Credit History:
The Evolution of Consumer Credit in America

. . . it was hardly an exaggeration to say that the American standard of living was bought on the installment plan.

Daniel Boorstin, historian

You walk into one of those New England souvenir shops where everything suggests a quaint past. Jars of "penny candy" sit beside an old-time cash register that once rang up sales in a real general store. Behind the register hangs a faux antique sign: In God We Trust. All Others Pay Cash.

You think to yourself, "Those were the days. No credit cards, no debt, no pressure to buy things you couldn't afford." Yet even before you finish the thought, you realize it's more myth than reality.

Nineteenth century Americans had more than their share of financial pressures, and they weren't opposed to borrowing. It's just that they rarely went into debt for things that were fun or frivolous. As Lendol Calder notes in *Financing the American Dream*, "Borrowing money was acceptable and safe only when used to purchase things that increased in value or had productive uses . . . better fences, better barns, better homes, and more land for the farmer."

Through much of the 19th century, borrowing to acquire luxuries and nonessentials was generally seen as imprudent, even immoral. Only the wealthy used credit to finance consumption of things that weren't

Courtesy of Globe Newspaper Company, Inc.

absolutely essential to daily living: fine china, crystal, expensive furniture, fancy clothes, lavish parties. Social pressures and the lack of willing lenders kept most others from doing the same. Using credit to buy seed for planting was one thing; going into debt for a pair of expensive dress shoes was quite another.

But the definition of "luxury" or "nonessential" has a way of changing from one generation to the next. In 1980 most Americans still thought home computers were frills or expensive toys; color televisions were luxury items in 1960; second bathrooms were a relative luxury in 1940; ditto for cars, refrigerators, and washing machines in 1920. Yet by 21st century standards, using credit to acquire any one of these things is neither extravagant nor extraordinary.

Credit and the Standard of Living

Could we get along without a lot of the things we buy on credit? Yes, but our lives would be very different. There would be far fewer households with multiple TV sets and full-blown entertainment centers; fewer island cruises and trips to visit a certain cartoon mouse during school vacations. But there would also be fewer washing machines, clothes dryers, home computers, air conditioning units, and a bunch of other things that we've come to regard as essential. Easier access to credit has meant that more consumers can buy more products and services, benefit from using them now, and pay for them out of future income — buy now, pay later. (Of course, the key is to remember the "pay later" part.)

For better or worse, our material standard of living has improved because more of us have access to credit. To find out why, let's start with a visit to the Federal Reserve Bank of Boston's New England Economic Adventure, a permanent educational exhibit that examines 200 years of economic change in New England. http://www.economicadventure.org

Displays in the Adventure's "Material Life" gallery focus on the possessions middle-income New England families might have owned in the 1810s, 1890s, and 1960s. Even a quick walk-through is enough to make the point that, for most New Englanders, and most Americans, everyday life is physically easier and materially richer than it was. **See for yourself.**

1810: The chamber pot says it all.

The 1810s display suggests a way of life that was almost all work and no play: lots of hard labor and very few creature comforts. The Industrial Revolution had not yet taken hold in America, and New England was still a place of small farms and market towns, a place where people spent their days tending to the basic necessities of food, clothing, and shelter. The rigors of daily life left little time, money, or energy for frills. And that's reflected in the objects that fill our 1810s display: tools, farm implements, household utensils, and a chamber pot (the 1810 version of indoor plumbing). Only three items have anything to do with recreation or spare time: a hoop-and-stick rolling toy, a ball-and-jacks, and a Bible.

1890: A nice place to visit, but you wouldn't want to live there.

By the 1890s, New England was a far different place than it had been in 1810. Foreign immigrants and the native-born children of upcountry farmers had filled the region's cities and towns, hoping to find jobs that paid steady cash wages — jobs in factories, offices, and the retail trade.

