CHAPTER ONE

A POPULIST ISSUE

IN THE THREE DECADES FOLLOWING THE CIVIL WAR, THE United States underwent more social and economic change than at any time since independence. In addition to the social upheaval caused by the war itself, the country was expanding west at a rapid pace. States and the federal government granted hundreds of millions of acres to the railroads so they could reach the West Coast, providing infrastructure to a country with extremely poor roads. But the country was experiencing other momentous changes that at first went unnoticed.

The United States had begun to develop its financial economy. The war had seen an explosion in the demand for life insurance, speculation and investing in common stock, and commodities trading. As a result, a growing class of well-to-do entrepreneurs emerged quickly, and investing in intangibles became more important in the get-rich-quick environment than working at a profession or in manufacturing or farming. These trends occurred about the same time, causing further upheaval and widespread suspicion among those on the lower rungs of the social ladder. At first, the rapidly emerging financial economy made sensational headlines. During the Civil War, gold traded actively on the New York market, and prices fluctuated wildly.

When Abraham Lincoln visited the gold exchange, he was appalled to discover that traders would buy or sell depending on news from the battlefront. When the North won a victory they would whistle the "Battle Hymn of the Republic." When the South won a battle, they whistled "Dixie." Lincoln was infuriated. Results did not seem to matter—only trading profits. Similar events continued after Appomattox. In 1869 the already infamous speculator Jay Gould and cohorts had attempted to corner the U.S. gold supply by bidding up prices on the New York gold market and selling out before prices eventually crashed. The day they did so became known as Black Friday, and the reported $10 million profit made by the speculators did not go unnoticed on the farms and in the factories, where the annual wage was well below a thousand dollars a year. Adding to the intrigue were rumors that Gould had persuaded President Ulysses S. Grant, elected the year before, to provide unwitting assistance in driving up the price of gold.

The result of the corner was a severe recession and a banking crisis—disruptions in the economy were felt all the way to the factory floor and the distant farm. But the allure of the financial economy proved too great to be resisted. The West proved a great attraction to the financial economy as well; not as a place to farm, but as a vast area requiring financial services. Initially, banking was concentrated in the big cities, mostly on the East Coast, and did not accommodate the needs of farmers and small businessmen, especially those in faraway states and territories. Many entrepreneurs packed their bags and moved west to open small banks and financial service companies to deal with individuals and small businesses. They soon realized that, by setting up shop west of the Ohio River, they had also escaped any sort of regulatory oversight imposed by Eastern states.

By the 1890s, loan sharking—as the practice of high-interest lending came to be called—had become a large cottage industry, especially west of the Ohio River. Merchants, businessmen, and even clergymen with a few thousand dollars to invest eagerly became high-interest lenders. They filled a large vacuum not yet occupied by banks and other small financial institutions. The practice had profound implications for economic policy from the 1870s to the beginning of the Great Depression. The overwhelming dominance of banks and the general reluctance of the federal government to intervene in economic affairs except in times of emergency set a precedent that became embedded in the financial system. Banks were given free rein in most states to charge interest as they saw fit, and usurious lending was attacked on a local or state level if it was challenged at all. Interest rates were set by businessmen, and complaints about excessive interest charges were regarded as nothing more than an annoyance. Litigation against predatory lenders was rare and, before long, the precedent became institutionalized. Lenders charged what the market would bear and borrowers seldom complained publicly. The rewards were plentiful; lending for mortgages and consumption loans could earn returns from a relatively modest 10 percent to well over 500 percent per year or more.

The term "loan shark" quickly became the preferred term for high-interest lenders in the American vernacular, replacing the much older term "usurer." The word "shark" was a popular epithet throughout the nineteenth century for describing anyone who was predatory in his chosen profession, whether it was playing billiards or selling snake oil. By contrast, the word "usurer" was derived from Latin and made the practice sound archaic and alien. Ironically, the term loan shark actually softened the image of the usurer, who had often been depicted as a moral scourge in popular art and newspaper cartoons. The loan shark was nothing more than a marginal businessman who provided a vital service for a price (albeit a high price). Later in the nineteenth century some loan sharks would acquire an even softer image, being depicted as "aunties and uncles" (although they, too, provided loans at unavuncular rates). When the filmmaker D. W. Griffith depicted the nationwide lending problem in his 1910 film *The Usurer*, he opted to use the harsher term.

Usury, Arguments for and Against

Many states had begun to look critically at their own usury laws even before the Civil War. The focus on usury laws in mid-nineteenth-century America came on the heels of their official repeal in Britain in 1854. England's usury laws dated back to the eleventh century, and over the centuries the country had, at times, made usury a crime and at other times, it had experimented with different maximum lending rates. In the decades before the repeal of the official usury laws English economists, from Jeremy Bentham to David Ricardo, had expressed misgivings about the laws in varying degrees, and their arguments on both sides of the issue were well known to Americans. The English movement was strongly influenced by a free market outlook that favored few restraints on economic activity. Ironically, Adam Smith, the father of free market economics, did not favor abolishing usury laws across the board. He recommended a band, or collar, of interest rates with a maximum and a minimum lending rate, using the market as a guide.

Usury laws occupied an unusual place in American society well before 1776. Georgia, founded in 1733 by James Oglethorpe, a member of the British Parliament, had the distinction of being the only colony that provided a haven for debtors. Each of the original thirteen states enacted laws on maximum rates of interest on real property loans, usually fixing a maximum of 6 to 8 percent as the highest rate lenders could charge. These limitations were written into their original colonial charters from Britain and into their first constitutions. The 8 percent rate remained in force in Massachusetts until 1692, when it was lowered to 6 percent. The Maryland legislature set the maximum rate at 6 percent, allowing for an 8 percent rate for trade-related transactions. New York introduced an original maximum rate of 6 percent for a five-year period; this was subsequently raised to 8 percent, only to be reduced again to the original rate in 1737.

Between the Revolution and the Civil War, lenders ignored usury laws with varying degrees of impunity. The fragmented nature of banking and the lack of a central bank meant that credit allocation originated with the large New York banks. There was little flexibility when the supply of credit and money became a problem unless those banks decided to act. If the banks perceived risky conditions they would curtail the amount of loans in circulation, often exacerbating already tight credit conditions. The large banks provided services to merchants and wealthier individuals but were not in the habit of making small loans to consumers. But even merchants relied on the judgment of the banks in tough times.

In any event, commercial loans of $250,000 were exempt from usury laws in most states. Small borrowers—generally those borrowing $300 or less—had to rely on private lenders or small institutions. Lenders did not overtly advertise rates in violation of local usury laws; instead, they hid them in the details of the loan agreement. This allowed lenders to appear to operate within the confines of the usury laws while exacting much higher effective rates of interest.

Following trends in England, many states begin to experiment with abolishing their often-abused usury ceilings or, at least, raising the maximum allowable rate of interest. This movement, which extended from the 1830s through the Civil War, drew heated debate on both sides. The arguments ran from defending usury ceilings on grounds of moral justice to economic arguments couched in the theory of money as a commodity that should fetch a market rate for its use.

Both sides provided compelling arguments but poor evidence. Adherents of usury ceilings could point to the short-lived attempts before the Civil War by some states to abolish ceilings. Despite those attempts, all states but one had usury laws back on their books by the mid-1850s. The lone exception was California; the state was reported to have ruinously high borrowing rates, fueled in part by the gold rush that created a borrowing frenzy for land and equipment and everything else tied to gold.

The repeal of usury laws in Eastern states met with varying degrees of success. New York's usury ceiling of 7 percent was maintained better than other states. The movement toward abolition of ceilings, interrupted by the Civil War, continued shortly thereafter. In early 1873, however, as repeal was being considered in neighboring Massachusetts, New York Governor John Adams Dix announced that his state should consider repealing its usury ceiling. The matter centered on whether the ceiling was economically viable for Wall Street. "It is quite clear that in the City of New York," Dix said, "that for scruples on the one hand and fears on the other by which conscientious and timid capitalists are restrained from lending at prohibitive rates, the enormous interest paid under the pressure of extraordinary demands for the use of money could not be maintained for a single day."[1] Dix recognized the enforcement problem that the ceiling created. Nevertheless, his plan to abolish New York's usury ceiling went nowhere.

Different laws in different states often created interstate tensions. Courts usually took the location of lenders into consideration when deciding charges of usury. In one case in 1862 a New York court rejected the suit brought by a borrower who had signed for a loan at 26 percent interest in Minnesota then claimed that the rate under the laws of New York, where he now lived, was usurious. The court acknowledged that the rate would be usurious under New York law but considered the matter to be governed by Minnesota law.[2] The U.S. Supreme Court would not definitively decide the location issue for another 100 years.

The patchwork of state usury laws was complemented by one usury prohibition at the federal level, but even that left the states' prerogatives intact. The National Bank Act of 1864 contained a usury provision seeking to restrain the national banks—a designation Congress had created for banks that would submit to oversight and regulation by the new Comptroller of the Currency—from overcharging customers on loans. Many banks originally sought the designation "national" during the Civil War as a matter of loyalty to Washington, D.C. The law explicitly stated that national banks had to observe the usury laws of the states in which they resided. If the state did not have one, then the maximum rate was set at 7 percent. This rate, like that for most states, was for real property loans, and even when local usury laws were abolished most mortgage rates never exceeded 8 percent legally. The rates for chattel loans (consumption loans) usually were much higher. Borrowers who claimed they were charged too much had two years from the beginning of the loan to seek redress. If they were successful, the damages awarded were typically twice the amount of interest originally charged.

