PART I The Principal Argument

1 The Time before the Debt Machine

We could have a country without much debt, and I know this to be true, because we once had a country without so much debt. Once you realize that Americans haven't always been as deeply indebted as they are now, it becomes easier to see that this system of debt had to be built, and hence, that our system of debt could also be torn down.

Credit cards, particularly, are a relatively recent invention. Although the first credit card, Diners Club, was invented in 1950, it took a while for credit cards to gain any traction. In 1961, while many stores had their own credit plans, only 1 percent of stores accepted general purpose credit cards issued by outside banks.[1]

Of course, while credit cards are new, credit is not.

Naomi Sizemore Trammel was born in 1887, and started working in South Carolina's textile mills at the age of ten; her father and mother had both died in quick succession—her father of a fever. While her younger siblings were taken in by uncles and aunts, she and her older sister Alma had to find jobs, so they found work spinning string and running frames of cloth. Naomi married at twenty-one to Percy Long, who worked in the weave room at Greer Mill, and who pitched for Greer Mill's baseball team, the Spinners. During the Great Depression, the mills laid off workers and cut back on hours.

"We couldn't even find a job nowhere, everybody else was laid off around. That was a bad time. We got in debt, but nobody didn't refuse us. And when we all went back to work, we soon paid it off. It just come around so good," said Sizemore Trammel. "Well, we was out of work a pretty good while. And there was a man, Frank Howard, we were trading with him, out there at the crossing, getting groceries and things from him, before that happened. And we always paid our debts. And we's getting milk from another man. And so we got in debt with that, and they wouldn't cut us off. So when we went to work, we'd pay our bills. We can pay a little bit, you know, add on to our bills. First thing you know, we come out on top. It wasn't near hard's it seem. But we didn't know what in world we's gon' do."[2]

That's what American debt looked like for much of the 1800s and 1900s. If you weren't a farmer, or a small business owner borrowing money for your company, typically, any money you borrowed was lent from whatever store sold the thing you needed to buy. Stores lent people like Naomi money to earn a profit on the goods they were selling, and occasionally, as a social courtesy, not necessarily to make a profit from the loan interest itself. These storekeeper-customer relationships were sometimes friendly, and sometimes predatory. Sometimes, like with Naomi, these relationships were personal, while for shoppers using installment credit at larger department stores during the same decade, the exchanges were at arm's length: credit, there, was provided after the submission of a formal application, with the merchant usually reviewing data from by a locally run credit bureau before making the lending decision.[3] But by most accounts, the customers who purchased goods on credit in the late 1800s and early 1900s were *less* profitable for shopkeepers and department stores than those who purchased with cash.[4] Credit was a means for retailers to drive sales, not its own center of profit; the costs of extending the credit and the interest collected generally canceled one another out.

It should be noted that the book you are holding is just one of many written throughout American history with complaints about household debt. Benjamin Franklin's *Poor Richard's Almanac,* dating back to 1732, but widely quoted throughout the Victorian Era, was littered with adages like "The second vice is Lying, the first is running into Debt."[5] The moral panic around consumer debt continued into the 1800s with Mark Twain's *The Gilded Age: A Tale of Today,* into the 1900s with Upton Sinclair's *The*

Jungle, which described in great detail the Rudkus family's installment debt, and once the credit card arrived, in books like Hillel Black's 1961 *Buy Now, Pay Later*.[6] But while there have always been some Americans in debt, and some who worried about the Americans in debt, the fact is our current moment *is* distinctive in two important ways. The first is that, by every conceivable measure—in absolute terms, per capita, adjusted for inflation, and as a percentage of household income or household assets—the amount of consumer debt is higher in the twenty-first century than it was at any point in the twentieth century, with the precise amount of credit card debt since roughly the year 2000 mostly ebbing and flowing in the opposite direction as what you might expect: more debt when the economy is doing well, and less debt when the economy is doing poorly.

What is less commonly discussed, though, is the second key distinguishing factor about American debt today relative to any other point in the past: the prices paid for credit card debt have risen substantially. The average credit card interest rate, 17.14 percent, reached a twenty-five-year high in May 2019, a fact that isn't explained by Federal Reserve interest rates, loan default rates, or any other cost of doing business.[7] Sitting with these two facts together begs the question, why exactly are Americans saddled with more debt, and more expensive debt, than ever before?

