

The Problem of Profit in American Social Policy, 1909-1946

by Daniel Platt

Baldy Center for Law and Social Policy

State University of New York at Buffalo



© 2019 by Daniel Platt



Abstract

Can the market be trusted to provide the bundle of goods and services that society deems a basic entitlement of citizenship? The retreat from state-centered welfare institutions and the rise of policy movements emphasizing market-based alternatives over the past thirty years is said to mark a breaking point from the progressivism of the early twentieth century. Evidence from the Russell Sage Foundation Records, housed at the Rockefeller Archive Center, suggests that the trajectory from state to market or public to private is less representative than is commonly thought. Among the Foundation's most successful campaigns was its battle to reform small-sum lending between 1909 and 1946. Inspired by journalistic tales of working families held in virtual slavery by nefarious loan sharks, the Russell Sage Foundation devoted considerable resources to freeing small borrowers from the high rates of interest and criminal intimidation thought to engender poverty, crime, class agitation, and political radicalism. The Foundation's gradual pivot from promoting philanthropic solutions meant to circumvent the market in money to embracing profit and competition as a market-oriented means of achieving progressive ends stands as a key moment in the rise of the personal finance industry. It also serves as an early case study in the privatization of American social policy and an object lesson in the challenges reformers have faced when forging partnerships with the competitive marketplace.

The Problem of Profit in American Social Policy, 1909-1946

Can the market be trusted to provide the bundle of goods and services that society deems a basic entitlement of citizenship? According to one conventional narrative, American political leaders once thought, “No,” but since the 1970s have increasingly said, “Yes.” In this telling, the early twentieth century saw progressive reformers break with their liberal predecessors and construct new governmental institutions designed to shield certain citizens in certain domains of life from the full brunt of untrammelled capitalism. Drug regulations drew medical facts out of the market; labor laws set moral boundaries around who could work for how long, at what wage, and in what conditions; and public assistance programs built a buffer between permissible want and extreme deprivation. The retreat from these state-centered solutions and the rise of policy movements emphasizing market-based alternatives over the past thirty years is said to mark a critical turning point in modern history and a dilemma for contemporary reformers. They must wrestle over the role of the market in such urgent arenas as schooling, housing, and healthcare.

Evidence from the Russell Sage Foundation Records, housed at the Rockefeller Archive Center, suggests that the trajectory from state to market or public to private is less representative than is commonly thought and that those who take the lure of the private to be a peculiar condition of the present can learn much from the past. Founded in 1907, the Russell Sage Foundation (RSF) ranked among the Progressive Era’s preeminent social reform organizations. It underwrote invaluable studies of life and work in the modern city and led movements to improve city planning, health care, industrial relations, and housing in the United States. Among its most successful campaigns was its battle to reform small-sum lending between 1909 and 1946. Inspired by journalistic tales of working families held in virtual slavery by nefarious loan

sharks, the RSF devoted considerable resources to freeing small borrowers from the high rates of interest and criminal intimidation thought to engender poverty, crime, class agitation, and political radicalism. The Foundation's gradual pivot from promoting philanthropic solutions meant to circumvent the market in money to embracing profit and competition as a market-oriented means of achieving progressive ends stands as a key moment in the rise of the personal finance industry, as such scholars as Lendol Calder, Michael Easterly, and Louis Hyman have noted. It also serves as an early case study in the privatization of American social policy and an object lesson in the challenges reformers have faced when forging partnerships with the competitive marketplace.¹

In the first decade of the twentieth century, muckraking journalists sounded the alarm on a scourge of high-rate moneylenders sweeping the nation's industrial centers and consigning working-class families to inescapable indebtedness. "The loan shark is a ravenous beast," declared one writer, while another estimated the ranks of "loan slaves" in the United States to number in the hundreds of thousands. "When we hear of [the work of the loan shark] we like to get out our pipe after dinner, take down a copy of Dante's *Inferno*, and settle back in an easy chair and figure over a proper form of punishment," opined one editorialist. Propelling public contempt for the moneylender were at least two significant currents in Progressive Era social thought. The first was a critique of modern consumer capitalism as a field premised on deception. Leaders of the Truth-in-Advertising movement, observes Jackson Lears, targeted "loan sharks, real-estate speculators, and mail-order frauds – confidence men on the margins of business respectability." Their defense of plain speech and the honest dealing they imagined to have characterized the pre-industrial economy was often delivered in the language of anti-Semitism, pairing fears of moral decline with those of ethnic dilution. The second current ran from those observers of industrial relations who believed that class tension was born not of the wage relation itself but of those exogenous and reformable forces that often held

