President McKinley signed the Bankruptcy Act in July of 1898.

The Bankruptcy Act of 1898 was the first bankruptcy law to become permanent. It incorporated five fundamental principles. It relieved all debts not just ones arising out of contracts entered into after the law went into effect; it permitted both voluntary and involuntary bankruptcy; it applied to all business corporations, including national banks, but exempted farmers and wage earners from the involuntary provisions; it protected whatever property was exempt under state law from attachment; and it provided provisions by which insolvent debtors could have a grace period in which to reorganize their affairs or reach compromises with their creditors. Creditor approval and other conditions for discharge were fully removed.

Who was in Debt? – Begging Letters

At the turn of the century so many people were hopelessly in debt that they wrote letters to rich and famous people asking for help, begging for money. On rare occasion these letters met with success and money was lent or given, or a job was offered. But most of them just went to chronicle the desperate times and document the utter frustration that would lead private people to share their deepest secrets with a stranger.

In 1903 Andrew Carnegie received 15,000 begging letters a week.

Edward Everett sought to explain the panic of 1857 saying if was because of “a mountain load of debt” taken on by the entire country – individuals and communities, businesses and government. Everett estimated that the household debt alone was $1.5 billion, $300 per household.

The concern about how much debt Americans were in and if they had the ability to repay it led to Congress demanding that the 1890 census collect statistics on corporate and individual debt. But then, as now, the subject of personal debt was one not often discussed with strangers especially census takers who were collecting information for the government. The idea was scrapped. But not to disregard the Congressional mandate the census bureau, based upon the information available estimated that the minimum total debt of the American people to be $11 trillion. This equaled to an average of $800 a household at a time when the average non-farm income was $475.

P.T. Barnum filed for bankruptcy in 1871.

Mathew Brady, distinguished Civil War photographer, filed for bankruptcy in 1872

President Ulysses S. Grant got involved in a banking house which went bankrupt. This left him so destitute that he had to hand over all his property, including his swords and trophies.

L. Frank Baum, "Wizard of Oz" author, ran a store into bankruptcy in 1888.

Mark Twain went bankrupt in 1894.

Oscar Wilde was forced into bankruptcy in 1895.

Milton Snavely Hershey started four candy companies that failed and filed bankruptcy before starting what is now Hershey's Foods Corporation.

Failure because so common that on New Year's Eve 1890 the Chicago Tribune asked its readers "To what do you ascribe your failure in life?"

1900-1949

The period of 1900-1949 was again one of turmoil and financial panics. This period included the Panic of 1907, World War I, the Great Depression (the second one), World War II and the rise of consumer credit.

The Panic of 1907

In the summer of 1907, the American economy was showing signs of weakness as a number of business and Wall Street brokerages went bankrupt. In October, the respected Knickerbocker Trust in New York City and the Westinghouse Electric Company both failed, touching off a series of events known as the Panic of 1907.

In the wake of the initial business collapses, stock market prices plummeted and depositors made a massive run on the nation's banks. The U.S. Treasury pumped millions of dollars into weak banks in the hope of saving them, but the string of collapsed institutions lengthened.

J.P. Morgan summoned the leading bankers and financial experts to his home where, over the course of three weeks, they set up shop in his library. Together they labored to channel money from the strong institutions to the weaker ones in an effort to keep them afloat.

The joint effort of the government and the business leaders improved conditions markedly over the course of several weeks. Following the Panic of 1907 reformers convinced Congress that thorough bank reform was necessary to provide badly needed currency elasticity (a major issue in the Panic) and the general soundness of the banking system. With the passing of the Owen-Glass Federal Reserve Act of 1913, the Federal Reserve System was created.

Early Payday Loans

As busy as New York City's pawnbrokers were during the early part of the twentieth century an estimated two-thirds of the total lending came from small-loan agencies. These companies loaned money either on the basis of a secured property, property the lender could hold onto, or on the assignment of future wages. These small loan agencies were often chain stores with one particular company run by D.H. Tolman operating offices in sixty-three cities.

Skirting usury laws by claiming they weren't lenders but "salary buyers" wage assignment lenders like D.H. Tolman often charged interest rates as high as 1,000 percent. Borrowers filled out a lengthy application and signed complicated-looking promissory notes. Because the interest rates being charged were illegal the documents had no real legal standing but relying on the ignorance of the borrower they proved effective in reducing the number of those skipping out on their debts.