While the rest of the book will take you on a tour of the United States as it sits today, introducing you to Americans in debt, and to the managers, investors, and machines that control that debt, I want to share with you a bit more about how Americans managed their budgets prior to the introduction of the credit card, because the more I came to understand about the history of debt in the United States the less certain I was that our status quo was defensible.

WHEN ALL CREDIT WAS "BUSINESS" CREDIT

Until the 1910s and 1920s, most states capped maximum interest rates on loans as low as 6 percent or 8 percent per year. It was rare for a chartered bank to make a loan directly to an individual if that person wasn't a businessman.[8] Although banks didn't lend directly to families, there were still a few (legal) options for cash loans, mostly pawn shops, and companies that issued installment loans, who were often at the time called "industrial lenders" because they focused on serving wage workers with industrial jobs in big cities. The largest of these industrial lenders, Household Finance Corporation, was founded in 1878, acquired by HSBC in 2003, and then sold off to Capital One and Springleaf Financial during the 2010s.[9] As late as the 1910s, though, wealthy individuals were one of the most important forms of credit: in 1910, 33 percent of home loans came directly from another individual person, rather than a financial institution.[10] When the first income tax was created by Congress in 1913, all forms of loan interest were tax-deductible, reflecting members of Congress' assumption that people only borrowed money if they were entrepreneurs, not to cover normal household emergencies or buy household goods. With that assumption, all loans were assumed to be business expenses, so of course all loan interest would need to be deducted against business revenues to calculate taxable business profits.[11]

Until the introduction of the credit card, most working-class Americans had *no* non-mortgage debt at any given point in time, and in fact, that situation persisted until 1983: until that point, most Americans in the bottom half of the income distribution didn't have a single dollar of installment loan debt, auto loan debt, credit card debt, student loan debt, or retail debt. When working-class Americans did borrow money, to buy a car, or a dishwasher, or, less commonly, to deal with an emergency, the amounts borrowed were comparatively low. Non-"retail" credit, by which I mean, credit that was not tied to a specific purchase, was even less common than retail credit. In 1950, families in the bottom half of income distribution had an average of twenty-seven cents worth of non-housing debt for every dollar of income. By 2016, that number had tripled: seventy-seven cents worth of non-housing debt for every dollar of income. For families in the top half of the income distribution, retail borrowing was already common by 1950, as postwar families outfitted their new homes with appliances and furniture purchased on credit, but their own levels of debt also tripled over the same period: these families had 10 cents worth of non-housing debt for every dollar of income in 1950, and thirty-seven cents in 2016.[12]

I don't mean to paint a utopian picture of life before credit cards. Life, clearly, was not perfect, and even if Congress assumed that all household borrowing was for business purposes, the questions of who received credit, and on what terms, were absolutely urgent.

It may have been the case that debt in the late 1800s and early 1900s wasn't a major part of life for Americans who weren't farmers or small business owners, but of course, for much of American history, most people *were* farmers or worked on farms. According to the 1860 census, of the 8.3 million Americans who were considered to have an "occupation"—free, adult men, mostly—3.2 million, or nearly 40 percent, were counted as farmers or farm laborers.[13] An additional 4 million Black Americans lived in slavery, the vast majority of whom were forced to work in agriculture.[14] These enslaved people made up roughly 15 percent of the country's population.[15] All-in, roughly half of American adults spent their days farming, some in enslavement, and others who kept fruits of their labor.

Our highly unequal system of banking has its roots in this era. Before the Civil War, enslaved people were a valuable form of collateral that made it easier for White enslavers to get loans: lenders considered enslaved Black people to be even better collateral than land, because people can easily move or be moved, while land is fixed in place. And as a result, credit was more accessible to slaveholders than it was to free farmers in the North or West.[16] JPMorgan Chase, Bank of America, Wells Fargo, and U.S. Bancorp are all known to have accepted enslaved people as loan collateral.[17]