You can see evidence of these changes in the 1890s display. Most of the items are factory-made, and, in contrast with 1810, many of the items are frills — a parlor organ, the complete works of Sir Walter Scott, an artificial bird in a cage, sheet music, toy coin banks — items that made life more pleasant for people who had a bit more money and spare time than their

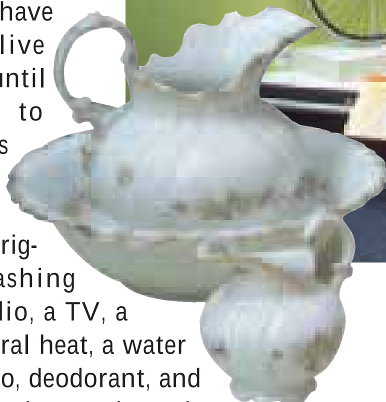
Photograph by Ralph Ragsdale

farming ancestors had in 1810.

Some of the display objects are gorgeous. The glass table lamp, the parlor organ, and the kitchen stove exhibit a level of detail and ornamentation that wouldn't have existed in the possessions of an average family in 1810. In fact, when school groups visit the Adventure, some of the kids are so taken with the 1890s display that they think it might have been nice to live back then . . . until we ask them to notice the things that aren't in the display — things like a refrigerator, a washing machine, a radio, a TV, a telephone, central heat, a water heater, shampoo, deodorant, and so many of the other products that add to the quality of modern life.

1890

Photograph by Ralph Ragsdale



Most of these things weren't on the market in 1890, but even if they had been, hardly anyone could have afforded to pay cash for them, and credit wasn't readily available.

One of the few "big ticket" items that consumers could purchase with credit was a sewing machine. By the 1850s, factories were able to mass produce them, but with most American workers earning well under $500 a year, only the relatively wealthy could afford to pay cash for a $100 sewing machine. So, in an effort to broaden its customer base, the Singer Sewing Machine Company began selling its machines on the installment plan, which, in theory meant a down payment followed by a fixed number of equal monthly payments. (Although, if you were dealing with an unscrupulous sales agent, your monthly payments might have continued indefinitely.)

1960: Let the good times roll!

The most striking thing about the 1960s display is that so few of the objects are related to work or basic survival. The possessions belong to people who have more disposable income and more spare time than their ancestors could have imagined — golf clubs, a tape recorder, skis, a hair dryer. A fondue pot! Even the TV isn't essential to survival. You could get along without it. In fact, you could get along without most of the stuff. But would you really want to?

When we ask Adventure visitors if they'd prefer to live in the 1810s, the 1890s, or the 1960s, most of them think it's a trick question. Who'd want to go back to the days of chamber pots, coal stoves, and no electricity? In fact, our school age visitors think the 1960s were too primitive — no Internet, no cell phone, no MP3 player. ("How did people live back then?")

By the time they leave the Adventure, most visitors are convinced that technology and increased productivity have helped to make life physically easier and, in many ways, more enjoyable than it was in the past. There's also a subtext that's less apparent: It's the story of how financial innovation and easier access to credit helped more Americans gain entry to "the more abundant life."

Cash to Credit

Your neighbor pays cash for everything — cars, clothes, vacations, everything. Rumor has it that he even paid cash for his house. So, what do you think? Is he:

a) thrifty and prudent;
b) eccentric;
c) involved in illicit activity;
d) trying to avoid paying taxes?

Somehow, "thrifty and prudent" sounds least likely. The notion that we should wait to buy something until we've saved enough to pay cash for it seems almost . . . quaint.

Like it or not, Americans have made the transition to a consumer

Photograph by Ralph Ragsdale

1960

society — a transition that was largely complete by the end of the 1960s. **Here's a recap of how it happened.**

Back in 1800

• More than 90 percent of Americans lived in rural areas.

• Approximately 75 percent of the U.S. labor force was engaged in food production.

• The census of 1800 didn't include statistics on the length of the average work week or the average annual wage, but you wouldn't be wrong to say that people worked very long for very little.

• Travel was slow, dangerous, uncomfortable, and expensive. The trip from Boston to New York took 74 hours in a stagecoach that had no springs or climate control.

• Information moved at the speed of a horse or a sailing ship, which meant it moved very slowly.

