

## CHAPTER 2

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# *The Great Transformation*

*I have no doubt that some of you who read this book . . . are trying to get out of debt, a very ancient slough.*

—Henry David Thoreau

LONG AGO I LEARNED THAT WALL STREET veterans are fond of scoffing at anyone who dares suggest America is entering a “new era.” Financiers will shake their head with world-weary eyes and quote the pioneering mutual-fund investor Sir John Templeton: “The four most expensive words in the English language are ‘this time it’s different.’”

There’s hard-earned insight behind this skepticism. Speculative manias throughout history thrived on a belief that new technologies and emerging industries upended the old rules of valuation and behavior. The argument that “this time is different” was used to justify stratospheric prices in everything from the stock market of the Roaring ‘20s to residential real estate in the 2000s. Eventually, the spell is broken, the bubble bursts, and prices plummet.

Yet every once in a great while the established order of everyday life is truly overthrown and the economy really does change. “Within a few short decades, society rearranges itself—its worldview; its basic values; its social and political structure; its arts; its key institutions,” wrote Peter Drucker, the late philosopher of management in *Post-Capitalist Society*.

"Fifty years later, there is a new world. And the people born then cannot even imagine the world in which their grandparents lived and into which their own parents were born."

The signs of a new world are all around us. This time the epicenter of change is the household. The age of excessive consumption supported by consumer borrowing is finished. It took us almost a century of consumer borrowing to get to this point, and as is true in so many aspects of life, we pushed what was essentially a positive development too far. Let's examine the evolution of consumer debt to understand where we are going next. What does this have to do with personal finance? Everything. By understanding the history of debt and consumer spending, we'll gain in sight into the rise of the New Frugality—and why *this time is different*.

### *The American Dream on the Installment Plan*

The conventional story is that, long ago, Americans were a thrifty people. The New World was built on a culture of thrift, self-denial, and hard work. Taking on debt was a moral failing. "The second Vice is Lying; the first is Running into Debt," said Benjamin Franklin. But then, the story goes, we lost our way. Americans went on a debt binge in recent decades. We abandoned the values of thrift and industry, whipped out our charge cards, and took out home equity loans to buy stuff—lots of stuff—from personal computers to iPods to second homes. Debt became a way of life. "A new lifestyle of gratification rather than restraint represented the modern wisdom," writes historian David Tucker in *The Decline of Thrift in America*.

That's a common narrative. There's some truth to it, too. Yet the real story about savings and debt is much more complicated. It's also a fascinating tale.

Americans were avid borrowers even in the early days of the republic. "The equation of debt and decline assumes that once upon a time Americans lived within their means and saved for what they bought," T. J. Jackson Lears, a historian at Rutgers University, declared in a *New York Times*

essay. "This is fantasy: there never was a golden age of thrift. Debt has always played an important role in Americans' lives—not merely as a means of instant gratification but also as a strategy for survival and a tool for economic advance." Adds historian Lendol Calder of Augustana College in *Financing the American Dream*, "It is often forgotten, but from Plymouth Rock to the present, American dreams have usually required a lien on the future."

The Pilgrims settled in Plymouth Bay in 1620 with the financial backing from London merchant adventurers. The Pilgrims eventually bought out their investors, paying off the debt in installments. In the eighteenth century, Americans borrowed from family, friends, pawnbrokers, loan sharks, and local savings institutions. In the nineteenth century, the national and state banking industries rapidly expanded. Mark Twain co-authored a novel with Charles Dudley Warner, *The Gilded Age*, and it has this delicious passage on debt, one that captures the borrowing mantra for spectacular debtors from P. T. Barnum to Donald Trump: "Beautiful credit! The foundation of modern society . . . [A] whole nation to instantly recognize point and meaning in the familiar newspaper anecdote, which puts into the mouth of a distinguished speculator in lands and mines this remark: 'I wasn't worth a cent two years ago, and now I owe two millions of dollars.'"

Still, much of the business borrowing in the nineteenth century funded the ambitions of America's legendary entrepreneurs. Their boldness and intelligent risk taking created some of the world's most dynamic companies. For instance, debt was critical to the initial fortune earned by the industrial titan Andrew Carnegie. In 1853 Carnegie was seventeen years old, a hustling Scottish immigrant, working as a clerk and telegraph manager for the Pennsylvania Railroad. Carnegie earned \$35 a month. A few years later his boss, Thomas Scott, approached his valued employee with an investment opportunity. Problem was, the price of admission was \$610. It was a small fortune to Carnegie, living off a clerk's salary. Carnegie borrowed the money from Scott to buy ten shares of Adams Express Company, a competitor to American Express. "The little acorn planted less than a decade previously with Tom Scott's money and

ten shares of Adams Express had grown into a mighty oak," according to business historian Richard Tedlow. "The returns from those investments were a staggering \$56,100."