These lenders had a well-defined system of collection. Employees of companies that forbad them from taking out wage assignment loans were routinely approved because the threat of telling the employer proved to be an effective collection tool. For others the collection started with letters and phone calls. If necessary a personal visit from a "bawlerout" was prescribed. This entailed having a female collector publicly embarrassing the debtor in front of his co-workers or family by browbeating him for being a sorry deadbeat.

Peddling Debt

Although installment selling for the well-to-do had been in vogue for decades of the 1880s and 1890s the new century opened up the practice to working-class households. For recent immigrants this opportunity often came from peddlers who supplied household good on very easy terms. The peddlers, often immigrants themselves, were given lines of credit by established merchants. This allowed them to introduce hundreds of households to the American style of consumerism.

The successful merchant peddlers forced many retailers to switch from selling for cash or thirty-day credit terms to using installment payment plans. Quick to take advantage of these easy payment plans were a category of merchants known as Borax Houses. They sold shoddy, overpriced goods to low-income customers. They discovered that by hiding high interest rates under easy weekly payments selling on the installment plan led to large profits.

Cash is King but Credit is Convenient

Within the expanding credit market there was also an increasing number of cash buyers. As early as 1831 buyers were schooled in the advantage of purchasing with cash, as it "really gives you more money to purchase with" because merchants give substantial discounts for cash. In the later part of the century merchants such as Macy's, Sears and Roebuck, J.C. Penny and Montgomery Wards championed the "cash and carry" cause. Sears in particular used its catalog to preach against "the evil of the credit system."

But as more and more stores offered credit, more and more customers expected to use it. This led to a centralization of credit operations that included the issuing of metal identification charge plates by the 1920s. This precursor to the modern credit card allowed customers to buy furniture, pianos, phonographs, and sewing machines on installment terms. As the easy availability of credit led to ever increasing payments Americans began the modern paradox of loving credit while hating debt.

The Small Loan Movement

The founders of the small-loam movement were not trying to spread consumerism by giving easy credit, in fact the reverse was true. Early small-loan lenders were philanthropists who thought that by providing capital to workers they could cultivate the habit of good money management and take themselves to the next financial level. To their dismay instead of building a society of independent, thrifty, and hard-working businessmen they laid the ground work for a debt-ridden consumer culture.

Usury and Illegal Lending

Prohibition against usury, the practice of charging high interest rates, dates back to at least the fifth century A.D. It was prohibited because of moral principles as well as a defense for the easily taken advantage of borrower. In 1545 King Henry VIII broke with tradition and set interest rates at 10 percent. That decree stood until the 1800s when Parliament repealed all usury laws

In the United States usury laws continued in effect until the early twentieth century. But this didn't stop the practice of small-loan lending from expanding rapidly, even if illegal.

From the 1870s on small-loan lenders began springing up around the country. In fact other than the Great Atlantic and Pacific Tea Company (the A&P), the largest chain stores in America were illegal lenders. Because of a desire to protect consumers from themselves legislators resisted changing the law. But that didn't stop illegal lenders from stepping in to fill the demand.

Small-loan lenders generally came in two varieties; the first being run by philanthropists or responsible businessmen. Often charitable organizations were formed just to lend small amounts of money to workers. Responsible businessmen saw an opportunity to earn money while providing a much desired service. Even though their interest rates were illegal they kept them to a minimum and provided terms that could be met.

Then there were those who sought to capitalize on the ignorant or desperate. They charged what ever they could and often inserted terms that seemed to go on forever. These unscrupulous lenders were the origin of the term "loan sharks."

The Fight for Legal Lending

The fight to change usury laws into a modern law that not only protected small borrowers but allowed lenders to earn a profit was led by Arthur Ham. Ham began his quest while working for the Russell Sage Foundation. There he undertook a comprehensive study into chattel lenders, lenders who made loans based upon securing property, usually furniture and other household goods. His study made no distinction between the "good" lenders and the loan sharks.

Ham undertook a two-pronged approach to the problem. He lobbied to have the illegal lenders put out of business while changing he laws to allow for regulated lending. His campaign against existing lenders netted the big fish, D.H. Tolman. Tolman, operator of a chain of offices, actually served a jail term of six months. This in addition to the lenders giving in to the obvious public campaign against them led the formation of the American Association of Small Loan Brokers, an organization that lobbied for legal reform.