Contemporaries who lived through the Civil War might have initially assumed that the Confederacy's defeat would ruin White enslavers financially, but these enslavers became the major beneficiaries of the National Bankruptcy Act passed in 1867. The founding fathers had planned for a federal bankruptcy law, even giving Congress the power to legislate bankruptcy in the Constitution, but Congress had a hard time reconciling the competing interests of creditors and debtors, farmers and merchants. Earlier attempts at writing bankruptcy legislation, in 1800 and in 1841, were both repealed within three years of their passage.[18]

The 1867 law, passed just one year after the Civil War ended, was considerably friendlier to debtors than the 1841 law. According to historian Rowena Olegario, although Southerners made up only a quarter of the population, they held most the debt in 1867, and accounted for 36 percent of all bankruptcy filings under the 1867 law. The new law gave Southern enslavers a chance to protect their land and other assets: former

Confederates were given a fresh start, and the children and grandchildren of former enslavers remained at the top of social and economic life in the South through the 1940s.[19]

The average interest rate for farm mortgages in the South after the Civil War was around 8 percent, but other types of debt relationships emerged as well: sharecropping and tenant farming.[20] As Mehsra Baradaran writes in *The Color of Money: Black Banks and The Racial Wealth Gap*, under a sharecropping arrangement, "Sharecroppers paid for the land, supplies, and tools using credit, and they paid back their debts with their crop yields, typically with nothing left to spare. Usually the landlord did the calculations himself, and the illiterate debtor would have to trust that he had made no surplus year after year."[21] Persistent indebtedness, clearly, was not invented in the twentieth century.

Sharecroppers' debt could be said to be a close cousin of the institution of slavery, and a distant cousin of the types of debt Americans hold today. Black southerners could be arrested and jailed under vagrancy laws if they didn't show a work certificate from a White employer, and even if Black southerners saved enough cash, laws often stopped Black people from buying land owned by White people.[22] It's easy to look at the situation of most Black southerners in the late 1800s and early 1900s, and identify that their sharecropping debt wasn't a voluntary arrangement: White political elites had foreclosed on the alternative ways that Black southerners could have made a living. The question of whether Americans today have freely chosen their debts is much thornier.

While their position may have been enviable compared to Black sharecroppers, the burdens of debt nevertheless weighed on White farmers in the South and West, and many ordinary White farmers demanded looser credit at lower interest rates. When William Jennings Bryan gave the famous "cross of gold" speech at the Democratic National Convention in 1896, arguing that the gold standard helped wealthy bankers at the expense of farmers, who paid higher loan interest rates as a result, it helped him leave the convention with the Democratic nomination for the White House.[23] For American farmers, the terms and availability of credit could make the difference between destitution and sufficiency.

The case of home mortgage credit in the twentieth century follows a similar arc: who received credit, and on what terms, determined who would become rich, and who would remain poor. Black families in the 1920s through the 1950s were forbidden, even in most northern cities, from receiving mortgages to buy houses in White neighborhoods, and were charged high markups to receive mortgages in Black neighborhoods, if they qualified at all. No individual choices a Black American could make would override their race in the eyes of lenders, or in the eyes of the Federal Housing Administration, who set the rules under which most mortgage lenders operated.[24] Millions of White working-class families received a massive handout in the form of access to federally guaranteed, low-interest rate mortgage loans, a subsidy worth about $200,000 per White family that was denied to Black families.[25] As with the case of farm credit, the fights over mortgage credit were about the opportunities for Americans to build wealth and to have one's hard work translate into a decent living and a safe home.

. . . . .

WHAT ABOUT LOAN SHARKS?

Today, any attempt to reign in the excesses of the credit card industry is met with the charge that it would merely push borrowers into the hands of payday lenders, or worse, loan sharks. It is helpful to consider, then, how Americans used to handle things like the loss of a job, a broken window, or an unexpected hospital bill, in the era when interest rates were capped at 8 percent per year, a price that meant most Americans had limited or no access to legally provided, small-dollar, short-term loans.