When the 19th century began, most Americans were farmers, whose uncertain income depended on the size and quality of their harvest. If they used credit, it was usually to cover essentials such as seeds for planting. They borrowed against the income they expected to earn at harvest time.

Credit was also much more personal and more local than it is today. Banks, for the most part, dealt with the well-to-do and the well-connected, so small farmers and artisans had to look for alternative sources of credit: family members and local merchants.

Anyone who has ever borrowed from a relative — even if it was just $5 from a sibling — knows that financial dealings with family members are fraught with peril. And this was no less true in 1800.

The other alternative — local merchants and storekeepers — had certain advantages for both the borrower and the lender. Small farmers and rural storekeepers needed one another and depended on one another for economic survival. Neither had anywhere else to turn. Bad roads and high transportation costs confined them both to a fairly limited market area. Farmers couldn't easily take their business elsewhere, and storekeepers weren't able to draw new customers from outside their market area. In a sense, they were stuck with one another, so when farmers needed seed money for spring planting, the local storekeeper extended credit, and after the fall harvest, farmers repaid the storekeeper (if insects, drought, death, or disability hadn't intervened).

Social pressure and mutual self-interest held the arrangement together. Merchants and storekeepers extended credit almost exclusively to those they knew. They had firsthand knowledge of their customers' financial condition, so they were fairly certain of who was a good risk and who wasn't. In 1810, your credit history was oral rather than written, and identity fraud was not an issue.

Back in 1890

• Nearly 35 percent of the U.S. population lived in urban areas.

• Less than 50 percent of the U.S. labor force worked in farm occupations.

• American workers earned an average of $475 a year. The average work week was 60 hours.

• The number of wage earners working in the cotton textile industry had grown from 1,000 in 1800 to 303,000 in 1900. Numbers were comparable in the iron and steel industry: 1,000 in 1800; 222,000 in 1900.

• People and information traveled much faster than in the early 1800s. There were 208,000 miles of railroad track to move passengers and freight faster and cheaper. (In 1830, there had been only 23 miles of track in the entire country.) Telegraph lines moved information quickly, and a transatlantic cable connected Europe and North America. The telephone had been invented, but in 1890 there were only 234 phones in the entire United States.

By the end of the 19th century, the United States was well on its way to becoming one of the world's leading industrial economies. Large-scale factory production and falling transportation costs had brought an astonishing variety of new products onto the market, and those products appealed increasingly to consumers who worked at jobs that were beginning to provide them with enough income to afford more than the bare necessities.

But many of the new products — bicycles, sewing machines, kitchen stoves — carried high price tags, and credit wasn't readily available. If working-class and middle-income Americans wanted to borrow money for a special purchase — or to cover an emergency expense — they had two main options other than the aforementioned family members and local retailers: (1) pawnshops and (2) loan sharks.

Anyone who has ever seen "mob" movies knows what a loan shark is, but pawnshops may be less familiar. Today, their number is relatively small, and their image is less than favorable, but in the 1890s they were a commonly accepted vehicle for making secured loans. People with no other access to credit could take a valued possession — a watch, jewelry, a musical instrument, you-name-it — to the pawnshop, where the pawnbroker might accept it as collateral on a small loan. Pawnshop interest rates were often exorbitant, but there was a major difference between pawning and loan sharking: Loans with a pawnbroker were secured by the items you pawned, whereas money owed to a loan shark was secured by the threat to break your legs . . . or worse. (For more information on how pawnshops operated, go to http://www.dca.org/history/history_pawn.htm)

The late 1800s were also a time when commerce and credit became less personal than they had been earlier in the century. Large retailers and companies such as Singer Sewing Machine rarely had personal connections to their customers — hadn't grown up with them or belonged to the same organizations; didn't know whether or not they came from a family that always repaid its debts; and often didn't even live in the same community.

Courtesy of Prints and Photographs Division, Library of Congress.

Back in 1920

• The 1920 census showed that, for the first time, more than 50 percent of the U.S. population lived in urban areas.