There was only one problem. Most of the entities that loaned money to consumers were not banks and, thus, did not fall under the act's usury limits. The language of the act created a gray area that would unwittingly produce a whole generation of entrepreneurs attracted to usury because of its high returns. Specifically, the act stated that national banks were limited in the amount of interest they could charge, but "natural persons" were not.[3] Individuals, therefore, could charge interest on loans at any agreed-upon rate of interest. State banks—those that did not apply for national designation—fell under state laws and, therefore, were exempt from the National Bank Act of 1864. New York and Massachusetts both had these contractual exceptions to their usury laws. Noncontractual lending, usually by verbal agreement alone, was a different matter and could be litigated under the usury laws—but of course it was difficult to prove usury without a written contract.

As a result, an unregulated lender could charge whatever the market would bear—that is, whatever his customers would agree to—and did not have to worry much about the consequences. Individuals in need of small loans were not likely to sue because lawyers were expensive and borrowers were typically unable to afford their counsel. But even when a court found in favor of a borrower, the old statutory rates usually entered. When states rolled back or modified their usury laws, they often retained a capture rate of around 6 percent. If a lender were found guilty of charging exorbitant rates, then that rate could be used to settle claims in court between borrower and lender. The net effect of the capture rates was that they appeared to be the same old usury ceilings used since colonial times.

In any case, the patchwork of national and state usury laws was in danger of doing more harm than good. In 1872, the *New York Times* declared that "although [usury] is entirely a dead letter, and is never enforced or regarded, and although it bears heaviest on those whom it is expressly designed to protect—the farmers—yet the prejudice by which it is sustained is too strong to be overcome and it still cumbers the statute book." The British magazine *The Economist* noted that American banks "have to comply with absurd usury laws, which prevent them from charging more than a stated rate for advances [loans]. These laws are of course avoided but still their existence prevents the banks from openly regulating their rates for money in accordance with the conditions of supply and demand."[4] Others were not as certain, however. "We regard the repeal of the usury laws as a capital blunder," the Fitchburg, Massachusetts, *Sentinel* commented in 1878.

Despite the disagreement over the laws and pronouncements about their demise, the fact that they remained on the books provided a warning to lenders. New York's banks and life insurance companies might, for example, comply with the state's usury laws for loans made to in-state borrowers, but the same could not be said for money they lent outside the state. New York City had already assumed the role of the major supplier of credit through its large banks and, while they were wary of charging too much at home, lending to borrowers outside the state was more lucrative. To avoid the 7 percent maximum stipulated by the National Bank Act while still keeping with the spirit of state laws, New York City banks and large insurers lent money to intermediaries in other states that were finance companies and did not fall under the umbrella of many state usury laws because they, technically, were not banks. The rates that finance companies were able to exact from their borrowers proved a strong lure to the banks and brokers that could lend to them on a wholesale basis and thereby avoid the stigma of illegally lending directly to individuals or small businesses. The same was true elsewhere. One loan shark firm in St. Louis was found to be the principal owner of the Edwards securities firm in the same city but lent money for chattel loans under a separate subsidiary to avoid the stigma of being labeled a usurer.

Some Midwestern states that were frequently the targets of high-interest lenders followed the example of Eastern states like Massachusetts, though with less success. Indiana abolished its usury ceiling in the mid-1830s, but reinstated it four years later. Wisconsin ended its ceiling in 1849, but reinstated it after only a few months. In both cases, the public clamored for the protections to be reinstated. "The argument in favor of this policy was that competition in the loan of money, the rate of interest being unrestricted, would produce a great influx of capital to the state. It certainly has produced an influx of money, but not of capital," commented Isaac P. Walker, the Democratic senator from Wisconsin. Walker was referring to money attracted for short-term lending, as opposed to money that would be used for long-term, potentially profitable capital investment. In Indiana, a judge who had presided over many foreclosures observed that "no sooner had the effects of the repeal been developed . . . [when] an irresistible public opinion called for usury laws. Had the legislature not interfered and tied the hands of the spoiler [loan sharks], an immense amount of property would have changed hands in a few years."[5]

Loans to homeowners and the workingman certainly had their appeal. Providers of loans recognized that demand for consumer-related loans was steady. They also recognized that these loans were often the only source of funds for many who were dependent on erratic incomes or low wages. Since the credit markets favored companies and the wealthy, lenders quickly realized they were in the driver's seat when dealing with these customers. As the United States expanded rapidly, the demand for consumer credit would often be satisfied only by unregulated lenders who exacted a high price for their services.

A COMBUSTIBLE MIX

During the latter part of the nineteenth century, many believed the United States was bedeviled by two great social evils: alcohol consumption and loan sharking. The two were considered part of the same overall defect in the human condition and were closely intertwined in the mind of reformers and businessmen alike. “Next to the rum evil, no evil is comparable to the burden laid on a community by the loan shark,” declared W. N. Finley, a leader in the war against loan sharks, when the Prohibition amendment was introduced during World War I. The workingman drank too much and put himself, his family, and his employer in difficult straits. He often needed cash to meet everyday expenses and as a result found himself at the mercy of unscrupulous lenders.

The temperance movement, which began organizing in the 1820s, vividly portrayed alcoholism as the country’s major social and economic problem. Consumption of beer and spirits caused broken homes, firings at work, and the denigration of women by their husbands. The DuPont chemical company forbade its employees coming to work with alcohol on their breath, and guards were placed at the entrances of its plants to detect the smell of alcohol. Since the consumption of alcohol did not mix well with the sensitive nature of the company’s combustible chemical products, the mere suspicion of drinking on the job was cause for immediate dismissal.

Following ratification of the Eighteenth Amendment to the U.S. Constitution in 1919, the production of beer and spirits for personal consumption was outlawed in the United States. The amendment was the first successful attempt at a national sumptuary law, an American version of laws that had been attempted with varying degrees of success since the Roman Republic. Unlike many previous sumptuary laws, Prohibition was aimed at producers and sellers rather than consumers. The idea was that if production was curbed, consumption would necessarily follow.

The same idea was behind the usury laws intended to protect consumers from predatory lenders. To protect society from the evils of indebtedness, laws were aimed at the supply of funds by attempting to control lending rates but, just as bootleggers and smugglers found ways to provide alcoholic beverages to a thirsty public, the suppliers of credit easily found ways around the laws that circumvented the good intentions of their framers. Ironically, the laws gave way to even higher consumer lending rates.

Facilities for saving and managing money were scarce for most individuals before the twentieth century. Banking in the nineteenth century followed a relatively simple model; large urban banks dealt with businesses and wealthy individuals only. Savings and loan associations, or thrifts, were founded after the War of 1812 and made mortgage loans on a local basis to their depositors. In areas where a thrift or a willing local bank did not exist, borrowers were often left adrift for loans, especially for small household loans. More often than not, the would-be borrower did not possess collateral that a small bank would find acceptable. For such individuals, a new source of consumer credit began to appear not long after the Civil War. They were lean operations that could move their offices quickly when necessary. They became known as loan sharks.

The term began to appear in the press in the 1880s. Borrowing from loan sharks often was considered one of the consequences of excessive alcohol consumption, since inebriation made household money management difficult, if not impossible. When the weekly paycheck ran out early, loan sharks provided a vital service, for a high price. Providing credit at high rates as a last resort did not endear them to the public. "The loan shark who lives on blood money is the most nefarious of all the humans," remarked the *Des Moines Daily News* in 1900.

These small lenders certainly counted the poor and ignorant among their clients, but customers came from all walks of life. The business was best described by Clarence Hodson, one of the major figures in the anti-loan shark drive who developed a consumer lending business: "If there are no local licensed money-lenders to supply small loans, the need for loans will nevertheless persist in that community just the same, and loans will be sought and supplied through underground channels, by offering or accepting oppressive terms and usurious rates."[6] It was generally recognized that a borrowing rate of 10 to 20 percent per month was common. Because the loan shark was frequently the only available source of funds, borrowers rarely complained; they could either accept the loan shark's terms or forego the loan.

The standard view of loan sharks today is that they were (and are) an urban phenomenon dominated by organized crime. In the cities before the Great Depression, organized crime did not have an influence in "private lending," as loan sharking was euphemistically known. Crime syndicates that provided consumer loans quickly appeared when other loans were hard to find during the 1930s. In the second half of the nineteenth century, farmers in rural areas also suffered at the hands of high-interest lenders and often dominated the headlines as victims of high-interest lending and foreclosures. Isolated in states with small populations, their choice of lenders was even more limited than that of city dwellers, leaving them vulnerable to a practice that violated state usury laws dating from the colonial period.