Entrepreneurs weren't the only borrowers. Farm families in the nineteenth century routinely ran up debts with local stores. Consumers started buying goods on the installment plan, too. Historians trace the first example of installment credit in America—the classic formula of buy now, pay later—as far back as 1807, to the furniture store Cowperthwaite & Sons. Other furniture stores soon copied the practice.

The really big shift in consumer borrowing came in the early twentieth century with the automobile. Cars were expensive, out of reach for most family budgets. The solution: Buy now, pay later. The pioneer was the financing arm of General Motors, the General Motors Acceptance Corp. By the late 1920s, 65 to 70 percent of cars were bought on credit, according to Martha Olney, economist at the University of California, Berkeley. All sorts of household items were bought on credit, too. "It was hardly an exaggeration to say that the American standard of living was bought on the installment plan," quipped the historian Daniel Boorstin.

Of course, America's eagerness to embrace consumer debt horrified advocates of self-restraint. The sociologists Robert and Helen Lynd were appalled. In the 1920s, the scholars investigated changing social beliefs in a "typical" American city. They settled on Muncie, Indiana. Their results were published in 1929 as *Middletown: A Study in Modern American Culture*. Muncie residents thought of themselves as thrifty savers. But the Lynds saw them differently. "Middletown lives by a credit economy that is available in some form to nearly every family in the community," they wrote. "The rise and spread of the dollar-down-and-so-much-per plan extends credit for virtually everything—homes, \$200 over-stuffed living-room suites, electric washing machines, automobiles, fur coats, diamond rings to persons of whom frequently little is known as to their intention or ability to pay."

The two sociologists believed that consumer credit undermined the community's financial and cultural health. Yet when Robert Lynd returned

to Muncie during the Great Depression, he learned something remarkable: Few borrowers defaulted on their debts. They did cut back on their spending. "People give up everything in the world but their car," Muncie residents told him again and again.

Muncie was indeed typical. The default rate on auto loans in the late 1920s was around three for every one hundred cars sold on installment, according to Calder. Yet during the darkest years of the depression that figure rose to only five out of one hundred. "Households did not default en masse," writes economist Olney, in the article "Spendthrift or Sophisticated Borrower?" "The sales finance industry was 'a safer investment in 1933 than cash in banks.'"

The consumer borrowing experience of the Great Depression taught bankers that households were an excellent risk. Bankers put that knowledge to good use in the postwar era.

### *It's a Wonderful Life*

Lending is an act of trust. The lender has to believe that the debtor will repay the loan. Borrowing is a strong statement of optimism. The



Frank Capra's 1946 movie *It's a Wonderful Life* is a charming tale that brings alive a big question: What makes life worth living? The movie is also a story about borrowing. One of the most memorable scenes about money in any movie is an exchange between the banker Mr. Potter and George Bailey (played by Jimmy Stewart). Peter Bailey, George Bailey's father and the founder of Bailey Brothers Building & Loan, had died. Mr. Potter is a coldhearted, avaricious banker. Mr. Potter and George Bailey have a tense exchange at a Building & Loan board meeting:

POTTER: You see, if you shoot pool with some employee here, you can come and borrow money. What does that get us? A discontented, lazy rabble instead of a thrifty working class. And all because a few starry-eyed dreamers like Peter Bailey stir them up and fill their heads with a lot of impossible ideas . . .

GEORGE: . . . But he did help a few people get out of your slums, Mr. Potter. And what's wrong with that? Doesn't it make them better citizens? Doesn't it make them better customers? You, you said that, what'd you say just a minute ago, they had to wait and save their money before they even thought of a decent home.

Wait! Wait for what? Until their children grow up and leave them? . . . Do you know how long it takes a working man to save five thousand dollars? Just remember this, Mr. Potter, that this rabble you're talking about, they do most of the working and paying and living and dying in this community.

Well, is it too much to have them work and pay and live and die in a couple of decent rooms and a bath?