Together with Ham the AASLB put together a compromise legislative package. By 1917 the proposal was introduced in several state legislatures. By 1932 twenty-five state had some version if the law on their books.

From Loan Sharks to Credit Counselors

As small lenders came out of dark back offices into modern high profile offices they attempted to redesign their business image. Holding onto the idea of the early lending philanthropists they claimed to teach the value of thrift and savings. They actually positioned themselves as the educators of finance for working-class people. The concept reached such lofty heights that lenders boasted that their education into the principle of household finance would allow the borrower to pay off his loan while establishing saving regimens that would keep him out of debt forever more.

This well-intentioned if not self-serving mantra did not always jive with the economics of the time. For as installment selling grew and workers longed for the new modern conveniences more and more borrowers went to small-loan companies, now called "personal finance" lenders, to consolidate installment payments into one loan.

So as the lending practice become legal and more socially acceptable it's nature changed from helping the poor worker survive financial doom to helping more affluent worker manage their financial boom.

The Rise of Installment Selling

Installment selling first became popular with high priced farm equipment. The equipment allowed much greater productivity but the price made a cash purchase impossible. Because of the increased productivity the new machine promised family farmers readily agreed to purchase on installment terms. In the best case scenario the machine would virtually pay for itself. The installment plan not only helped build the business of Cyrus McCormick but also help I. M. Singer and Company bring the sewing machine into thousands of American homes.

Soon almost every type or consumer good could be purchased on the installment plan. While large ticket items like furniture, pianos, and sewing machines were among the most popular purchases items like curtains, dishes, and clothing were sold on installment plans too. Many merchants set up shop to sell exclusively on the installment plan. They came in a variety of classes. Some catered well-made goods to high-class buyers while others sold lower priced, often shoddy, merchandise to lower class customers.

Selling on the installment plan became so popular that business empires that were built on it still exist today. After attempting to sell high quality furniture for cash led to bankruptcy the owners of Spiegel made a decision to change course. They began to buy low-priced furniture added good mark-ups and sold it on the installment plan using high pressure sales tactics that stressed it was of a superior value. Sales were so brisk that in 1902 the company established a mail-order department that offered credit to customers nationwide.

Soon the catalogue department became the most successful part of the business. Even though the Spiegel catalogue had prices 5-25 % percent higher than the Sears & Roebuck catalogue their installment terms prevailed over Sears' cash only policy. Still the stigma over installment buying continued. It was fed not only by class prejudice but by gender stereotypes. Large items purchased on credit, homes and farm equipment, were the decision of men but as more women took control of household expenses smaller purchases on credit were seen as a sign of financial weakness. But this was about to change.

In the 1920s the installment plan become common place and had become acceptable to the point that the social stigma had all but disappeared. The leader of the installment plan, now known as "Acceptance" or "Finance Plan" was the automobile. In 1924 three of four cars were purchased that way.

Automobiles on Time Payments

Early automobile purchases on the installment plan were not a result of car manufacturers or dealer. They were the result of wealthy car owners wanting to replace their old car with a newer model. In 1909 even the cost of a used car was well beyond what most people could afford so individuals began advertising their used car for sale with a down payment and the balance on payments.

It wasn't until 1916 that the new automobiles were offered for sale on time. But even then financing wasn't offered by the manufacturers and dealers but a third-party company that saw a business opportunity. Feeling threatened manufactures applied heavy pressure to have the financing ads discontinued.

Two weeks after the first installment plan ad ran a Ford Motor Company employee proposed that they set up a separate company to offer financing for consumers as well as dealers who had to pay cash for their cars. But Henry Ford, being steadfastly against most aspects of financial capitalism, squashed the idea.

Three years later the executives at General Motors saw the idea as a way to compete against the lower price Model T. By offering financing they were able to sell the higher priced more powerful Chevrolet and Oldsmobile to average car buyers. The 1919 formation of the General Motors Acceptance Corporation helped tripper the decline of Ford Motors throughout the 1920s.

Ford tired to merge his concept of Victorian money management with the installment plan by offering potential customers the opportunity to open up a savings account. This account would earn interest and be in the name of the consumer. Once the purchase price of the new Ford car was saved up the transaction was made and the consumer drove off in his new car. This simple plan fit Henry Ford's model of the financial world but it increasingly seemed antiquated to those accustomed to buying on time.