High-interest lenders were, nevertheless, easy to find, both in cities and rural areas, although there were fewer in the latter. Newspapers ran ads for loan sharks, sometimes devoting entire pages to them, while many streets had more than one storefront with large signs painted on the windows advertising rates and terms. Loans ran the gamut, from financing farm and home mortgages to purchasing small items costing less than ten dollars. Anti-loan shark societies were founded in the years following the Civil War as the problem of high lending rates began to cause foreclosures of farms and the impoverishment of families. Unfortunately for this movement, many of their arguments focused on the morality of high-interest lending rather than the economics. Their strident tones were more characteristic of a Sunday sermon than of solid economic arguments during this period of rapid industrialization. In language reminiscent of the distant past, the Anti-Usury Society, founded in 1867, resolved that "until our finance is delivered from the morally blinding, insidious and all powerful corrupting power of usury, we cannot reasonably expect that many will maintain their moral integrity or be able to withstand the swelling tide of moral corruption that this wicked system has brought upon us."[7]

In the following decades, Populists seized on the interconnecting themes of government policies, Wall Street bankers, and the overall economic malaise to make their case against loan sharks. This grassroots movement that began in the Midwest and Prairie states during the post–Civil War years focused on the workingman and his troubles and soon became a strong voice in defending the economic rights of workers. Indeed, loan sharks would become a favorite *bête noire* of the Populist movement:

> We want money, land and transportation. We want the abolition of the National Banks, and we want the power to make loans direct from the government. We want the foreclosure system wiped out. . . . We will stand by our homes and stay by our fireside by force if necessary, and we will not pay our debts to the loan-shark companies until the government pays its debts to us. The people are at bay; let the bloodhounds of money who dogged us beware.

This passionate appeal was spoken by Mary Elizabeth Lease in 1890. Lease was a Kansas Populist who oversimplified the loan shark issue by blaming profligate borrowing for the country's money woes. While "the bloodhounds of money" quotation was perhaps not as memorable as her famous admonition to farmers to "raise less corn and more hell," it certainly made clear the Populists' frustrations with their current conditions.

Given the relative isolation of many farmers and the scarcity of reliable information on events taking place in New York and Washington, D.C., farmers were more likely to be susceptible to conspiracy theories that portrayed the economy as rigged against them. An extremely popular book that circulated throughout the Midwest in the late 1880s was *Seven Financial Conspiracies Which Have Enslaved the American People,* published in 1887 by S. (Sarah) E. V. Emery, a Michigan woman with little experience in politics or in writing until that point.

Emery's book attempted to delineate the several ways in which the average farmer was at the mercy of Wall Street, Congress, the railroads, politicians, and the financial markets. In Emery's account, bankers had used their power to influence government after the Civil War and were now pillaging the country with impunity. The subtitle of Emery's book, *How the Producers Have Been Robbed by the Non-Producers through Evil Legislation*, became a popular refrain of the Populists. Portraying Easterners at the heart of the problem, however, was not entirely without merit.

One passage in Emery's polemic struck close to the heart of many farmers, employing a simple quantity theory of money popular at the time. The Populists' main fear was the contraction in paper money (greenbacks) caused by the resumption of specie (gold and silver backed coin) payments in 1879, after passage of the Specie Payment Resumption Act in 1875. The U.S. Treasury returned to "hard" money to replace the "soft." After the first paper money, or greenbacks, had been created and circulated for several years, specie payments resumed and the amount of paper money in circulation began to fall according to a Treasury schedule, creating a contraction in the supply of paper dollars and depressing farm prices in the process. Farmers relied on inflation to increase their incomes and the contraction of the money supply caused the opposite effect:

> In 1868 there was about $40 per capita of money in circulation; cotton was about 30 cents a pound. The farmer put a 500-pound bale of cotton on his wagon, took it to town and sold it. Then he paid $40 taxes, bought a cooking stove for $30, a suit of clothes for $15, his wife a dress for $5, 100 pounds of meat for $18, 1 barrel of flour for $12, and went home with $30 in his pocket. In 1887, there was about $5 per capita of money in circulation; this same farmer put a 500-pound bale of cotton on his wagon, went to town and sold it, paid $40 taxes, got discouraged, went to the saloon, spent his remaining $2.30 and went home dead broke and drunk.[8]

Emery's case against high-interest moneylenders was more convincing when it used statistics and interest calculations like these. This followed an established tradition often overlooked, since Populism also was known for its fiery rhetoric. In a speech in Kansas in 1886, the activist W. D. Vincent, a Populist activist who became a dominant force in the state's politics several years later, stated that "we as a country are paying out, every eleven years in interest, a sum equal to the assessed value of all our property. In making this calculation the rate was placed at 12 percent simple interest, which no one will deny is much lower than the average rate of interest charged."[9] These simple facts made Vincent's message clear: contracting paper money supply and high interest rates charged to farmers were destroying the workingman.

Another book, *Bond-Holders and Bread-Winners: Portrayal of Some Political Crimes Committed in the Name of Liberty*, by S. S. King, a Kansas City lawyer, also became a popular success after its publication in 1892 and was often advertised in newspapers alongside Emery's book. Readers could purchase them for 10 cents each. King divided the country into two classes: the producers and the wealthy. The producers were the farmers and laborers in the Midwest, Plains, and Southern states, while the wealthy were the owners of financial capital located primarily in the Eastern states of New York and Massachusetts. According to King, the wealthy Easterners owned more assets than all the producers combined and extended credit to farmers through high-interest rate mortgage bonds, which became popular investments. Those sorts of inequalities perpetrated further injustices upon the producers. The rhetorical message was typically Populist and blunt, but the book did cite statistics from the recent 1890 U.S. census in making its case.

Eager to avoid a Populist backlash against high advertised interest rates, loan sharks began attaching fees of all sorts to their loans. Often they failed to mention to borrowers that these fees would substantially drive up the effective rates of lending. Even if the nominal rate of interest on a loan seemed more or less reasonable, the cost to the borrower could be much higher as a result of the fees. Newspaper reports abounded of lenders who demanded up-front fees just to consider a loan. Frequently the fees amounted to more than the loan itself, raising the effective rate of interest to more than 100 percent. Fees were attached to mortgages as well as to smaller consumption loans.

In 1889, farmers recognized the ruse and rose in protest in South Dakota and the furor quickly caught the attention of politicians and the press. The state's official usury ceiling was set at 12 percent, but farmers demonstrated that they routinely were being charged 5 percent or more per month. The protests were heard far beyond Bismarck. The *New York Times* commented that "the money shark is doing more harm and causing more suffering than the drought of 1889. . . . Statehood will enable the people to borrow money directly of Eastern companies, if they desire to do so."[10]

While high interest rates were generally deplored by the newspapers in the East, few substantive comments were to be found concerning the effect of usurious rates on actual farm production. The press kept the focus mostly on the personal hardships of farmers, whose financial needs (both for mortgages and working capital) were understood to be distinct from those of city dwellers. Stories tended to focus on the effects of droughts and winter freezes on farm income and how such losses forced farmers into the clutches of loan sharks. But the effect on state income or the overall economy was rarely, if ever, mentioned.

The Exception Clause

One of the Populists' complaints about the economic system being rigged against them appeared remarkably accurate and on target. It centered on the differences between specie (gold and silver coins) and paper money. Clearly, they favored paper money over specie for its ability to inflate prices, which would, in turn, keep incomes from dropping. It was easier for Washington, D.C., to print paper money with no metal backing than it was to produce coins. Technically, coins required metals; paper money required only the desire to produce more currency.

On the back side of greenbacks, the paper currency issued during the Civil War, was the following statement: "This note is legal tender for all debts, public and private, except duties on imports and interest on the public debt." Greenbacks were part of a plan to finance U.S. war needs and were tied to the issuance of Treasury bonds. But technically, the new paper currency was nonconvertible and could not be redeemed for gold. As a result, when an importer needed to pay import duties or when the Treasury was required to pay periodic interest on its obligations, they had to do so in gold itself. Paper money would not be legally accepted because Section 5 of the Greenback Act of 1862 stated that all duties on imports and interest on government bonds be payable in specie only. The language printed on the back of the notes became known among Populists as the "exception clause."

Because specie was made of gold (in whole or in part), many Populists, including Sarah Emery, concluded that bankers had conspired with politicians in Washington, D.C., to get the exception clause inserted into the Greenback Act (Legal Tender Act of 1862). When the paper money was created by Congress to pay for Civil War expenses, it was considered legal tender but was backed only by the "full faith and credit of the United States," a guarantee not yet accepted without reservation. The idea behind the clause was that the effect of paying a foreigner for an import could be offset partially by requiring the buyer to pay the duty in coin, thus reducing the potential outflow of gold. The act also excluded greenbacks from being used as payment of interest on Treasury notes, but there the effect was quite different. Since many Treasury obligations were held by foreigners and represented an export of gold when paid, interest on Treasury notes represented a net outflow of gold (assuming the interest was not reinvested in the United States). The exception clause was, thus, seen as a concession to bankers and their foreign investor clients. Populists naturally seized on both as an example of bankers' collusion with Congress to harm the workingman and the farmer.

The exception clause was not Populist fancy. Addressing an audience in Lancaster, Pennsylvania, in 1863 Republican Congressman Thaddeus Stevens excoriated the clause for its debilitating potential on the workingman, soldiers in need of their pay, and farmers:

> When the bill first came from my hand it contained no clause about specie. It provided that the notes should bear the broad name of the United States, and that these notes should be accepted for all things as payment. But when the bill went to the Senate it was so mangled and torn that its main features were altogether changed or modified. There the bill was so altered that the interest was to be made payable in gold and the revenue paid the Government was also made payable in gold.[11]

Stevens remarked that he had "melancholy forebodings that we are about to consummate a cunningly devised scheme which will carry great injury and great loss to all classes of people throughout this Union except one. It makes two classes of money—one for the banks and the other for the people."[12] As far as the Populists were concerned, they definitely got second-class.