No, it's not too much to ask. The working people in the movie, many of them immigrants, borrowed to have a place to call their own.

borrower has faith that the future will be good enough for him or her to repay the debt. The American Dream is essentially a story of optimism. Immigrants come here to make a better life for themselves and their children. Entrepreneurs believe customers will flock to their new business. Homeowners borrow enormous sums to buy a house convinced that tomorrow will be better than today.

My dad was one of those optimistic borrowers when he bought his first home in Levittown, America's most famous postwar suburb. Between

1947 and 1951 the developer William Levitt adapted factory-inspired assembly-line techniques to construct more than seventeen thousand homes in Nassau County, Long Island. Levittown became the prototypical suburb reviled in books such as *Revolutionary Road* and *Catcher in the Rye*. But World War II veterans and their families who bought these affordable homes loved Levittown and similar developments. "To these people, the new suburbs were an affordable paradise," says historian John Steele Gordon in *An Empire of Wealth: The Epic History of American Economic Power*.

That's how my parents felt. They moved to Levittown in 1949. After World War II, my dad was attached to Kings Point, the Merchant Marine Academy on Long Island. My parents rented the top floor of a nearby mansion. The bathroom ceiling was so low my father had to kneel to shave. Their next home, in Springfield Gardens, Queens, was not much better. Dad could shave standing up. But the walls of the apartment were so thin my mom says you could hear everything that went on next door, above and below.

Like many men after the war, my father attended night school. He went to Columbia University, and there he saw a brochure for Levittown. My parents purchased a two-bedroom Cape Cod-style house. The home had radiant heat, a refrigerator, and a washer. The price of homeownership: \$7,990. They put \$90 down, and the monthly mortgage, insurance, and tax payment totaled \$58. Translated into current dollars, they bought a \$72,000 home with \$815 down. They loved their new home.

My grandfather was furious at my father for buying a home. He had worked as the head bookkeeper at Anaconda Copper, the giant mining company in New York. During the Great Depression, he saw almost all of the thirty employees in his department laid off.

He, too, had borrowed to buy a home, taking out an interest-only mortgage in the 1920s. As in the 2000s housing bubble, borrowers expected to refinance their interest-only mortgages after a few years as housing values rose. It worked out okay during the '20s.

Of course, when the Depression struck, prices fell and many homeowners couldn't refinance. The bank foreclosed on my grandfather. His

family crowded into a two bedroom rental apartment in Yonkers, sometimes as many as seven people. The torture of watching his colleagues lose their jobs one or two at a time and then losing his home made my grandfather deeply fearful of debt. He shunned it. He never owned a home again, and he truly believed my father was ruining his life and squandering his family's future by taking out a mortgage. Yet my parents were optimistic. They borrowed. It paid off for them and millions of other Americans in the postwar era.

President Franklin D. Roosevelt backed that optimism with the GI Bill of Rights. It was a sweeping program of benefits, including government-backed home loans. Thirty-year mortgages became industry standard because of the GI Bill. FDR made it possible for millions of Americans to buy a home and to start building up equity. Put somewhat differently, the GI Bill introduced a whole generation to the potential benefits of long term debt. The radio documentary producer Stephen Smith rightly calls FDR "the most influential mortgage broker of the 20th century."

When Jerry Ulrich returned to Minnesota from the U.S. Navy after the war, he and his wife Gertrude wanted to buy a house in the budding Minneapolis suburb of Richfield. They had little money. But they got a home because the federal government backed their mortgage. The GI Bill also paid for Jerry's dental school and it provided a low-interest business loan so Jerry could set up a practice. Gertrude Ulrich and her husband paid their bills on schedule, raised six children, and sent them all to college. Gertrude says it's all because the government made it possible for a young sailor and his wife to borrow some money, and to work their way into the middle class.

It's fair to say that the GI Bill helped build the modern American suburb. And suburbia meant shopping malls, interstate highways and the baby boom. With more credit available, Americans bought more consumer goods like cars, refrigerators, and televisions.

## The Democratization of Credit

It's striking that as early as 1954 the American historian David M. Potter could write, "The compilation of statistics might be extended endlessly, but it would only prove repetitively that in every aspect of material plenty America possesses unprecedented riches and that these are very widely distributed among one hundred and fifty million American people. If few can cite the figures, everyone knows that we have, per capita, more automobiles, more telephones, more radios, more vacuum cleaners, more electric lights, more bathtubs, more supermarkets and movie palaces and hospitals, than any other nation." Fact is, most of those goods were bought on the installment plan. The postwar years marked the high point of American prosperity.