The installment plan, although costlier than paying cash, had one big advantage. When saving to buy a house one still needed to pay rent and when saving to buy a car one still had to pay for other transportation costs. When buying the home or car on a payment plan you got immediate use of it had could stop the other payments. Your cash flow actually improved. This fact led to the failure of the Ford savings plan.

By 1926 2 of every 3 cars sold in America was bought on credit. By the end of the 1920s phrases like "Buy Now, Pay Later!" and "Take Advantage of Our Easy Payment Plan!" were standard phrases in the American vocabulary.

With the unveiling of the Model A in 1927 Ford announced the formation of the Universal Credit Corporation, its version of GMAC. But it came to late to help regain its market leadership.

Financing Other Consumer Durables

The tide towards financing was overwhelming those who held onto the cash-and-carry policy. Even those who had preached so fervently against it, like Sears and Roebuck and Montgomery Wards had to give in. Some merchants of smaller priced goods continued the moral campaign against financing. Often because consumer would buy higher priced durable goods and then cut back on consumables to make the payments. But in the end virtually everything, even candy and nuts could be purchased on time.

Self-Enforced Budgeting

For all of the fears that preachers of Victorian money management voiced about credit purchasing, the most common was the decline of morality and financial control that was sure to ensue. And their argument seemed to make sense. For those who over did it the demons of debt took control of their lives. But for those who maintained level-headedness the payment plan forced financial management on them that they could often not enforce on themselves. For those who hadn't been able to save the necessity to make payments and to avoid collectors and repossession provided all the incentive needed to budget, save, and work harder when needed. Victorian principles, it seems, came in through the backdoor of consumer financing but took a prominent place in the modern household.

The Acceptance of Consumer Debt

In 1927 The Economics of Installment Selling was published. In it the author, E.R.A. Seligman introduced the concept of "pay as you use" as an alternative to "buy now, pay later." This happened because you were actually simultaneously paying for and using the item. Seligman opened of the idea of "wise borrowing, foolish borrowing." His view differed greatly from the Victorian era's thinking in terms of borrowing to produce profit and borrowing to produce immediate comfort. In his view the production of comfort, in essence bringing happiness to one's life, was just as valuable as the production of profit. In this sense the distinction of good and bad as defined by how the credit was used was erased. The real distinction was made in the borrower's ability to pay the bill.

The Depression of 1921 and 1922

The Depression of 1921 and 1922 was short and relatively painless, not so the next one.

The Stock Market Crash of 1929

The 1920's were a time of unbelievable prosperity. The stock market was going through the roof and there seemed to be no end n sight. Ironically the widespread prosperity led to an attitude of contentment. The desire for consumer durables (expensive items refrigerators, radios, and automobiles) went down as Americans became satisfied with what they had. This in turn affected the companies and workers that produced these items and the economy began slowing.

A large amount of investing in the 1920's was done margin. Investors borrowed money from their brokers to buy stocks. This worked well as long as stocks were going up. Bank lent brokers money, brokers lent their customers money and everyone profited.

But with the crash of 1929 stocks lost value, and the profit chain reversed. Companies lost value, stock prices dropped, investors, brokers and banks alike all lost money, lots of it, overnight. On just one day, October 29, frantic traders sold off 16,400,000 shares of stock. At year's end, the government determined that investors in the market had lost some $40 billion. Of course the economy weakened and unemployment skyrocketed. The Great Depression had begun.

The Great Depression – 1929-1942

By the start of the 1930s 4,340,000 Americans were unemployed. Soon more than 32,000 businesses bankruptcies occurred and at least 5,000 banks failed. This led the unemployment ranks to swell to more than 8 million.

Because of the Stock Market crash millions of citizens suddenly had no savings. With factories and shops closing it was a desperate time for families. Starvation stalked the land and to add to the misery a great drought ruined numerous farms, forcing mass migration. This caused local governments to face great difficulty collecting taxes and to paying for ongoing services.

When Congress passed the Hawley-Smoot Tariff Act in 1930 every major trading nation protested against the law and many immediately retaliated by raising their tariffs. The impacts on international trade were catastrophic. This and other effects caused international trade to grind nearly to a standstill; the depression spread worldwide.

In spite of widespread hardship, President Hoover maintained that federal relief was not necessary. Farm prices dropped to record lows and bitter farmers tried to ward off forecloses with pitchforks.