Sarah Emery argued that the exception clause elevated the price of gold and depressed the value of greenbacks since it created demand for gold, which, of course, was controlled by bankers. In her *Seven Financial Conspiracies* she repeatedly referred to the New York bankers group as "Shylock," hoarding gold at the expense of the country and forcing it to a premium. As a result, while gold prices rose, commodity prices fell—and the purchasing power of farmers eroded because they used paper currency. The depressed value of greenbacks also helped explain the high interest rates exacted of farmers and those outside the East Coast money centers, where interest rates were lower. For the most part, farmers could only repay their debts with paper money, so lenders charged a premium to offset the depreciation of the paper currency in terms of gold.

Emery also realized that importers were obliged to venture into the New York gold market to purchase the gold they needed to pay import duties. Prices there were high as a result, adding another layer of expense to the import. But when the bankers and brokers became involved, the problem immediately became more complicated. Emery noted that when the importer paid brokers $100 in gold, the broker "immediately invests in government bonds at face value. His next step is to draw interest on his bonds, for the act of February 25, 1862 [the Legal Tender Act] stipulated that his interest should not only be paid in *gold* but in *advance*." Having drawn his gold, she further suggested, "he is prepared on the morrow to sell it to the next importer and with each exchange he clears $185 on every $100 in gold."[13] The exception clause, thus, presented bankers with an immediate arbitrage bonus at the cost of everyone else.

Over 400,000 copies of Emery's book circulated in the Midwest, making it one of the most popular books of the period. It made its point using facts and analysis rather than pure rhetoric (though it was laden with its share of sententious language) and helped highlight financial and economic issues. Her familiarity with recent history and the law made her arguments difficult to dismiss.

Emery's book was roundly condemned by Republicans, who viewed it as a strong rebuke to John Sherman, the senator from Ohio who had been Treasury secretary from 1877 to 1881 under President Rutherford B. Hayes. In his first stint in the Senate (prior to serving in the Hayes administration), Sherman had sponsored the Currency Act of 1870, which kept greenbacks in circulation. Back in the Senate for a second go-round as the political fires of the 1890s were heating up, Emery's indictment of greenback supporters suddenly became a threat to Sherman's incumbency. Others saw it as a rebuke to the memory of President Lincoln himself, although Emery did not criticize him explicitly. Upon first learning of Emery's book, Sherman said he would not respond to it "seriatim," but soon changed his mind. In 1891, he responded to each point in a letter made available to the newspapers. About the exception clause, he wrote:

> This clause had not only the cordial support of [Treasury] Secretary Chase but of President Lincoln and had proved to be the most important financial aid of the government during the war. Goods being imported at coin values, it was but right that the duty to the government should be paid in the same coin. . . . If the interest on our debt had not been paid in coin we could not have borrowed money abroad and the rate of interest instead of diminishing as it did would have been largely increased.[14]

Sherman did not take aim at the technical side of Emery's argument; he instead tried to show that she was incorrect in her conclusions, but only helped to prove them correct. In 1892, despite the popularity of Emery's arguments among his political opponents, Sherman easily won a sixth term in the Senate against his Democratic opponent.

The historic side of the argument was also supported along with the gold trading argument. Greenbacks lost 22 percent of their value against gold in 1862, their first full year in circulation. A low was reached in 1864, when they dipped to 44 cents before rebounding back to 68 cents.[15] Conversely, gold was at a premium and bankers could purchase excess greenbacks with that premium if they so desired. Their increasing revenues led to enormous differences in wealth across the country. Commodity prices in general fell between the Civil War and the turn of the century. Farmers and workingmen slowly were becoming impoverished while Wall Street and Chicago's LaSalle Street prospered. Upon losing his presidential reelection bid to Democrat Grover Cleveland, Benjamin Harrison (who had narrowly defeated Grover Cleveland four years earlier) remarked that "they indicted us first for having too much in the treasury and now they say we have left too little." This was clearly a reference to the Populists.[16] Those who controlled the allocation of credit made sure that money was available for lending, but only at a high price.

The argument had raged for over thirty years with no clear conclusion. Immediately after the Civil War, the *New York Times* reached a conclusion that Populists would have supported even though the movement, let alone the party, had not even been organized. Noting the usefulness of paper money in winning the war, the newspaper concluded, somewhat prematurely, that "they [greenbacks] have served their first and chief purpose so truly and faithfully that the people will never again distrust them—if they ever have done so—will never part with them as a paper currency, save by distribution of a circulation equally national and bearing the same stamp and seal of the Treasury."[17] The newspaper ignored the words printed on the back of the greenbacks because that issue had not yet blossomed into a controversy. The exception clause left a lasting impression that would not recede easily from memory.

Foreign Appeal

Foreign capital was a major factor in America's economic development during the nineteenth century. More than one commentator referred to the source of capital investment as Wall Street *and* London's Threadneedle Street, the heart of Britain's financial district. British investors were the major source of demand for many U.S. railroad bonds and it was well recognized that the railroads and some industrial companies as well as many municipalities, especially before the Civil War, were reliant on British capital. What was less clear was that those investors were becoming more discriminating in their choice of American investments because many had not worked out well in the past.

After a large municipal default by several Southern states on their bonds in the 1840s, the United States was increasingly viewed by foreign investors as a nation of swindlers who failed to honor their obligations. Convincing foreigners to invest was not an easy matter. In one unusual instance before the Civil War, the city of Cincinnati decided to actively court foreign investors after Ohio raised its usury ceiling, as part of the nationwide experiment with higher usury ceilings, to 10 percent. The idea was to attract foreign investors' funds at rates that were still lower than those demanded by Wall Street and local banks. But outside investors would have none of it, deciding that if they did invest, 10 percent would be the minimum rate from which to start. The problem was that a usury law remained on the books. If municipal authorities decided they didn't like the rates they were being forced to pay, they could always invoke the usury laws as protection against the same foreign investors they were trying to attract. As the *New York Times* succinctly stated, "Foreign money lenders might reasonably hesitate to confide in the law of today, authorizing 10 percent interest, which might be broken tomorrow on the first attempt to collect the principal."[18]

As Cincinnati discovered, foreigners viewed direct investment in American companies or private investment in land as preferable to lending money to municipalities. The hope of drawing foreign money to states and territories of the Midwest and Plains was far more realistic for that very reason; raw land was involved. The flow of funds from abroad followed different paths. British money followed the Kansas land boom, and by the late 1880s fourteen British mortgage firms (along with eleven other foreign firms) had funded rural loan agencies to invest in Kansas farm mortgages. These firms represented some of the most visible and sizeable properties in the state.[19] Investing in overseas real estate was a British phenomenon; the country invested about 5 percent of its gross national product in overseas land purchasing and mortgage lending, with North America forming the largest part. British investment extended from Texas north to Manitoba and from Tennessee west to Colorado.[20] The sheer size of the holdings made many Populists suspicious. As a result, several state legislatures reacted by passing laws that restricted the influence of any foreign entity.

Ever since the Homestead Act of 1862, which prohibited non-Americans from acquiring lands from the federal government, an element of xenophobia could be found in the laws that governed the ownership of land and property in the United States. As the extent of British holdings became more widely known, state legislatures began to pass laws that denied legal process to foreign companies, banned nonresident ownership of land (especially farmland), and increased taxes on foreign owners. Most of these laws were passed between 1885 and 1895, when the fervor against high-interest lending was also building. As with states' usury laws, the laws directed at foreign investors were sometimes revoked and sometimes ignored, creating a confusing patchwork for those investors.

The reaction against foreigners holding land was a matter of direct investment. If, however, they owned debentures (bonds) supported by farm mortgages (classified as portfolio, or indirect, investment), there was much less fanfare because many of the would-be critics outside the investment world would never be aware of the phenomenon. Ordinarily, foreign direct investment was viewed with suspicion while indirect (portfolio) investments such as securities drew much less attention. As a result, securities backed by farmland mortgages were developed, appealing to investors who were attracted to the idea of land as collateral. *The Economist*, however, was quick to note that the mortgage companies that peddled these securities had something in common with loan sharks: "It is worthy of note that these mortgage companies are liberal advertisers in magazines and religious weeklies and not in the columns of journals where applications for capital are usually presented to experienced men of business. The inference being that the unsuspecting are their best customers."[21]

During the great land boom of the late 1870s and early 1880s, several foreign investors acquired extensive amounts of acreage despite local laws prohibiting their ownership. The Duke of Sutherland was reputed to have become one of the largest direct owners of American farmland. Many British companies (and later Dutch and German ones) had been formed to buy land directly from the railroads, which was not prohibited by federal law. By 1884, an estimated 21 million acres in the South and West were owned directly by foreign investors. Some investments were for single tracts of more than a million acres. Many of these vast tracts had been acquired before the states began passing land laws to discourage foreign ownership, so the investments were safe. The nationalistic message still was clear all the same. Other kinds of direct investment that had no restrictions on them—mining and oil, for example—became increasingly attractive alternatives, as well. Even so, direct land investments began to be liquidated by World War I because of increasing hostility. British acreage in North America declined by 70 percent from 1885 to 1913 and the foreign menace that many Populists perceived waned.[22]

Money, for a Price

Despite complaints about high-interest lending in the nineteenth century, rates did, in fact, vary greatly from place to place, depending on the type of loan involved. The farther west from the East Coast, the higher rates tended to be for mortgages and business loans. Small lending, which was more commonly provided by loan sharks, tended to feature uniformly high rates regardless of where the loan was made. But in general, time and place were important elements in the price of credit in the decades after the Civil War, with short-term loans more expensive than longer-term ones and remoteness from credit centers only adding to the cost.