workers in a state of precariousness, like the high rates of illness and injury in the industrial city. That corporate leaders and conservative spokesmen joined with muckraking journalists in castigating high-interest urban moneylenders underscored the era's sensitivity to the icons, if not the underlying structures, of unrepentant market exploitation.²

Such concerns were not new. The problematic relations between debtors and creditors had long inspired state legislatures to nest personal finance in a thicket of regulations which, in the forms of property exemptions and usury laws, set a firm limit on the reach and power of the commercial market. Concluded one student of personal finance, the “most obtrusive characteristic of American money lending in the nineteenth century and the early years of the twentieth was its illegality.” Though reformers with the RSF, which began investigating the loan shark problem in 1909, deemed prohibitory measures an observable failure, succeeding only in driving usurers underground where they were free to act with de facto impunity, their early efforts were colored by an enduring suspicion of the market as an entity at odds with the project of social improvement. For officials like Arthur Ham, the first director of the RSF's Division of Remedial Lending, the prevalence of usury signaled a legitimate demand in working-class communities for fast cash born of unexpected yet unavoidable obligations, such as doctor's bills and funeral expenses. To entrust those needs to the market was to force the vulnerable to compete for capital like any other investment opportunity and, indeed, to sanction the conditions that gave rise to the loan shark problem in the first place. The RSF's skepticism of market-based solutions in this arena was most clearly revealed by the reformers' distrust of the Morris Plan Banks, a for-profit lending enterprise that spread across the nation in the 1910s touting itself as “a panacea for the loan shark evil.” “In spite of the claims of the organizers of the Plan, it is apparently a cold-blooded business proposition without philanthropic aspects and with no similarity to the cooperative banks abroad,” Ham wrote in a Foundation memorandum. It would never free the very small borrower from the loan shark

because “such loans are not profitable ... [and] the borrowers of these smaller sums are apparently unable to get satisfactory co-makers to sign their notes.” On practical rather than moral grounds, the RSF thus devoted the first several years of its campaign to urging the prosecution of usurers under existing state laws and to promoting the creation of philanthropic, cooperative, and limited-dividend lending institutions that would prioritize service, access, and social improvement over profit.³

This period was not without its achievements. The ranks of the National Federation of Remedial Loan Associations grew from thirteen non- and limited-dividend institutions in 1909 to thirty-six in 1915. Laws permitting the incorporation of credit unions—a model of cooperative banking imported from Canada and Europe—were passed in Massachusetts and New York. But at mid-decade, the loan shark problem persisted, and leaders in the reform movement, while not completely adrift from their original preference for semi-charitable solutions, were beginning to reconsider the use of profit in spurring social change. Was not the goal of reform simply to emancipate poor borrowers from intimidation and extortion? “Will you tell me why the companies [that do this and] pay 4% and 6% dividends are regarded as philanthropists and the other [for-profit companies] are regarded with suspicion?” asked one reformer. What did it ultimately matter how a firm was organized internally so long as it delivered a quality service to the public? Some observers went further and, like Lyman Beecher Stowe, argued that dealing with a profit-making institution preserved the dignity and self-respect of the borrower, eroding the trappings of class by proving that “the propertied classes ... ‘have nothing on’ the unpropertied classes in point of the honorable discharge of financial obligations.” Others, like Ham, placed their trust in profit “to attract into the [small loan] business reputable capital”—the moral pole of an influential binary in social thought. Such reasoning echoed the critique of monopoly popularized in this era by Arthur J. Eddy in *The New Competition* (1912) and Louis Brandeis in *Other People’s Money* (1914) and signaled a significant change in the RSF’s

strategy. Rather than trying to create sources for social provision outside of the market, funded by those who did not require a return on their investment, the Russell Sage Foundation would seek a more equitable distribution of credit by turning charity into a profitable and competitive business venture.⁴