Eventually the Hoover administration launched a road, public building, and airport construction program. More significantly they administration established the Reconstruction Finance Corporation (RFC) with $2 billion to shore up overwhelmed banks, railroads, factories, and farmers. This action signified, for the first time, the U.S. government's willingness to assume responsibility for rescuing the economy by overt intervention in business affairs. Nevertheless, the Depression persisted throughout the nation.

The Federal Government as Lender

The New Deal solidified the Federal Government as a major lender by supporting consumers with several kinds of credit. One type provided funding to business that in turn lent money to consumers. In 1932 the Federal Home Loan Bank system was opened for business. Designed to function for mortgage lenders as the Federal Reserve did for commercial lenders, it lent money to building and loan associations so that they could lend it to home buyers.

The most active of the New Deal governmental programs was made possible by the Home Owner's Refinancing Act of 1933.Through the establishment of the Home Owners' Loan Corporation (HOLC) money was lend to families in danger of losing their homes to foreclosure. By 1936 the HOLC suspended operations but by that time one out of ten mortgages in the country was assisted by a HOLC loan. It had also firmly established the long-term (twenty year) self-amortizing loan. It replaced the previous standard five-year loan with its semi-annual interest payments and lump-sum principle payment.

Also in 1934 the National Housing Act established the Federal Housing Authority (FHA). The FHA was established to do two things: to create jobs in the very depressed housing industry and to repair, modernize, and replace the existing stock of homes in order to bring them up to the standard of the times. It was a complete success with new construction starts going from 93,000 in 1933 to 530,000 in 1940. It also established a new norm for the home mortgage. Requiring a down-payment of 10% and a careful credit check the new FHA Bached loans extended the mortgage to twenty-five and thirty year terms.

Another type of government lending involved direct lending. The very first consumer credit program operated by the Government was the Electric Home and Farm Authority (EHFA) incorporated in 1933 as a subsidiary of the Tennessee Valley Authority (TVA). In an effort to promote the use of electricity the EHFA bought refrigerators and other appliances and made them available through local utility companies. The program, aimed at households that had been using washboards and iceboxes, helped bring increased demand for electricity to the Tennessee Valley. It also marked the first time the federal government was in direct competition with private lenders.

The New Deal's Farm Credit Administration (FCA) was another program that involved the federal government in private lending. It started in 1933 and through twelve regional banks lent money to farmers. Unlike previous lending programs that helped farmers buy farm equipment this program focused on the purchase of consumer goods, automobiles, refrigerators, and the like.

The Federal Insurance Deposit Corporation (FDIC) also played a significant role in cementing the role of consumer credit into everyday life. By insuring depositors money it freed commercial banks from policies that prevented them from extensive lending. Until that time commercial banks had primarily lent money, on a short-term basis to businesses. This was considered both safe and morally acceptable.

There were a few notable exceptions. In 1920 a bank in Bridgeport, Connecticut, advertised small loans to individuals; four years later a Jersey City bank opened the first small-loan department in a commercial bank. But it wasn't until 1939 that commercial banks surpassed small-loan companies in the total amount or personal cash loans extended. The following year commercial banks also became the largest lenders of consumer installment credit surpassing installment financing companies.

Also on that note there was the Federal Credit Union Act of 1934, It established credit unions as co-operative banks that lent members money at lower interest rates than institutions. Within a year of its passage over one hundred credit unions per month were opening.

The Chandler Act 1938

The Chandler Act of 1938 amended the bankruptcy law and created a menu of options for both individual and corporate debtors. In addition to traditional liquidation individual debtors could seek an arrangement with their creditors through Chapter 10 of the Act or they could attempt to obtain an extension through Chapter 12.

Corporations could seek arrangements on their unsecured debts through Chapter 11 or reorganization of both secured and unsecured debts through Chapter 10. However, because Chapter 10 required Securities and Exchange Commission review for all publicly traded firms with more than $250,000 in liabilities corporations tended to prefer Chapter 11.

With the enactment of the Chandler Act of 1938 American bankruptcy law had obtained its central features. Both individuals and businesses could declare bankruptcy. Both voluntary and involuntary petitions were allowed. Individual debtors could choose liquidation and a discharge, or some type of readjustment of their debts. By choosing Chapter 8 debtors retained possession of property, mainly residences, and offered creditors a three to five year payment plan during which a stay prevented lenders from enforcing liens. By 1939 involuntary bankruptcy became rare, never rising above 2,000 a year.