In the common law tradition, real estate was not considered movable but a freehold, something fixed that could be owned and passed on in perpetuity. Movable property was referred to as "chattel." A chattel loan referred to a loan on property considered movable; small consumption loans were also referred to as chattel loans. One leading text on law at the time distinguished two types of chattel: personal and real. Personal chattel referred to property literally not tied down, such as furniture, equipment, or slaves (before emancipation). Real chattel referred to real estate (or real property).

One category in particular of real chattel would provide an opportunity for loan sharks. Real chattels also included "chattels less than freehold, which are annexed to or concern real estate."[23] In other words, property attached to the freehold, such as additional acreage added later or outbuildings. This provided many finance companies with a link to the farm itself even if they made chattel loans. If a farmer pledged his outbuildings as collateral for a loan, it clearly was an opening for a loan shark to demand attachment of the farm to satisfy the loan if it went into default.

The borrower was required to provide collateral, usually in the form of furniture, household items, or other personal property. If the borrower fell behind on repayment, the lender would seize the property until payments continued. There was a high cost involved, however. Each time this occurred, the borrower was charged a fee to compensate the lender for his trouble. Fees were a large part of the chattel lending business. Often a lender would not release a loan until the borrower paid the fees in cash up-front. The actual collateral was often not as important (or valuable) as the fee itself. If an unscrupulous lender was forced to move his operation quickly, one step ahead of the sheriff, collateral would do little good. At any rate, lenders were not much interested in the actual value of a borrower's dining table; its real value was in the fees it could generate each time the borrower fell into arrears.

The same was true of mortgage lending. The duration of a mortgage in the nineteenth century was usually just five or ten years, and the payments borrowers made over that time were for interest only. Since amortization of the principal was not included, mortgages required a balloon payment at the end to avoid renegotiation and more fees. In such cases, the value of the collateral—which was the real property—was significant and of paramount importance to the lenders. Despite the fact that their income was highly cyclical and dependent on weather, blights, and other unforeseeable conditions, farmers, especially, were considered prized borrowers by many lenders. In fact, they were generally regarded as better risks than railroad or industrial bonds. On one level, the attraction was obvious. Bonds often dominated the balance sheets of railroads and many industrial companies, where debt-to-equity ratios of 8 to 2 or 7 to 3 were not uncommon. Farmers' mortgages were just the opposite, with farmers holding around 80 percent equity in their farms. The balance was held by private lenders, the largest of whom were insurance companies, based mainly in the East.

Five insurance companies, four located in Connecticut and one in Wisconsin, held 30 percent of the insurance industry's total portfolio of mortgages and had significant holdings in farm mortgages.[24] The attraction of insurance companies to the mortgage market is generally attributed to their need to match assets to long-term liabilities. But the relatively short lives of nineteenth-century mortgages were not the best match, suggesting that the high rates of interest and the rollover nature of the typical mortgage was what really attracted them. When Western Populists ranted about Eastern investors exploiting farmers, their complaints were not unfounded, since the same features of mortgages that attracted insurance companies—which at least superficially appeared to be legitimate investors—also attracted loan sharks.

There were contradictory views of lending rates in the latter decades of the nineteenth century. The first came from Wall Street, the ultimate source of loans. Existing usury laws had little effect on its business because corporate loans were exempt from state usury ceilings and the market view of interest rates prevailed. Henry Clews, a noted Wall Street trader and writer, wrote that the usury laws "are placed on the statute-books in deference to a sentiment . . . that poor people must be protected from the rapacity of money-lenders." In his opinion, nothing could be farther from the truth, as "the alleged principle on which the usury laws are based is illogical." Clews's assessment was based in part on the notion that lending on securities collateral (which was part of his business) was riskier than lending on real property. In other words, those pledging their property against small loans or mortgages were already receiving the best rates available if one assumed that solid collateral meant low borrowing rates.

But the New York money market had its own internal contradiction that showed how confusing the entire issue could be. In the money market, call loans (loans on stock sales) made for a specific term (thirty to ninety days) were subject to New York's usury laws, usually 6 percent per annum. But loans made overnight for more than $5,000 were subject to market rates of interest, which often exceeded 6 percent, reflecting market conditions and attempts by some large banks to manipulate rates. *The Economist* noted that "under the operation of these provisions of the law a borrower of money at call, in excess of the minimum stipulated sum, can be required to pay any rate which may be established by reason of the operation of the unwritten law of supply and demand." As a consequence, "it may be observed that the facilities which are offered for the manipulation of money in the manner indicated result in evil conditions without the least compensating advantage, except for those who are instrumental in their creation."[25]

Thus, the argument that securities lending necessarily reflected high interest rates did not square with the realities of the money market. If a bank or other institutional lender made a loan to a broker or investor, accepting common stock or bonds as collateral, the lending rate should have been higher than that charged on a loan collateralized by property. In reality, it was often lower, and the rates that farmers paid for mortgages collateralized with real property were actually higher. According to the

Wall Street theory, money was nothing more than a commodity and all commodities had their standard prices dictated by the market. But the inversely sloped yield curve that applied to personal lending was evidence of the contrary.

The reality of lending rates was quite different for small borrowers. The rates charged for small loans (under $300) was consistently over 30 percent and often reached 500 percent, depending upon the lender and the borrower's ability to produce reasonable collateral. By contrast, the rates on New York call money for common stocks were even lower than mortgage rates for farms in the Midwest, South, and the Great Plains during the last two decades of the nineteenth century, which typically ranged from 8 percent to 70 percent. Quite often, borrowers in rural areas realized they were paying too much, but there was little they could do to improve their circumstances.

Specifically, many Eastern insurance companies and other large investors invested in farm mortgages through debentures, not directly. Loan agents in the Midwest packaged these loans and put them in a trust that, in turn, backed the debentures. The process was similar to the mortgage-backed securities and collateralized mortgage obligations in use later in the twentieth century. At the time, the model employed was the *pfandbriefen* (mortgage covered bond) issued by institutions in Germany earlier in the nineteenth century. As the *pfandbriefen*, the actual bonds were meant to be stronger than the agents or institution issuing them because of the diversification principle. The issuer promised to cover payments in case payments made to it from the pool of underlying loans failed. But in the case of rural America, packaging mortgage loans was difficult because of the distances involved.

What's the Matter with Kansas?

The major loan agent in Kansas in the 1880s was J. B. Watkins of Lawrence, Kansas. The Watkins firm was one of the more successful of its type and contributed to the farmland boom of the 1880s. Its founder was a lawyer who began working for insurance companies in the Midwest, and when he organized his own company in 1883 he decided to back securities issued against the mortgages with the assets of the company, creating "covered bonds." Watkins was persuaded to issue securities of this type by brokers in the United Kingdom when he first started his firm, assuming that the cover would convince investors that their money was secure.[26] Mortgages were created, bought by the firm, and placed in the hands of a trustee who held them on behalf of investors. Watkins used newspaper advertising extensively to sell his securities and measured his success in terms of the number of securities sold and the number of investors attracted. At the end of September 1893, the firm advertised that it had sold almost $19 million of securities to 4,800 investors. The firm packaged about $6 million in loans between 1883 and 1886 alone, and sold them through agents on the East Coast and in London. Watkins securitized properties all over the state, but those located farthest from his office in Lawrence required more effort to process and required higher fees as a result.[27] The popularity of debentures such as the ones issued by Watkins's firm helped fuel the overall lending boom outside the East Coast. They demonstrated that relatively low mortgage rates, certainly lower than loan sharks were providing, were compatible with good farm credit.

As the number of farms in the country increased, so, too, did the number of banks. The lending situation was greatly aided by the number of state-chartered banks. In 1888 there were over 3,500 state banks; by 1895 there were over 6,100. The number of national banks also increased, though not as dramatically, from 3,100 to over 3,700.[28] Much of this growth was attributable to the land boom. Many ads appeared in newspapers about cheap land available in the Midwest, where people could live in peace and quiet. Railroads commissioned brokers and hucksters to dispose of land they acquired by grants from Congress. The land, some of dubious agricultural worth, was sold cheaply to the unsuspecting (accounting, in part, for the relatively low debt ratios of many farmers). But when crops were threatened, incomes dropped and many farmers had recourse only to loan sharks, who quickly recognized that, in the event of foreclosure, farmers' land was a great deal more valuable than their movable property.