The year 1958 was a watershed in the history of consumer credit. BankAmerica launched a general-purpose credit card in Fresno, California, with three hundred retailers and nearly sixty thousand cardholders. By the end of the following year those numbers had swelled to twenty-five thousand merchants and nearly two million cardholders. That experiment eventually led to the credit cards we're familiar with today, such as Visa and MasterCard. A majority of American households have at least one credit card, and government statisticians calculate that some 1.5 billion credit cards are in use in the United States.

Another consumer-debt milestone was the inflationary spiral of the 1970s. Inflation erodes the value of a dollar. By definition, inflation is a decline in the purchasing power of money, and the higher the rate of inflation the steeper the drop. The consumer price index—the main measure of changes in the overall price level—soared into double-digit territory in the seventies. Inflation is devastating for savers, but it is the borrower's friend. After all, you're paying off yesterday's loan with dollars that are worth less today. "My parents could tell me till I'm blue in the face debt is bad, debt is bad, debt is bad," says *New York Times* columnist Joseph Nocera. "But my experience told me debt is good."

The "democratization of credit" marched on even after inflation rates subsided. The credit card, the home mortgage, the student loan, the auto



Journalist William H. Whyte Jr. chronicled the evolution of business culture and suburban living in a remarkable series of articles for *Fortune* in the 1950s. He captured the borrowing ethos of the new suburban middle class in a 1956 article, "Budgetism: Opiate of the Middle Class": "They save little not because they cannot save—people have never been more prosperous. They save little because they do not really believe in saving . . . the people who are most responsible for the dangerous increase in mortgage and short-term debt are younger couples in the \$5,000-to-\$7,500 bracket. Sober suburbia is their habitat . . . And they are the true prodigals."

Whyte details a typical young middle-class suburban-family budget. Ed Doe is a twenty-nine-year-old accountant. He's married to Mary and earns \$6,000 a year. They have two children.

Whyte takes a look at Ed's paycheck. He nets \$416.34 on his \$500 paycheck after automatic deductions. When Ed writes the bills, he pays out \$80 for the mortgage, \$54 for a car loan, \$21 on a life insurance premium, \$14.75 for their furniture loan, \$18.30 on a medical bill, \$15 on a revolving credit to a department store, \$6.18 to the telephone company, and \$20 to the utility company. That leaves them with about \$190. Ed sets aside \$100 or so in the checking account for food, and \$39 to \$45 goes toward church, gas, car maintenance, and the newspaper boy. They have about \$45 left. "This must provide for clothing, entertainment, drugstore purchases, cleaning, laundry, a part-time cleaning woman once a week, baby sitters, cigarettes—not to mention any savings," writes Whyte. "There will not, of course, be enough money. But no matter; the deficit can easily be taken care of by another loan. Ed and Mary are glad they live so conservatively." Sound familiar?

loan, and other types of consumer credit were widespread tools for getting ahead. Loans once limited to the well-heeled were gradually offered to middle-income and then lower-income households. Women could get credit on their own rather than through their husbands. Minority neighborhoods were no longer redlined. Banks even solicited business from illegal immigrants. Credit was everywhere.

### *The Wages of Debt*

That's the positive side of the consumer-credit narrative. It's also true that throughout our history people took on too much debt. Michael Boyle was a salaried employee in St. Paul, Minnesota, in the late 1880s. An Irish American, he had improved his standard of living from a dry goods day laborer to a buyer and seller of gingham, prints, and jeans over the previous decade, according to the social historian Jocelyn Wills of Brooklyn College. Yet on the eve of his thirty-first birthday, a miserable Boyle wrote in his diary, "I am powerless because I am in debt and clearly my first duty is to get out of that condition. This is the harvest one reaps when one sows in extravagance and dissipation."

I imagine Boyle would have agreed with the definition of debt penned by the nineteenth-century journalist Ambrose Bierce: "Debt, n. An ingenious substitute for the chain and whip of the slave-driver."

The tragedy of William Rodriguez briefly gained notoriety in 1960. He was a twenty-three-year-old Puerto Rican living in Chicago with his wife and their four children. He owed about \$700, most of it for furniture, clothing, a secondhand television set, and a religious medal he'd bought for his mother. His wages had been garnisheed three times before, and a lender was threatening garnishment again. Rodriguez killed himself on a cold February evening. The coroner's verdict: "Suicide while temporarily insane due to pressure from creditors."