The End of the Great Depression

At the start of the 1940s the United States had not fully put its economic woes behind it. The 1940 census counted 11.1 percent of U.S. heads of household as unemployed and a deep latent productive capacity existed within American industry.

That changed soon after Japan attacked Pearl Harbor in December 1941. The nation swiftly changed gears from a peacetime to wartime footing that mobilized the populace and numerous industrial sectors. In 1942 the President called for unheard-of production goals. Soon labor unions, farmers, miners, factory workers and virtually every industry focused on the war effort. Massive unemployment became a thing of the past and the Great Depression was swallowed up in the effort to win World War II.

As great of a financial challenge as the Great Depression was, only a small number of consumer loans defaulted. But it did help popularize the use debt consolidation loans

For the period 1934-1937, the National Bureau of Economic Research estimated that approximately 50 percent of personal finance company loans were used to refinance miscellaneous existing debts.

Consumer credit actually declined during the Depression. Many paid off loans and simply declined to take out others until times got better.

Prosperity grew steadily thanks to the governmental spending that was necessary to win World War II. Americans enjoyed an economy that allowed workers to own homes, cars, and televisions. The fact that consumer credit didn't lead to a total collapse of the economic system during the Great Depression, as some had feared, and with commercial banks, the Federal Government, and even Macy's offering credit, America was primed for the next financial innovation. They soon embraced the invention of Frank McNamara, the credit card.

Who was in Debt?

Walt Disney's company Laugh-O-Gram Corp filed bankruptcy in 1923.

Paramount Studios filed bankruptcy in 1932.

William Fox, co-founder of 20th Century Fox Film Corporation, filed bankruptcy in 1936.

1950-1999

This era started out as perhaps the greatest economic period of all times. But it was not without challenges including a recession in 1957, one in 1960, another in 1969, the inflationary period of the 1970s, a recession in 1982, the stock market crash of 1987, and another recession in 1990. But one of the biggest influences on modern debt had its start in 1950, the credit card.

The Credit Card

It was 1950 when Frank McNamara of New York's Hamilton Credit Corporation came up the idea of giving affluent businessmen a convenient way to charge business-related expenses. The original Diners Club card was pasteboard with the customer's name on one side and a list of the twenty seven restaurants that accepted it on the other. The first plastic cards came out in 1955 creating a whole new way of monetary exchange.

American Express, the traveler's check company, began issuing cards in 1958 followed by The Bank of America and their BankAmericard. Because The Bank of America had California as its base of operation, the BankAmericard quickly became the most widely know card. Other smaller banks joined the BankAmericard system and the system continued to grow. In 1977 the card underwent a name change and became Visa. By the 1990's Visa was the largest credit card in use with nearly 400 million cards in circulation and more than 12 million businesses that accepted it.

In 1967, City Bank of New York issued the Everything card, the card that eventually became MasterCard. It was during the 1960's that the credit card took hold of the American consumer's pocketbook. The credit card freed people from the restraints of having to have money to buy something by allowing them to use money that they had not yet earned. By freeing their immediate constraints the credit card took a firm hold of the card user's future. And the future showed up in the form of a bill the next month and every month after. And by the mid 1990's the consumer debt in America surpassed $1 trillion dollars, much of it through the use of credit cards.

Inflation in the 1970s

In the 1970s, weak economic growth, mounting unemployment rates and rising prices combined to create something new: stagflation. The gas crunch made matters worse. It helped eroded the value of the dollar. A dollar in 1970 would be worth only 47 cents just 10 years later. Because incomes rarely keep up with inflation, many people became poorer just standing still.

The Recession of 1982

The nation endured a deep recession in 1982. Business bankruptcies rose 50 percent over the previous year and. farmers were hit hard by a decline in agricultural exports, falling crop prices, and rising interest rates. There was however a silver lining. By 1983, inflation had eased and the economy began a sustained period of growth. The annual inflation rate remained under 5 percent throughout most of the 1980s and into the 1990s.