The growth in the number of banks, especially state-chartered banks, followed the growth of the population. The farm population alone rose from 22 million in 1880 to 30 million in 1900 while the number of farms rose from 4,000 to 5,740 from 1888 to 1895.[29] During the same time period, seven new states were admitted to the Union (Idaho, Montana, North Dakota, South Dakota, Utah, Washington, and Wyoming). Clearly, lending was a profitable business. While the exact number of finance companies is not known with any certainty (because so many of them were unlicensed), it would be expected that the presence of so many competing lenders would have forced loan sharks out of business. But in reality, all lenders, legitimate and otherwise, wanted to be in the high-interest lending business. As a result, Midwest and Plains farmers had a choice of potential lenders, but not many offered low-interest rate loans other than firms like Watkins, whose rates were still higher than those available in the East.

By the turn of the twentieth century the Kansas banking commissioner reported that more than 600 banks were operating within the state. During the last quarter of the nineteenth century, farming in general had suffered because of overcapacity, and the incomes of many farmers fell dramatically. In many areas, the cost of planting crops far exceeded the price they fetched upon harvest. Only the high equity levels in their personal finances saved many farmers from foreclosure. The accompanying decline in farm real estate values made many farmers the targets of loan sharks, even when they needed only a small consumption or working capital loan. The proliferation of chattel loans made their real property vulnerable during bad times because lenders would seek to attach the farm as well as the movable property in the case of delinquent payments.

Ownership figures show why Kansas in particular was a favorite with mortgage lenders. The potential for new loans was strong and high interest rates were justified because of the state's size. Kansas had the most mortgage debt of any Midwestern or Plains state but it was also the wealthiest. Among its farmers, 69 percent were owner/operators, while 31 percent were tenant farmers. While roughly 55 percent of the farm owners were mortgage-free, the other 45 percent had mortgages of some sort. Most important, 36 percent of the value of owner/operator farms ($74 million) had liens against them. The average interest rate for a mortgage in Kansas in 1880s was 8.83 percent for real estate with dwellings and 8.71 percent for acreage alone. Wisconsin had lower rates, with the average mortgage at about 7 percent. In neighboring Minnesota, rates were about one to one-and-a-half percentage points higher. In contrast, the rates in New York were 5.53 percent for property with dwellings and 5.80 percent for acreage. New Jersey, Connecticut, and Massachusetts showed similar or even wider spreads when compared with South Dakota, North Dakota, Montana, and Wyoming.[30] In other words, the farther the state or territory from the East Coast money centers the higher the mortgage rate attached.

Kansas was especially hard hit by loan sharking. The state attracted a wide variety of lenders, and when crop failures came, high-interest payments could not be met and foreclosures hit the state's economy hard. The economic effects were felt by loan sharks, as well. As one Kansas farmer remarked:

> All alike, loaner and borrower, banker and farmer, were overwhelmed in a common ruin. The three hundred exploded loan agencies in operation in Kansas, together with their bankrupt head centers, situated in Kansas City, which went down burdened with millions, and the general hegira of the people from the region affected all attest the terrible effects to those immediately concerned as well as to the reputation of the state at large.[31]

The loan sharking problem helped create an exodus from the state only a few decades after the lure of cheap land initially caused an influx of settlers.

Not all the damage of high-interest lending was inflicted on farms. The *Western Kansas World* noted that "mortgage companies say that foreclosures on city properties are as frequent as on farms. This clearly shows that farmers are not the only class suffering from the depression."[32] Kansas's farm depression attracted a wide array of hucksters, storefront preachers, and "demagogues" (as one newspaper referred to them) who offered relief for farmers—for a price. For the preachers, that meant a donation; for the demagogues, it was usually a vote in an upcoming election. Nevertheless, as the mortgage crisis was unfolding in Kansas, there were efforts by some who, in order to reverse the exodus of farmers and lenders, claimed there was no crisis at all. One reader wrote to a newspaper asking about a comment he had read in a rival, business-friendly newspaper that there had only been six foreclosures in all of Kansas in 1890. The same article also claimed that the cost of planting corn was only 10 cents per bushel which would, when harvested, fetch many millions for farmers who would be even better off than before. The reader's response was simple: "It is a direct insult to the intelligence of every loans agent and farmer in the state."[33]

The mortgage and lending crisis was reported by the Populists in a formal document that was much more analytical and less emotional in tenor than the remarks of some of their leaders in the 1890s. They produced a handbook of facts and figures to refute the claims of those who said that the financial situation in the state was normal. The handbook estimated that approximately $391 million of mortgages was outstanding in Kansas. Even after making allowances for overestimates, the figure would not be lower than $260 million, far higher than the official $236 million reported in the 1890 federal census. The same document also reported the interest rates of Kansas mortgages in the range of 10 to 70 percent. The Populist estimate used a constant 8 percent throughout the state, despite the fact that it was considered low.[34]

Farmers continued to suffer from the fragmented nature of banking before the establishment of reform efforts in agrarian finances later in 1916. Commodities prices slumped after the Civil War as slackening demand depressed the price of foodstuffs. Lenders and investors crossed state lines seeking borrowers but did so indirectly. A national banking system did not exist despite the fact that the National Bank Act of 1864 created "national banks," a designation that the larger banks received by agreeing to submit to the regulation of the Comptroller of the Currency, also created by the act. States' prerogatives concerning bank regulation and usury ceilings still prevailed although many bankers recognized that the United States was desperately in need of a central bank that would be able to allocate credit more uniformly on a national basis.

In the Pits

Among the many problems affecting farmers' ability to earn a livelihood, the commodities futures markets in Chicago were at the top of the list. They were blamed, along with Wall Street, for the erratic changes in the availability of money and the wild swings in commodity prices. Eastern bankers held credit in their hands, while traders on Chicago's LaSalle Street manipulated agricultural prices for their own benefit. Farmers were intimately familiar with the latter. From its inception before the Civil War, the Chicago Board of Trade (CBOT) handled virtually all the U.S. trade in agricultural commodities futures contracts. Yet few traders ever called for the actual delivery of the commodity being traded. This was antithetical to the founding objective of the exchange, which was to serve as a place where forward deliveries could be negotiated to ensure farmers could sell their crops at a certain price in the future.

Speculation in the Chicago commodity pits occasionally had a severe impact on prices. In the decades after the Civil War, the most widely traded commodity in the futures pits was wheat, the major agricultural product of the American Midwest. From the early days of the CBOT, wheat trading became known as "wind wheat." This meant that farmers and traders suspected that wheat was never meant for actual delivery and that the wind could affect its price as much as any other factor. Within a few years, that term was given additional significance by cornering operations mounted by infamous pit traders.

In a corner, a trader would attempt to dominate (corner) the available or visible supply of a commodity, temporarily forcing up futures prices. In the early decades of the CBOT, cornering operations had been dominated by two pit traders, Benjamin Hutchinson and P. D. Armour, both of whom became legends in Chicago but were often vilified on the farms for their deleterious effect on prices.

The largest cornering operation of its type was mounted in 1897 by Joseph Leiter, the son of a Chicago businessman who, after graduating from Harvard, was entrusted with $1 million of his father's fortune. Leiter's plan was to corner the supply of wheat by emulating previous cornering operations by Hutchinson. One trader remarked that "it can't be done again. The market is too big, too immense." But Leiter proceeded nevertheless, and after several false starts began to mount his corner. The syndicate he formed to pursue the operation cornered nearly 16 million bushels of wheat at a time when world reserves of the grain were running low. In addition, Leiter planned to corner wheat for delivery in December, when the supply was naturally short because of winter weather. Just as it appeared that Leiter had successfully completed his corner, the plot thickened.[35]

While Leiter's syndicate was buying all the futures contracts available, P. D. Armour and his agents had begun selling. Suddenly, other traders were not sure that the market had been cornered after all, especially since Armour was taking the opposite trading position. In a classic confrontation on the floor of the CBOT, Leiter told Armour he would force him to settle (buy back his short sales) contracts at a great loss. Armour became so infuriated that he devised a method to break the corner rather than capitulate. He ordered his agents to send all visible wheat through Duluth, to be forwarded to Chicago. He then hired adventurous seamen who were willing to sail the Great Lakes in the dead of winter to deliver the wheat. He even hired tugboats to break the ice on the lakes so the boats would arrive before the delivery date of his contracts. To the surprise of the CBOT, Armour delivered his wheat on time, adding to the visible supply, depressing prices, and, in the process, breaking Leiter's corner. Armour's actions turned Leiter's $7 million profit from the corner into a $9 million loss.

Initially, Leiter's attempt to corner the market was popular with farmers, who were elated over the increase in the price of wheat. Criticism of the speculators who drove up the price was nowhere to be found. But when the forces of supply and demand again set the market price, the abundant wheat harvest meant a return to depressed prices.

At the same time, the Progressive movement was gaining strength and would prove to be a more significant adversary than the Populists. The rumors that speculators and rapacious Easterners dominated the futures markets would continue, but calls for regulation and trading ethics also began to be heard. Their comedic value was also on display. In 1895, the play *Other People's Money* began a brief run in New York. The comedic actor Hennessy Leroyle starred in the role as king of the Chicago wheat pit; he just happened to bear a striking resemblance to Joseph Leiter. One memorable line from the play: "There is nothing so good as money, and no money so good as other people's."

"Aunties and Uncles"

As the spread of high-interest lenders demonstrated, lending became big business after 1880. The farm lending problem would be tackled by Congress in 1916 when the Farm Loan Act was passed, but in the intervening years lending became something of a national pastime. Farm mortgages were only a part of the overall problem of high-interest lending in the post–Civil War decades as lenders developed other ways to provide credit than chattel and mortgage loans. With the United States industrializing at a rapid rate, money lending became a favorite pastime of just about anyone who had excess cash and was in search of a safe, high-yielding investment. Loans were advertised in newspapers from a wide variety of sources. Merchants, lawyers, banks, finance companies, and pawnbrokers all offered their money to consumers.