For much of the late 1800s and early 1900s, loan sharks operated in larger towns and cities, charging interest rates from 60 percent to 480 percent per year. Notably, the loan shark interest rates of the early 1900s aren't so different from payday loan industry of the 2020s—today, the customary rate charged by payday lenders is $15 per $100 borrowed for a two-week period, or 360 percent per year. The term "loan shark" first became popular in the 1890s, to refer to any lenders whose interest rates or repayment terms ended up trapping the borrower in debt; these business practices were illegal and widely believed to be unethical.[26]

The industrial lenders like Household, mentioned earlier in the chapter, didn't become legal and popular borrowing options until the 1920s, when states began to loosen their interest rate caps for some small dollar loans to rates as high as 24 percent or 36 percent per year, and occasionally as high as 42 percent per year. These first "Uniform Small Loan Laws," gave reprieves for non-bank lenders, but not banks themselves, and only lifted the interest rate caps for small loans; larger loans still fell under the 6 percent or 8 percent caps. The theory pushed by social reformers at the time was that if the government allowed legal loans with interest rates of 30–40 percent, it would push the loan sharks out of business.

It should be noted that before the Great Depression, when organized crime began to take over the loan shark business, Americans viewed loan sharks as rapacious but not bloody—a hybrid, perhaps, between how people today view unsavory landlords and how they view those who engage in insider trading, not as violent thugs, but as greedy businesspeople. By the time mafiosos entered the game, in the 1930s, the old school of unlicensed lenders had mostly either fled the market, or, like Household, lowered their interest rates and applied for licenses to operate legally. When Prohibition ended in 1933, organized crime syndicates could no longer make money selling bootleg liquor; high-interest rate lending was an attractive alternative. While the pre-Depression loan sharks lent directly to families, the mob-backed juice lenders gave out much larger loans to three main groups: business owners, gambling debtors, and operators of illegal rackets like gambling or drug dealing.[27] Black entrepreneurs were especially likely to turn to loan sharks, because they were generally denied business credit from White-owned banks, regardless of the strength of their business plan or profit statements; one estimate from 1972 suggested that as many as one in four Black-owned businesses were funded by the Mafia.[28]

The earlier generation of loan sharks, when legal interest rates were capped at 6 percent or 8 percent, didn't hire enforcers to break borrowers' kneecaps; most of their collection officers were women, under the assumption you'd be less likely to turn away a woman from your front door. These "bawlers-out," as they were called, would also frequently show up to your office, to loudly give a speech in front of your coworkers, embarrassing you into repaying your debt. The loan sharks' target customer was a salaried employee of the government or the railroad, someone with family ties and a steady income, who wouldn't skip town if they ran into financial trouble, and who would be willing to pay a high price to avoid public humiliation.[29]

What is most striking about the loan sharks of the early twentieth century is how tame their criminal actions seem in comparison to the actions legally taken by payday lenders today, even as newspapers and nonprofits of the early twentieth century decried the loan sharks as one of the country's greatest economic ills.

Enforcement of anti-usury laws ebbed and flowed in the late nineteenth and early twentieth centuries. At times, unlicensed loan sharks even felt emboldened enough to run ads in newspapers.[30] But campaigns in the 1910s led to organized national crackdowns. One notorious high-interest lender, Daniel Tolman, who operated at least sixty loan sharking offices in the United States and Canada, was sentenced to prison by a judge who declared at his sentencing, "Men of your type are a curse to the community and the money they gain is blood money."[31]

The loan sharking industry was always highly contentious, and mainstream newspapers frequently covered the industry, offering lurid details to eager middle-class readers. But in absolute terms, the loan shark industry never lent out very much money: it was tiny compared to today's credit card industry, and even compared to today's payday loan industry. Rolf Nugent, director of the Department of Credit Studies at the Russell Sage Foundation estimated that in 1939, the loan shark industry had about $72 million in outstanding loans. Adjusting for inflation, $72 million works out to $1.3 billion in 2020 dollars—roughly half the size of today's payday loan industry per capita.[32]

The pawnshop industry attracted even more interest from middle-class readers and observers than did the loan sharks: mainstream newspapers treated pawnshop borrowers with prurient contempt. One New York Times article from 1932 with the headline "His $100 Teeth In Pawn, Negro Cheers Rise In Cotton," offered a paragraph describing the plight of Joe Milligen, a Black man who "had to pawn his thousand-dollar set of gold teeth for $55 to get something to eat." Another article was written in 1933 to inform readers that historians had discovered that late President Ulysses S. Grant had pawned a watch seventy-six years earlier—noteworthy, ostensibly, because such an action would strike readers as a huge embarrassment.[33] Pawnshops were legal in many states, and were sometimes operated on a nonprofit basis by charities. Pawn operators could easily evade anti-usury laws by only giving borrowers loan amounts that were fraction of their belongings' auction values, generally, one-fifth to one-third the auction value for clothing, or up to two-thirds the value for bigger-ticket items like jewelry.[34]