The Russell Sage Foundation found a ready partner in this project in the American Association of Small Loan Brokers (AASLB), founded in 1916 by Clarence Hodson of the Beneficial Loan Society of Wilmington, Delaware. The AASLB was an organization of lending agencies that ran their business on a thoroughly for-profit basis. Its objective was twofold: to improve the reputation of commercial lending in order to staunch the outpourings of antipathy that routinely threatened the industry; and to reform the usury laws that in most states capped the allowable interest rate on personal loans at a very low level and in others outlawed personal loans altogether. Over the remaining years of the decade and through the 1920s, officials with the AASLB, which would regroup as the American Industrial Lenders Association (AILA) in 1917, and the RSF collaborated on drafting and building legislative support for a state-level Uniform Small Loan Law (USLL) that would raise the permissible interest rate on small, personal loans from the standard 5 or 6 percent per year to 3½ percent per month, an amount the lenders claimed was required to realize a profit. Defending this embrace of the market mechanism to the RSF's directors, Ham cited Blackstone: "Without some profit allowed by law, there will be but few lenders, and those principally bad men who will break through the law and make a profit will endeavor to indemnify themselves from the danger of the penalty by making that profit exorbitant." Avarice was best controlled by meeting it at an agreeable midway point rather than trying to stamp it out altogether, and the RSF's participation was essential for legitimating that midpoint. Observed longtime Foundation leader John M. Glenn, "[M]easures which are known to be backed by philanthropic organizations, whose motives cannot be questioned, are looked upon with favor" by legislatures and leading progressives. The partnership with the AILA was not always easily maintained, but over the late 1910s and the 1920s the commercial lenders and the RSF had

successfully guided the USLL through twenty-five states, a labor-intensive accomplishment that gradually drew the RSF away from its promotion of philanthropic and cooperative alternatives.⁵

Liberalizing the small lending market earned the endorsement of many reformers, including William Green, President of the American Federation of Labor, and Aubrey Williams, General Secretary of the Wisconsin Conference of Social Work. But it also inspired two distinct streams of criticism from those on the political center-left. The first came from those who saw lending reform as a stopgap measure that actually threatened the movement to construct a more generous and comprehensive welfare state on the model of European countries. If working families inevitably required emergency funds to weather periods of unemployment, cover doctors' bills, and maintain safe and sanitary homes, then what was truly needed were social programs designed to decommodify those necessary expenses rather than cheaper and more abundant sources of borrowed capital to pay for them in the private market. The anti-poverty activist Henry Neil voiced this position when he characterized the RSF's work as a "back thrust ... at the mother's pension laws" which allowed capitalists to "pose as a great friend of the poor and a philanthropist and yet get a good profit on the money invested." "Let the mothers' pension law, honestly administered, do the work," Neil urged the voters of one Midwestern state, and "thwart the schemes of the Russell Sage Foundation." The second line of criticism, which was more damaging in the end, called the Foundation's broader motives into question by suggesting that its sole purpose was to turn social improvement *into* business rather than accomplishing social improvement *through* business. This charge was made publicly by liberals like Fiorello La Guardia and in private exchanges like the call John Radway of the National Association of Legal Aid Organizations received from a woman who accused the RSF of "bargaining with criminals."⁶