The Bankruptcy Reform Act of 1978

The Bankruptcy Reform Act of 1978 replaced the much-amended 1898 Bankruptcy Act. It maintained a menu of options. Chapter 7 provided for liquidation for businesses and individuals. Chapter 11 allowed for debt reorganization with incumbent management rather than court appointed trustees left in control of bankrupt companies. Chapter 13 provided for readjustment of debts for individuals with regular income.

The Bankruptcy Amendment Act of 1984 limited the right of companies to terminate labor contracts. It also rolled back some of the pro-debtor provisions of the Code. Because bankruptcy filings continued their rapid ascent after the 1984, recent studies have tended to look toward changes in other factors, such as consumer finance, to explain the explosion in bankruptcy cases.

Chapter 12, added in 1986, allowed farmers to readjust debts with a special provision by allowing a "knockdown" of farm mortgage principal.

The Savings and Loan Crisis

The Savings and Loan crisis of the 1980s was a wave of savings and loan failures in the USA, caused by rising interest rates, fluctuation in real estate values, deregulation, lack of regulatory oversight, mismanagement, failed speculation, and, in some cases, fraud. The Federal Home Loan Bank Board reported in 1988 that fraud and insider abuse were the worst aggravating factors in the wave of S&L failures. Over 1,000 savings and loan institutions failed. The ultimate cost of the crisis is estimated to have totaled around $150 billion, about $125 billion of which was directly borne by the U.S. government. This substantially contributed to the large budget deficits of the early 1990's. The slowdown in the finance industry as well as the real estate market may have been a contributing cause of the 1990-1991 economic recession.

The Stock Market Crash of 1987

On Monday, October 19, 1987, the Dow Jones Industrial Average fell 508.32 and closed at a record-breaking low of 1,738.40 points. This date, now known as Black Monday, is documented as the worst stock market crash in history. The 22.9% loss in 1987 almost doubles the percentage lost in the Crash of 1929, which was 12.82%. More than one factor affected the Stock Market Crash of 1987. Economists agree that there are many reasons for the 508 point loss, but not one can name a single event that was the sole cause.

The panic that followed the Crash of 1987 led to a sharp recession that hit hardest those countries most closely linked to the United States, including Canada, Australia, and the United Kingdom. The economies of Europe and Japan were hurt, but not as badly. The US economy continued to grow as a whole, although certain sectors of the market such as energy and real estate slumped. While government activity may have played a part in the recovery most economists give the majority of the credit to increased consumer spending.

Bankruptcy Reform Act of 1994

The Bankruptcy Reform Act of 1994 included provisions to expedite bankruptcy proceedings, to standardize fees, and to encourage individual debtors to use Chapter 13 to reschedule their debts rather than use Chapter 7 to liquidate. It also included provisions to aid creditors in recovering claims against bankrupt estates.

The Act’s nudge towards Chapter 13 didn’t work but the bill did create the National Bankruptcy Commission. It was created to investigate further changes in bankruptcy law. It did work. In November 1997, the National Bankruptcy Review Commission completed an extensive and detailed report on bankruptcy reform. The report included the provisions for the most pro-creditor reforms in the one hundred years of uninterrupted bankruptcy laws.

Who was in Debt?

- Actress Dorothy Dandridge filed for bankruptcy in 1963.
- Larry King, talk-show host, filed for bankruptcy in 1978.
- John Connally, former Texas governor, filed for bankruptcy in 1987
- Dino De Laurentis, film producer, filed for bankruptcy in 1988.
- Actress Kim Basinger filed for bankruptcy in 1993.
- Actor Burt Reynolds filed for Chapter 11 bankruptcy in 1996.
- Musician (M.C.) Hammer filed for bankruptcy in 1996.
- Actress and Casino Owner Debbie Reynolds filed for bankruptcy in 1997.

- Actor Gary Coleman filed bankruptcy in 1999.

2000+
Ah, our current economic times. Where are we now? Has the concern about business globalization that was expressed in 1790 gone away? No. Has the concern that consumers are taking on too much debt that was expressed in 1857 gone away? With over $2.1 trillion in outstanding debt, no. Has the way we think about ourselves and our debt changed? Yes. For the better? No. Is it easier than ever to get into debt? Yes. Are there as many ways as ever that are beyond our control to get into debt? Yes.

Are there controls in place that regulate credit reports and debt collection? Yes. Are credit reports accurate? Not completely. Do debt collectors still intimidate and bend the law? Oh yeah.

Is it easier than ever to get out of debt and to get a fresh start? The answer is, fortunately, yes.