• For the first time, more Americans worked in manufacturing (11.2 million) than in agriculture (10.8 million).

• The average work week had decreased from 59 hours in 1900 to 51 hours in 1920.

• The number of U.S. retail chains (with two or more stores) had increased from just one in 1872 to more than 1,000 in 1922.

• Between 1900 and 1920, the number of passenger cars registered in the United States increased from 8,000 to 8.1 million.

• Thirty-five percent of all U.S. households had telephone service in 1920.

• In 1900, less than 8 percent of all U.S. dwellings had electric service. By the end of the 1920s, the number was up to 68 percent.

• By the end of the 1920s, 39 percent of all U.S. households had a radio.

Everything came together in the 1920s: mass production, electrification, highway construction, mass communication, the expansion of consumer financing.

Auto manufacturers perfected assembly line production and began to turn out cars at a price that would "put the middle class on wheels." Public investment in a federal highway system helped to expand the market even further.

Other manufacturers adapted assembly line techniques to produce affordable home appliances and consumer electronics: ovens, refrigerators, washing machines, phonographs, radios, telephones. And investment in the utility infrastructure — electrical power grid, phone lines, water and sewer systems — helped to bring these products into more homes.

But the catalyst — the thing that helped to bring all these industrial and technological marvels within the reach of so many consumers — was the expanded use of installment credit. The big breakthrough came in 1919 when General Motors Acceptance Corporation (GMAC) became the first to make financing available to middle-income car buyers. Instead of having to come up with the entire purchase price, prospective car buyers needed only a down payment and an income that was big enough to cover monthly payments over the life of the loan.

Before long, manufacturers of other "big ticket" items began to adopt the practice. And if consumers were hesitant to go into debt, the flood of advertisements in mass media outlets — newspapers, magazines, and radio — helped them to overcome their inhibitions.

Back in 1950…and Beyond

By the end of the 20th century:

• More than 75 percent of the U.S. population lived in urban areas.

• More than 62 percent of the U.S. work force worked in the services sector.

• The average work week had decreased from approximately 50 hours in 1920 to roughly 40 hours.

• The number of motor vehicles registered in the United States topped 210 million.

Courtesy of Prints and Photographs Division, Library of Congress.

• Information moved at the speed of an electronic impulse. Between 1998 and 2001, the number of U.S. households with Internet access nearly doubled, from 26 percent to 50.5 percent. More than 56 percent of U.S. households had a home computer. Close to 95 percent of U.S. households had telephone service, and more than 98 percent had at least one TV.

• The use of consumer credit had become a fixture of everyday life. In 2000, more than 70 percent of U.S. households had at least one general-purpose credit card — MasterCard, Visa, Optima, or Discover. Thirty years earlier, in 1970, the number was only 16 percent.

After the 1920s there was no turning back. Widespread use of consumer credit became an indispensable part of American economic life. But for the next 40 years it was still limited mainly to installment buying — "a small down payment and easy monthly payments," as the ads used to say. The people who extended you the credit were the same ones who sold you the product you were buying.

During the early years of the 20th century, a few hotels issued credit cards to favored guests, but the cards were mainly a gimmick — status symbols that distinguished the cardholders from the masses of cash-paying customers. Retail stores and oil companies were issuing credit cards during the 1920s, but they were single-party cards issued by merchants who saw them as a way to sell more goods and services. They offered cardholders a certain measure of convenience but very little flexibility. Department store cards weren't accepted by competitors, and unless they were issued by a national chain, they weren't much use when traveling.

Installment Credit versus Revolving Credit

When you take out a loan to buy a car, you're using installment credit. When you pay for concert tickets by credit card, you're using revolving credit. Here are the main differences between the two.

Installment credit is offered mainly by companies that sell the product you're buying. Sometimes the products are "big ticket" items like cars, boats, and home appliances, but stores also offer installment financing on things like high-end televisions and home entertainment equipment. It's called "installment credit" because you make payments in equal installments. Usually, there's a down payment followed by equal monthly payments over the life of the loan. Interest – the price you pay for using the money – is calculated for the life of the loan and then factored into your monthly payments.