The merchants of debt promote the convenience of credit but hide the true costs. Through various methods they hike rates and fees on consumers. When regulators crack down on certain practices, ingenious new

ones are developed. "It is the life of quiet desperation, the ceaseless tension, the fear of ultimate impoverishment that haunt so many, who because of modest means find themselves chained to the treadmill of never-ending debt," wrote journalist Hillel Black in *Buy Now, Pay Later*, a 1960s exposé about consumer-debt malpractice. Five decades later the same sentence and observation holds for millions of Americans trapped by rapacious payday lenders and unscrupulous credit card issuers.

### *The Economics of "Budgetism"*

Clearly, the consumer-debt revolution that began in the 1920s made it easy for some people to live beyond their means. Yet consumer debt also encouraged something else: middle-class prosperity. And personal spending during the postwar period essentially tracked the overall growth of the economy, adjusted for inflation. Sometimes we'd get ahead of the real economy with our spending and borrowing. We'd back off for a while, especially during recessions. We'd pull back enough so that our spending growth dipped below the economy's growth rate. Then we'd spend more. Throughout the business cycle a majority of borrowers paid their bills on time.

Case in point: the Mall of America, a stunning citadel of consumerism. You can't miss the mall if you drive along Interstate 494 near the Twin Cities' airport. It boasts some 520 stores in a space big enough to hold thirty-two Boeing 747s. The center of the Mall is an indoor amusement park with a roller coaster, a water slide, and other rides. The Mall has movie theaters, an aquarium, adult-education classes, a wedding chapel, and stores—lots of stores.

The Mall was built during the 1990–91 recession. It opened in August 1992. The recession ended the previous spring, but employers were slow to put new workers on their payrolls. A *New York Times* article wondered about the Mall's prospects considering the state of the economy: "Many industry analysts . . . question the sanity of launching a monster mall in the middle of a recession, at a time when studies suggest that

Americans would rather do almost anything with their leisure time other than shop."

Yet four months later a *New York Times* editorial marveled at the megamall on the prairie: "To roam the Mall of America is to mourn those family members and friends who were born to shop but, alas, born too soon to see this monument to credit cards . . . Up and down the escalators they go, in and out of hundreds of stores. Some are laden with packages; others carry only a small bag or two. The empty-handed are rare, perhaps because the urge to make a dent in this vast pile of prodigality is close to overwhelming."

It's easy to make fun of people with a "shop 'till you drop" attitude. Yet critics who highlight the pursuit of immediate gratification by consumers miss an important dynamic: Borrowing on a monthly installment plan for much of the postwar era enforced a kind of economic discipline. Lendol Calder observed, in *Financing the American Dream*, "Far from causing the demise of thrift, consumer credit has actually worked to make most modern credit users at least as disciplined in their finances as the generations that lived before the credit revolution. The fact is, 'easy credit' is really not all that easy. Installment credit imposes on borrowers financial regimens requiring discipline, foresight, and a conscious effort to save income in order to make payments on time."

Calls for greater thrift are appealing during recessions. But is it any wonder that thrift is abandoned when good times reemerge? Our attitude toward thrift and savings has long been a secular variation on a famous remark by Saint Augustine, "Give me chastity and continence, but not yet."

### *A Stunning Break with Our Money Past*

Budgetism broke down in the decade leading up to the Great Recession. The household borrowing boom was unprecedented. To fund the buying of homes, remodeled kitchens, SUVs, personal computers, iPods, college tuitions, vacations, and other goods and services, Americans borrowed

so much that household debt hit a record 131 percent of annual disposable income in early 2008: We owed a third more than we were taking home each year after taxes. The household debt ratio was 90 percent a decade earlier and less than 80 percent the decade before that. Little wonder the personal savings rate—the share of income left after our spending—went from the 8 percent range in the mid-1980s to almost zero during the height of the housing bubble.