While getting into debt may or may not have been due to our own actions getting out of debt is our responsibility. You have options, there are money management tools to use and there is help available. Ultimately how you get out of debt is up to you. Choose a path that fits your finances and suits your personality. Then get busy and make it work. But first let's take a look at what the new century has brought us.

2001 recession
Following a 15% increase in income during the 1990s boom 2000 brought a change of direction. Falling by 0.4% in 2000 and 2.2% in 2001 income slumped, especially among the bottom 20% of households. Similar to the bursting of the stock market bubble in 1929 the 2001 recession was precipitated by the stock market bubble of the late 1990s bursting in 2000.

The Bankruptcy Abuse Prevention & Consumer Protection Act of 2005
In 2005 the United States Congress took a comprehensive look at bankruptcy. In regards to Chapter 9, for government entities, and Chapter 12, for farms, it took no action. In regards to Chapter 11 where incumbent management retains control of ongoing operations, can obtain new financing, and continue business all while having exclusive rights to propose reorganization plans to creditors theoretically for 120 days but in reality for the duration of the case, Congress did nothing.

However Congress did pass extensive changes designed to make individual filings more expensive, more cumbersome, and less effective.

The Bankruptcy Abuse Prevention & Consumer Protection Act of 2005 requires debtors to receive a briefing from an approved credit counseling agency at least six months before they can file their bankruptcy case. Then they must pass a strict Means Test to determine whether they can have their debts liquidated through Chapter 7 or whether they must enter a repayment plan through Chapter 13. And they must take an approved class on debt management techniques that they have to pay for, before they receive their bankruptcy discharge.

Who's In Debt Now?
Since you're reading this probably you're in debt. You have lots of company.

Boxer Mike Tyson filed for bankruptcy in 2003.

Actor Robert Blake filed for bankruptcy in 2006

More than one million people have filed for bankruptcy in each of the last ten years. Millions more have struggled with debt either by just scraping by or just giving up.

The current amount of consumer debt is over $1.7 trillion dollars.

The Future of Debt

Who are we to look to when planning our economic futures? Perhaps the experts. But perhaps not.

In July 1957 George Humphrey, the U.S. Secretary of the Treasury, said, "I don't see any significant recession or depression in the offing." The recession of 1957 began in August.

In April 1960 Robert A. Anderson, U.S. Secretary of the Treasury was quoted in The Wall Street Journal saying, "1960 promises to be the most prosperous [year] in our history." The recession of 1960 began that month.

As we've seen debt can come from a variety of sources. They can be personal, bad money management, bad business decisions, and personal tragedy. And they can just as easily be caused by events a world away. In 1857American grain farmers probably weren't even aware that the Crimean War was on let alone that it's end would cause them financial hardship, but it did.

Debt has brought personal destruction and, in the case of William Duer, death in debtors prison. It has also brought redemption and, in the case of George Lyman, a successful second chance.

People who have done everything right have still met with financial ruin just as surely as others have, through no effort on their part, succeeded wildly.

So what do we do? We do the best we can. We work hard and we take reasonable risks. Some of the things we do will work, some won't. We'll make stupid mistakes, often more than once and on occasion we'll get lucky. The financial road will never provide a smooth ride.

It's a good bet that we will have tough times ahead and an even better bet that we'll find a way to get through them.

While there is no guarantee it is prudent to have a plan. Chances are you won't get to where you want to go if you don't know where you're headed. But you can't stop the trip just because you get off track once in a while. You must continue.

Perhaps the most important financial lesson is to learn that money, while important, is not everything. We all know of stories of the miserable miser who died with money but nothing in the way of friends or happiness. And we've seen stories of people with little financial assets who amassed a great fortune in terms of love and spirit. But please be aware that there are many people who are rich and happy as well as those who are miserable and poor.

Money, again, is important but it is not the determining factor in true wealth. So when you get in debt make a plan to get out and stick to it. Let go of your past mistakes. Forgive yourself and forgive others who may have played a part in your debt.

The original Lord's Prayer said, "Forgive us our debts as those who are in debt to us."

Build your true wealth from the inside out. Be true to yourself and help others when you can. Learn to enjoy the experiences that come freely with life, embrace the people and natural beauty that surrounds you. When you do you will find that money takes it proper place. It will ebb and flow but the true wealth that is you is eternal.