The most common form of "revolving credit" is credit card use. The card issuer grants you a fixed line of credit – a credit limit that's based mainly on your income and your credit history – and you can't go over the limit without approval. The total amount you owe and your minimum monthly payment can fluctuate from one month to the next. When you buy more stuff, your balance increases, and so does your minimum monthly payment. If you don't pay off the entire amount each month, you'll have to pay a finance charge. The rate can be fixed or variable, the method for calculating it can vary from one card issuer to another, and some cards carry a much higher rate than others. So, before you decide which card you want in your wallet, do a little comparison shopping.

Gasoline credit cards covered a wider market area, but they weren't accepted by competitors, nor were they much use if you needed something that wasn't sold at a gas station.

Credit cards as we know them today didn't take off until the 1960s, when financial innovation, improved technology, and changing consumer attitudes all converged. Financial innovation came in the form of a concept pioneered by Diners Club in 1949: the dual-party card. Dual-party cards represented a major breakthrough because the card issuer wasn't actually providing the goods or services being purchased. Diners Club was not a restaurant chain or a food service company. It simply signed up hotels and restaurants to participate in its credit card plan, and it then issued cards to creditworthy people who were willing to pay a yearly fee for the convenience (and status) of having a card — no need to handle cash or fumble with a checkbook. When a cardholder charged a meal, the restaurant sent the bill to Diners Club, and Diners Club then paid the price of the meal, minus a small commission, directly to the restaurant's bank. Finally, Diners Club sent the cardholder a monthly statement (bill), and the cardholder sent Diners Club a check.

But Diners Club was only a first step. The innovation that ultimately put dual-party credit cards into so many wallets was the bank card — a general-purpose card that consumers could use in a wide variety of situations. Franklin National Bank (Franklin Square, New York) introduced the first bank card program in 1951. A few years later, Bank of America launched BankAmericard (now Visa), and Chase Manhattan Bank followed with MasterCharge (now MasterCard).

When they first came on the market, general-purpose credit cards were slow to catch on. Two hurdles stood in the way: (1) Large retailers with well-established credit card programs of their own were reluctant to participate in bank card programs, and (2) attracting cardholders and merchants from outside an issuing bank's marketing area was problematic.

The first problem took care of itself. Large retailers set aside their reluctance when they realized that general-purpose cards made it easier for customers to spend even more.

And technology eventually overcame the problem of distance. Improved telecommunications and better computers gave banks and merchants the tools to move information quickly and manage it more efficiently. Quick exchanges of information were the key to making the whole system work.

Today, you can travel halfway around the planet and pay for your hotel room with a credit card issued by a bank or financial services company based a thousand miles from where you live. And here's the really remarkable part: The hotel clerks in Perth or Pago Pago don't know you, don't know your family, don't have any firsthand knowledge as to whether or not you pay your bills. But within seconds, they're able to receive electronic approval from your credit card issuer, and if the card issuer says you're OK, that's usually all the merchant needs to know.

How do card issuers decide whether or not to give you a card in the first place? They check your credit history, a computerized record of information related to your bill-paying habits, which is usually maintained by one of a handful of major credit reporting bureaus — private, for-profit businesses that maintain computerized records of your bill-paying habits, the number of credit accounts you have, how much you owe on each account, where you work, and how long you've worked there. (To learn more about credit files and credit bureaus, go to this site: http://www.frbsf.org/publications/consumer/creditreport.html)

It's all quite impersonal and very different from the way things were in 1800, or even 1900. Just try to imagine how old-time storekeepers and bankers would react to the idea of granting you a $10,000 line of credit without ever shaking your handing, looking you in the eye, or knowing anything about your family. Then try to imagine their reaction if you asked to borrow money for a vacation: *Let's see. You want to use this money for a pleasure trip to Florida, where your children will visit a kingdom ruled by a mouse? You won't be doing any trading while you're there, nor will this journey have any other productive purpose. . . . I think not.*