Such accusations were especially wounding to officials with the Russell Sage Foundation because they too had doubts about their accord with the private

sector. “As we have all realized, almost from the start,” Ham reflected in 1927, “the alliance of the Foundation and the lenders is an unusual one which can be made to work only by the exercise of the greatest care and diplomacy on both sides. The lenders are essentially selfish and consider themselves practical and the Foundation impractical.” In the mid 1930s, in an attempt to blunt the charges that the RSF had a financial stake in lending business itself (and reflecting an important shift in liberal thought from seeing personal lending as an emergency measure to treating it as a permanent instrument of economic growth and management), officials changed the name of the Department of Remedial Loans to the Department of Consumer Credit Studies. Wrote Director Rolf Nugent, “The implication of our name that the Department is engaged in or has an interest in small loan enterprises injures the effectiveness of our recommendations and is frequently embarrassing to members of the Department.” By the 1940s, despite almost totally divesting itself from the field of financial reform, allegations of the Russell Sage Foundation’s partiality intensified, wielded not by suspicious liberals but by mainstream commercial bankers who were entering the consumer credit business and sought to cast the modest regulations contained in the USLL, such as the ban on hidden fees, as insulating established lenders from competition, to the detriment of borrowers. “The present trend is definitely toward elimination regulation,” wrote one official in 1943. “With the emasculation of a few small loan laws and the passage of a few enabling acts for banks to do as they please, the tide will have gone so far the other way that I doubt that it can halted short of a real debacle.” Three years later, fearing that rumors of interest were a liability both for the cause of regulated lending and the RSF’s broader reformist agenda, the Department of Consumer Credit Studies was shuttered.⁷

The history of usury reform in the early twentieth century belies the notion that progressive Americans confronted an unregulated marketplace and sought to tame its excesses by creating laws and state agencies designed to replace destructive competition with expert management and to remove certain

commodities for certain people from the market entirely. Spurred to investigate small-sum lending by media tales of “loan slaves,” officials with the Russell Sage Foundation discovered an industry that was not so much unregulated as excessively regulated, weighed down so heavily by usury laws that it was pressed underground where the profit motive was allowed to run rampant. The RSF first sought to emancipate working-class borrowers by promoting small lending as a philanthropic pursuit, attracting capital into remedial loan societies that prioritized public good over the bottom line and were even willing to take a loss on some loans to the truly necessitous. When that failed to seriously improve urban lending conditions, reformers changed course and embraced market liberalization, targeting the usury laws that, in their way, sought to shield the necessitous borrower from the full brunt of the market mechanism. Partnering with commercial lenders and their professional organizations, the RSF embarked on fifteen-year campaign to make social policy profitable by lifting allowable interest rates on personal loans. Said one industry leader, the work of the campaign was not “to justify the rate [of interest we charge], but to justify the profit which is possible under this rate.”⁸

The Russell Sage Foundation’s legislative achievements were real, but the legacy of its allegiance with commercial lenders and the competitive marketplace was mixed. Some contemporary liberals believed that the plan to address social problems by making credit more abundant drew political energies away from more comprehensive and democratic state-centered solutions. At the very least, it threw a wedge between the RSF and those reformers, who might have made fruitful allies. Foundation officials themselves found their partnership with the for-profit sector difficult to maintain and, by the 1940s, worried that the industry they had helped to legitimize in law and public consciousness was beginning to run roughshod over the regulations they believed were necessary to protect consumers in a more competitive market. And as historians of urban and suburban development in the mid twentieth century have shown, the erosion of firm legal limits on the personal finance industry did not mean that

lenders would treat the borrowing public equally. Residential redlining stands as only the most visible artifact of the ways in which the pursuit of financial profit engendered new forms of categorization and discrimination. In 1925, Walter Lippmann described the modern indebted man as “a link in a chain that stretches beyond his horizon.” Like the mortgaged farmer or the family buying furniture on installments, the RSF’s partnership with the marketplace bound it to forces it could barely see and rarely control.⁹

¹ Lendol Calder, *Financing the American Dream: A Cultural History of Consumer Credit* (Princeton: Princeton University Press, 1999), ch 3; Michael Edward Easterly, “Your Job Is Your Credit: Creating a Market for Loans to Salaried Employees in New York City, 1885-1920” (PhD diss. UCLA, 2008), ch 4; Louis Hyman, *Debtor Nation: The History of America in Red Ink* (Princeton: Princeton University Press, 2011), ch 1.