Between 1890 and 1900, call money rates in the New York market ranged from 3.5 to 6 percent. At the same time, mutual savings banks offered customers a deposit rate of just 4 percent. As a result, those with cash to lend were drawn to chattel and mortgage lending, as rates were much higher. Investing in a securitized debenture, the safest method of lending to farm mortgagees, could yield around 6 percent, while direct chattel lending could fetch much higher returns.

Everyone joined the game, and from all walks of life. In 1894, Chicago was experiencing financial difficulties, and money to pay for essential public services was in short supply. To meet its payroll obligations, the municipal government paid many employees with vouchers, which employees then sold to lenders at a discount to obtain cash. That the city would ever redeem the value of the vouchers the lenders bought up was doubtful; but the lenders, as creditors to the city, would be in a strong position to demand future concessions. Brokers also eagerly bought up judgments against the city that it could not afford to pay; for example, when a municipal worker was injured and the city was found negligent. As one newspaper reported, "the judgment draws interest and there are lots of people willing to buy it from the lucky litigant and hold it for the interest—indefinitely it would seem."[36] Or at least until the city could afford to settle the account. To free market advocates, these ploys simply added liquidity to a system that was desperately short of it; to detractors, they were nothing more than extortion at high interest rates.

In their frequent ads in daily newspapers, loan sharks would advertise lending rates that appeared to abide by official usury ceilings. What they failed to mention were the fees that could push the effective rate of borrowing much higher than advertised. But not all lenders advertised publicly—or needed to. Many employers lent money to their employees at extortionate rates, keeping the process from public view. In 1911, a scandal was exposed at the Bureau of Engraving and Printing, the agency of the federal government that printed the country's currency and stamps, when it was discovered that senior employees were lending money at usurious rates to lower-level employees. The practice was not confined to men ("uncles") but included women ("aunties"). The head of the department remarked, "I understand that my bureau is not the only one in which this practice is going on . . . I do not think it necessary that they resort to Shylock methods to make a living."[37]

Similar problems were reported in other major cities. In some cases, municipal authorities actively intervened to protect their own workers and residents from outside lenders and punishment for falling behind on payments. The governor of Missouri and the two highest ranking officials in the St. Louis police department traveled to New York City to intervene at Western Union's headquarters on behalf of employees in St. Louis whose jobs were in jeopardy after dealing with loan sharks. When the workers fell behind on their payments, the loan sharks had their salaries garnished, and that meant immediate dismissal from the company. As a result of the meeting, Western Union agreed to pursue dismissals only in the most egregious cases in the future. The trip had an additional consequence. One of the police officials was also a well-known attorney in St. Louis, and he offered to take up the case of anyone in similar circumstances in the future, pro bono. Reports had circulated widely of borrowers who could not afford to repay loan sharks committing suicide, and it was hoped that simple legal recourse, unaffordable to many in debt, would help avert such dire outcomes. The *New York Times* optimistically remarked that "the outcome of the fight is looked for with interest, as its results may be far reaching."

Police in some large cities were also involved in high-rate lending. Louis Dalrymple's famous cover for *Puck* in October 1894 listed it as one of many grievances against police in New York. New York City police also were investigated for acting in concert with pawnbrokers to warehouse stolen goods. In Chicago, municipal authorities enacted a short-lived sumptuary law prohibiting women from frequenting certain saloons in the theater district after numerous complaints of rowdiness and illicit behavior. After money changed hands between the establishments and the police, women were allowed to return, on the provision that they could be served only soft drinks. Chicago police officials were also implicated in acting in concert with a firm of loan sharks, presumably to direct their lower-paid subordinates to them for business. One local newspaperman commented that "these blots on the city's life have been permitted to exist without their paying someone for the privilege is too much for sophisticated belief."

Taxing Issues

For most of the years after the Civil War, loan sharks lent out their money, collected their interest, and enjoyed their profits without having to pay a dime to the federal government in taxes. Suspended in 1872, no income tax was levied by Washington, D.C., for the next twenty-one years. But a new tax came into existence in 1894 that imposed a tax of 2 percent on incomes over $4,000. At a time when the average annual income was barely $1,000, the tax would affect only 85,000 earners in a population of 65 million, according to one congressman. Because the tax was comprehensive and included earnings from investment sources as well as earned income from employment or business, those affected by the tax included lenders and investors, as well as those who earned interest on real estate. The tax met with fierce opposition in the East, where incomes were higher and where many lenders resided, but was supported by people in the rural South and Midwest. Opponents of the tax claimed that the country's top income earners would move abroad rather than pay the tax. The lines were drawn along social and income lines, as the tax was clearly a class tax aimed at high earners.[38]

The tax was almost immediately challenged in federal court by parties who were opposed to the tax on passive income. The following year, the Supreme Court, in *Pollock v. Farmers Loan & Trust*, found the law to be unconstitutional.[39] Congress would not institute a new tax on personal income until 1913, with passage of the Sixteenth Amendment. The lack of an income tax for nearly four decades was crucial for lending in the United States for two reasons. First, it had an impact on the structure of mortgages, since many loans were structured as interest only; lenders were only interested in the interest income produced, and borrowers were faced with repaying principal as a lump sum at the end of the term. Second, the treatment of interest derived from real estate as income suggested that if an income tax were passed in the future, it was reasonable to assume that interest income would be included, as it eventually was. The combination of the two, along with the general neglect of the state usury laws, opened the way for continued high-interest lending after 1895.

Stories of suicides, broken families, and destitution continued to be heard as before. But in some cases, the press was not always helpful. A Buffalo newspaper ran an incredible story on its front page about a property owner who had purportedly approached a loan shark to obtain a loan of $3.50 to pay his servants. The man told the shark that he owned $10,000 worth of property, meaning he could collateralize the loan many times over. The loan shark was unimpressed and told the man he would need to pay a fee of $2.00 just to be considered for loan. After the man handed over the fee, he was told he would then have to wait a year for his loan. When he returned the next year, he was told he would need to pay another fee of $1.50. The story clearly strained the imagination, with fees equaling the amount the man wanted to borrow in the first place. The larger point, however, is that reporting on loan sharking was inconsistent at best. The story was not unique. Papers around the country routinely reported similar incidents.

A story reported in New York City demonstrated that some judges were becoming tired of the antics of loan sharks. A complainant sued a loan shark for kicking in his door in his absence and repossessing the furniture he had used as collateral for a small loan. His eight-year-old daughter was home alone at the time and bewildered by the incident. After hearing the complaint, the judge bound the loan shark over for trial and recommended criminal charges against him as well, claiming he had no respect for privacy or personal property. Similar events occurred in rural areas but the stories traveled slowly and by the time they reached their intended audience their shock value had diminished substantially. Urban states had no better protections against loan sharks than rural areas, but in the latter high interest rates simply were considered the costs of doing business given intangibles such as weather, insect infestations, and remoteness.

Panic and Conspiracy

In the decades following the Civil War, the United States experienced several panics in the markets. The most notable, the Panic of 1873, was triggered in no small part by the infamous gold corner by Jay Gould in 1869, which, in turn, caused a run on several well-known banks, notably Jay Cooke and Company, several years later. The link between gold, greenbacks, farm prices, and the cost of money became well established. The United States experienced another banking crisis in 1893. Although it would be the last of the century, it proved to be one of the most serious. The term panic, defined at the time as a massive loss of confidence in the markets, was entirely appropriate. The fragmented nature of banking, the tenuous position of gold, and the country's reliance on foreign capital were all on full display. According to the Populists, all were self-induced because of faulty legislation and bankers' greed. The Gilded Age, created in part by an increasing reliance on finance at the cost of farming, was also in full bloom by the 1890s.

The panic began after silver entered the gold discussion. The United States was a debtor nation, owing more to foreigners than it earned from them. By the beginning of the 1890s, this dependence became very clear when foreign investors began to panic over the gold–silver debates that had been waged in the United States, especially since the Specie Payment Resumption Act of 1875. In 1890, President Benjamin Harrison signed the Sherman Silver Purchase Act, which required the Treasury to buy a specific amount of silver each month to maintain its price. Politically, this was a bow to the Western mining states in Congress. But the policy also suggested a move toward bimetallism, with two metals (gold and silver) backing the currency rather than just one (gold). The clear preference was for gold but politics intervened on behalf of silver. Seeing the resurgence of silver as an example of American equivocation regarding the dollar, foreign investors began to sell American securities. They had read of the fiery speeches in favor of silver by William Jennings Bryan, the firebrand lawyer and opponent of gold and the rhetoric of Populism added to their uncertainty. British investors had already begun to liquidate many of their landholdings and took this new opportunity to unwind other investments. This caused an outflow of gold from the country and precipitated the Panic of 1893. It began to appear that Populist fears about the reliance on British investors were well founded.