The cost of all types of material goods were much higher during the Gilded Age than they are today: before the era of Walmart, fast fashion, or mass manufacturing, nearly any physical object a working-class family owned was valuable enough to serve as collateral. Even underwear had a high enough resale value to pawn—clothing as an overall category was the most commonly pawned item. The pawn industry appears prominently in novels and magazine articles of the era, but it was even smaller than the illegal personal loan market.[35] In *Harper's Magazine,* writer William Stoddard, former assistant secretary to Abraham Lincoln, estimated that pawn lenders did at most half the amount of business as New York City's unlicensed lenders.[36]

The biggest difference between the loan sharks of the early twentieth century, and the payday lenders of today, is the fact that we legalized what was once illegal. Today's payday lenders require borrowers to provide a checking account number; if the borrower doesn't pay on time, the lender will attempt to pull money from the borrower's checking account, two or three times a day. Any money a borrower receives effectively gets routed directly to the lender, before children are fed, diapers bought, or rent is paid. If the automated withdrawals don't work, the payday lender can take the borrower to court, and sue them to win a civil judgment, allowing the lender to garnish the borrower's paycheck. Purposefully evade a civil judgment, and the borrower winds up in jail. All in all, today's system is considerably more violent: the "enforcers" aren't private associates of the loan sharks, but police officers, bailiffs, and sheriffs who ultimately make sure payday lenders don't get stiffed.

Two Ways of Life

The basic nature of Americans' financial lives has completely changed over the last seventy years: on average, we each have a lot more debt, but we also each own more in assets. In 1950, just over half of working-class families owned a home, roughly the same proportion of working-class families that own homes today (51 percent versus 47 percent). But in other respects, lower-income families owned a lot less than they own today: In 1950, only 41 percent of lower-income families owned a car. By 2016, 77 percent would own a car. In 1950, adjusted for inflation, lower-income families had an average $45,000 in physical assets, including the value of their home if they owned it, and $13,000 in other savings. By 2016, lower-income families had an average of $121,000 in physical assets, and $49,000 in savings. Although assets have risen, debts have risen much more quickly. While assets rose threefold, debts rose fivefold.[37] Credit is more widely available in the twenty-first century than it ever was before, but a higher proportion of each American's paycheck is sent directly to lenders.[38]

How did Americans deal with emergencies before? Partially, through setting aside more of their paychecks. For every year between 1959 and 1984, the personal savings rate was over 10 percent; by comparison, in 2019, it was 7.5 percent, although even this figure is misleading, because in our era of acute inequality, the ability to save is itself unequally distributed. Economists Atif Mian, Ludwig Straub, and Amir Sufi have shown that that in the 1960s and 1970s, the bottom 90 percent of income earners had a positive savings rate, but since the 1980s, their savings rate has been *negative* each year, meaning, they spent, on average, more than they earned.[39] Importantly, as we'll discuss in chapter 2, 1977 is the beginning of what I call the First Debt Boom—the moment when credit cards, two decades after their invention, first became commonly used. Before the 1970s, when working-class Americans didn't have any open credit lines, and had limited access to cash loans, particularly any type of cash loan that would be available quickly, setting aside money for a rainy day was a practical necessity.

Amid our country's present economic despair, it might seem naïve to even point to a higher savings rate as a possibility for ordinary people. And yet, we must grapple with the fact that many Americans can't afford to save *because* of the proportion of their income that is given to lenders in the form of interest. The fact that Americans, in general, *do ultimately pay the interest* is the very proof that over their lifetimes, they could have afforded to save, and summed across borrowers' lifetimes, the majority of items purchased on credit are ultimately paid for, with interest added. As we'll discuss in chapter 3, it would be a mistake to chalk this just up to