² “The Loan Shark Evil,” *Chicago Tribune* (21 Nov. 1908); Lewis Edwin Theiss, “Loan Slaves and Their Emancipation,” *The Independent* 65 (5 Nov. 1908). “Loan Sharks,” *The American Lawyer* 12:2 (Feb. 1904): 49. Jackson Lears, “The Ad Man and the Grand Inquisitor: Intimacy, Publicity, and the Managed Self in America, 1880-1940,” in ed. George Levine, *Constructions of the Self* (New Brunswick: Rutgers University Press, 1992), 132.

³ May quoted in Charles E. Clark, review of *Annotations on Small Loan Laws* by F. B. Hubachek, *Yale Law Journal* 48:2 (Dec. 1938): 357. Arthur Ham, “Report for the Year Ending September 30, 1915,” Box 25, Folder 193, Russell Sage Foundation Records (hereafter RSFR), Rockefeller Archive Center (hereafter RAC). Arthur Ham, “Memorandum on Morris Plan,” 14 April 1915. Box 26, Folder 199, RSFR, RAC. John M. Glenn to Julius Rosenwald, 04 Jan. 1917. Box 26, Folder 198, RSFR, RAC.

⁴ “Decennial Report of the Division of Remedial Loans,” 1917. Box 25, Folder 193, RSFR, RAC. “Extract from a paper by Mr. Stroup in discussion of Problems of Newly Organized Remedial Loan Societies, read at the Baltimore 1915 convention,” 1915. Box 26, Folder 199, RSFR, RAC. Lyman Beecher Stowe, “Credit Versus Charity: The Morris Plan,” *The Outlook* (17 Mar. 1915). Arthur Ham, “The Trend and Progress to Improve Small Loan Conditions,” 23 Sep. 1921. Box 26, Folder 201, RSFR, RAC.

⁵ “Decennial Report of the Division of Remedial Loans,” 1917. Box 25, Folder 193, RSFR, RAC. John M. Glenn to L. C. Harbison and C. H. Watts, 29 Jan. 1924. Box 26, Folder 200, RSFR, RAC. “General Form of Uniform Small Loan Law,” 1929. Box 26, Folder 207, RSFR, RAC. On the fractious relationship between the RSF and the credit union movement, see the letters exchanged between John M. Glenn and Roy F. Bergengren, Director of the Credit Union National Extension Bureau, in 1922, in Box 26, Folder 200, RSFR, RAC. On the decline of the philanthropic movement, Calder writes, “Eventually, the remedial lending societies either suspended their operations or were sold to commercial lenders. The Russell Sage Foundation sold its Chattel Loan Society to the Household Finance Corporation in 1925.” (134-5)

⁶ William Green to Messrs. Marvel, Layton & Norford, 27 Feb. 1929. Box 25, Folder 191, RSFR, RAC. Green's approval was tepid: "Where it is impossible to secure a more advanced, progressive measure, labor gives its support to the Russell Sage Foundation anti-loan shark measure." Aubrey Williams to Leon Henderson, 25 Nov. 1929. Box 26, Folder 206, RSFR, RAC. Neil quoted in "Sage Foundation Assailed by Neil," *Des Moines Register-Leader* (12 Oct. 1914). John S. Radway to Leon Henderson, 5 Nov. 1929. Box 26, Folder 206, RSFR, RAC.

⁷ Arthur Ham to John M. Glenn, 23 Feb. 1927. Box 24, Folder 187, RSFR. Rolf Nugent to Harrison, 28 September 1937. Box 24, Folder 188, RSFR, RAC. F. B. Hubachek to Rolf Nugent, 24 Dec. 1943, Box 25, Folder 191, RSFR, RAC.

⁸ L. C. Harbison to Arthur Ham, 14 Apr. 1922, Box 26, Folder 200, RSFR, RAC.

⁹ Walter Lippmann, *The Phantom Public* (New York: Harcourt, Brace and Company, 1925), 176. On the history of redlining, see David M. P. Freund, *Colored Property: State Policy and White Racial Politics in Suburban America* (Chicago: University of Chicago Press, 2007); and Jennifer Light, "Discriminating Appraisals: Cartography, Computation, and Access to Federal Mortgage Insurance in the 1930s," *Technology and Culture* 52:3 (July 2011): 485-522.