The gold reserve of the United States had fallen to low levels in part because of revenue losses created by protective tariffs. What was considered an adequate reserve level of $100 million was breached in January 1893 and investors began to sell securities. In February, the New York Stock Exchange had a record trading day, with over $6 million worth of bonds traded. As a result, President Grover Cleveland, who defeated Harrison in the 1892 election, asked Congress to repeal the Silver Purchase Act in an attempt to bolster the Treasury's gold reserves and restore order in the financial system. A special session of Congress was convened in October and, after a heated debated, both houses voted for repeal. In the interim months, however, the reserve situation had become even more acute. Reserves dropped to around $80 million and numerous business failures followed. Over 500 banks and 15,000 businesses failed nationwide. By the end of 1893, an estimated 30 percent of all American railroads had filed for bankruptcy.

Investors' faith in American investments was also shaken in August 1894, when the federal government announced its first budget deficit, a $60 million shortfall, since the Civil War. The Cleveland administration proposed the first of two bond issues, of $50 million each, to shore up the Treasury's finances. Both were heavily subscribed by New York banks, which paid for their subscriptions in gold. This temporarily solved the Treasury's immediate problems. However, since the Treasury was using the proceeds of the two sales to pay back debt that was currently maturing, within a year the Treasury was back in the same position. The Treasury needed, somehow, to regain some of the gold it had lost when foreign investors sold their securities. In a desperate attempt to reverse the outflow, President Cleveland struck a deal that would allow the Treasury to sell bonds to foreigners, who would pay for their purchases in gold coin.

To pull this off, Cleveland enlisted the help of major Wall Street banks, including J. P. Morgan & Company and August Belmont & Company. Both institutions had enviable reputations at the heart of U.S. financial markets but were, as noted earlier, derided as "Shylock" by Sarah Emery and other Populists. Conspiracy theorists held that Shylock—the vast cabal of New York bankers—had seized control of the gold supply after the Civil War and used it to keep prices low, to the everlasting detriment of farmers ever since. Morgan and his banker allies sold $50 million worth of 4 percent bonds to a syndicate that paid a premium for them. They were then sold to foreign investors for a higher price. With the purchases boosting its reserves, the Treasury was spared the indignity of a default by the United States on its obligations although the rate of interest on the Treasury bonds was considered high. An official Treasury document justified the transaction by stating that "it must be conceded that the risk which the purchasers ran of failing in their attempt to supply the Treasury with gold was so great that they were justified in making hard terms.[40] But silver advocates and Populists were highly critical of the deal. The syndicate of bankers had netted about $6 million on their trading of the deal, which seemed to confirm the belief that Shylock controlled the financial system for his own gain.

Despite these measures, saving the Treasury came at a price to the bankers. The wave of criticism sparked by the affair was directed against bankers in general and Jews in particular. (Belmont was the U.S. representative of the Rothschilds, the Jewish family that had amassed the largest private fortune in the world). One critic characterized President Cleveland as a tool of "Jewish bankers and British gold." Cleveland had defeated Benjamin Harrison in the recent presidential election in 1892 in part because the public believed that Harrison was part of the tariff problem that had caused the contraction in the availability of money. The writer Henry Adams pointed out the dangers of having so much

American debt in foreign hands when he claimed the "Jews of Lombard Street" (by which he meant the Rothschilds in London) "threaten to withdraw their capital if there was even a danger of free coinage of silver." In the eyes of Adams and many others, foreign investors not only controlled the flow of American capital, they also apparently helped decide the silver question in favor of gold.

The liquidation of securities and land investments during the early and mid-1890s created an untenable situation for many leveraged investors and businesses that relied heavily upon borrowing. The panic took its toll on the mortgage industry when the Equitable Mortgage Company of Missouri, which had offices in New York and London, was unable to meet interest payments on mortgage-related debentures and became one of the most notable casualties of the panic. The company had been founded in 1884, expressly to make loans to farmers in Missouri and surrounding states. According to the company itself, Equitable had been able to meet its obligations, including paying an annual dividend of 10 percent, without fail until the financial crisis of 1893 (although nine years was not a particularly long history). The panic laid bare Equitable's precarious financial situation, however. When it was organized, Equitable had capital of $2.1 million. By 1894, it claimed assets of only $600,000, with $940,000 in interest payments due on its bonds and debentures at the end of the year. Equitable's unpaid liabilities to British investors alone totaled £1 million.[41] The firm's failure not only left its investors in the lurch but helped cast a darkening shadow over the new securitized market for mortgages.

Doubts about the market for mortgage debentures began to develop well before the panic unfolded. In fact, Equitable was just one of dozens of hastily founded lending companies whose financial situation deteriorated as the agricultural economy worsened and more and more farmers defaulted on their mortgages. Another company that failed was Kansas City's Jarvis-Conklin Mortgage Company, which—like Equitable—maintained offices in New York and London. A correspondent of the *Financial Times* asked company officials as early as 1891 about the mortgages it held and was told that they were "judiciously chosen and safe."[42]

Three years later the company was in receivership and faced claims of nonpayment from its bond investors after many of the mortgages it underwrote had failed. Since the company's dealings had beguiled more than just a handful of investors, the collapse of Jarvis-Conklin received widespread attention. The firm had used a subsidiary to buy up foreclosed mortgages and then leveraged the purchase when it bought them from the subsidiary at a higher, inflated price. When the new mortgages defaulted, the losses were unsustainable and the pools failed. An English investment journal remarked that "these mortgages have been hawked up and down the country [UK] as good advances against properties worth two and a half times their face value. The whole thing was a screaming farce in which all who had a hand must have laughed at the innocent faith of the British investor."[43] Jarvis-Conklin was sold to another, larger firm in 1895 and, despite the negative press, continued in business with the same management.

J. B. Watkins's firm in Lawrence, Kansas, also failed. It filed for bankruptcy and was placed in receivership in April 1894. The firm had become aggressive in land deals in the late 1880s and early 1890s at a time when the farm depression was worsening. At the time of its bankruptcy, J. B. Watkins & Company listed assets of $7.77 million and bills payable of $80 million. But the firm had cash on hand of only $18,229, and interest due from borrowers totaled $124,000.[44] Clearly, the inability of farm mortgage holders to meet their mortgage payments strained the firm, which did not have the resources to pay its bills.

Debenture holders were not the only investors damaged by the mortgage crisis during the panic. Many of the mortgage companies that had been organized in the farming states held few assets other than the property they bought. Creditors who lodged complaints against them often found that there were few, if any, assets to be liquidated to satisfy their claims. In some cases, an Eastern state's attorney general (often the attorneys general of Connecticut or Massachusetts, where many debenture investors resided) would request that his Midwestern counterpart (often the Kansas attorney general) require stockholders in an insolvent company to add additional capital to the firms' balance sheets to satisfy the claims.

When the attorney general of Massachusetts wrote to his Kansas counterpart about the matter, he received the following reply: "Our statute is in substance that . . . such execution may be issued against any of the stockholders to an extent equal in amount to the amount of stock owned by him, together with any amount unpaid them. This execution against the stockholder however cannot be issued except upon motion and notice to the stockholder."[45] This practice, common for investors in bank stocks in the nineteenth century, extended shareholder liability beyond paid-in capital and exposed them to more liability, usually double the amount paid in. The mortgage companies were included because they were often owners of one or more banks in their home region that did the original lending. Kansas was one of many states where the concept was written into its constitution. The notion of extended liability, as opposed to the contemporary limited liability, was imported from Britain in the colonial period and was adopted by many American states.[46] This problem developed three years before the crisis occurred, when the mortgage companies and their securities first showed signs of weakness. It was another contributing factor to the liquidation of many British investments in the United States because British investors did not want to incur financial double jeopardy by having to pay in additional amounts equal to their original stock investment. British investors were already in the process of liquidating many of their land holdings and took the opportunity as another sign to exit.

Within a year, however, the severe depression began to abate. The silver debate would continue, but gold remained as the standard for the dollar. The United States was still feeling the effects of unequal credit allocation and an inelastic (inflexible) currency. There was no central authority over the supply of money, such as a central bank, that could turn on the tap when necessary to provide the economy with more cash. That function was still filled by the major New York banks. Seizing upon this, Populists established another link in their attempt to connect domestic ills to foreign and banker cabals. Nevertheless, the influence of the Populists began to wane after the election of 1896. Five years earlier, the movement had organized into an official political party (the People's

Party) and, in 1986, supported William Jennings Bryan as their candidate for president.

Unfortunately, Bryan was also the candidate of the Democrats. On July 9, Bryan sealed the nomination with a fiery speech to the national convention in which he again advocated for silver as an alternative standard. "You shall not crucify mankind on a cross of gold," he thundered to the assembled delegates. Bryan lost the election to the Republican candidate, William McKinley, by more than 100 electoral votes by splitting the electorate, which had become increasingly urban and whose workers were more likely to work in factories than on farms. Factory workers feared the inflation that adding silver to the mix would create. Silver was their enemy but remained the farmers' friend, helping to raise farm prices and their incomes.

From this point on, the Populists' influence on regulating usury and loan sharking would be limited at best. Many of the states in which they appeared strong and vociferous never passed meaningful legislation to control the problem. In the early decades of the twentieth century, Populism would be supplanted by another movement that would have a greater voice in shaping solutions to social problems. The Progressives and their ideas appealed to all political parties, and the movement would include them all in its ranks. Unlike the Populists, many Progressives were based in urban areas in the Northeast, well educated, and better able to organize into a substantive political force.