The epicenter of the borrowing mania was housing. The initial stages of the housing market's gains were mostly driven by improving fundamentals. Mortgage rates in the early 2000s were almost as low as in the 1950s. The after-tax cost of mortgage payments absorbed 18.5 percent of household income in 2001, down considerably from 22.5 percent in 1990. Competition in the home-mortgage market had lowered fees and loosened down-payment requirements. The lure of owning a home increased after some \$8 trillion in stock market wealth vaporized during the dot-com bust and the trauma of 9/11. A four-bedroom, center-hall colonial, a one-bedroom condo with a brick wall, a town house nestled along a mountain ridge, and even a mobile home blocks from the ocean are made of solid materials. A common remark at the time was, if you owned stock, you had nothing of value when it went down. If the price of a house fell, you still had a place to call your own. Everyone wanted to talk about real estate. I remember in the years between 2004 and 2006 taking calls from listeners berating me for my cautious advice on homeownership. Real estate prices kept spiraling higher, and buyers dangerously stretched their finances to buy. Owners treated their home equity like an ATM.

The borrowing binge went beyond housing. People bought everything from aged balsamic vinegars to Sub-Zero refrigerators on credit. The average cost of a wedding soared to nearly \$30,000. Students and their families borrowed record sums to pay for college. Car loans reached an average of nearly \$31,000, up almost 40 percent over the past decade. Almost half of all car loans were six years or longer, a sure way to owe more than the car is worth. The flush times couldn't last, and didn't.

The largest consumer-borrowing boom in U.S. history went spectacularly bust starting in 2007. The canary in the debt coal mine was the collapse of the subprime mortgage market. But consumer-credit problems quickly rippled throughout the credit economy. The worst financial crisis since the 1930s hit the housing market hard. Companies shoved millions of workers out the door. The bust unveiled breathtaking instances of greed by the heads of financial institutions. At Washington Mutual, CEO Kerry Killinger pocketed more than \$88 million in the years leading up to one of the biggest banking failures in history. The downturn uncovered monumental frauds, such as the multibillion-dollar Ponzi scheme run by Bernard Madoff. The Federal Reserve, the U.S. Treasury, and the Federal Deposit Insurance Corporation (FDIC) took unprecedented actions to prevent the recession from plunging into something far worse. "I never thought I would live to see a recurrence of things I did see up close during the Great Depression," says Paul Samuelson, the Nobel laureate in economics.

Talking to a legendary economist about the financial crisis and the prospects for another depression is one way to measure the extraordinary time we went through. A far more personal marker is to pick up the phone and have your eighty-three-year-old mother ask you, in all seriousness, "Are we going into another Great Depression?"

"No, I don't think so," I said. I quickly ran through my reasons. I was confident that Federal Reserve Board chairman Ben Bernanke, a scholar of the Great Depression, would do whatever it would take to prevent a reprise of the 1930s. The bank bailouts engineered by U.S. Treasury Secretary Henry Paulson and his successor, Tim Geithner, may have been flawed, but they were critical for shoring up the system.

"Well, I hope you're right," she said. "But you didn't think it would get this bad either."

**BUSTED.** LATER, Mom assured me that I could always move back in with her. Several of her friends from school had had to move back in with their parents in the thirties. She meant it, and it was a touching moment, a

sign of the perilous times we were in. Thankfully, a depression was averted.

I won't have to move in with Mom. And Americans won't go back to borrowing as usual.

### *Stagnant Incomes, Loopy Lenders*

Plenty of culprits are to blame for the financial crisis, but I want to highlight the ominous combination of stagnant incomes and lender profligacy. These two factors help account for the staying power of the New Frugality.

Remember, borrowers are optimistic. When the economy left the 2001 recession behind, people started borrowing again in anticipation of earning better incomes. It had happened before. From the 1969 business cycle peak to the 1979 peak, household income grew by 4.5 percent after adjusting for inflation, according to economist Jared Bernstein. The comparable figure for 1979 to 1989 was 6.5 percent, and from 1989 to 2000, 8.3 percent. Problem is, from 2000 to 2007 real household income fell by 0.6 percent, he calculates. The income gains households reasonably anticipated didn't happen.

Bernstein dissected the household income numbers even further. He calculated that the real median income of working-age households—those headed by someone less than sixty five—rose by some 10 percent or \$5,200 between 1989 and 2000. The experience of working-age households in the subsequent business cycle was dismayingly different. He figures that the income of working-age households fell \$2,000 between 2000 and 2007, from about \$58,500 to \$56,500. Households were forced to pay for rising energy, food, and health insurance costs on a shrunken income. For instance, an estimated 116 million people, or two-thirds of working-age adults, were either uninsured for a time, faced steep out-of-pocket medical costs relative to their incomes, had difficulties paying their medical bills, or didn't get the care they needed because of cost in 2007, according to a Commonwealth Fund Biennial Health Insurance

Survey. Oil prices, which had been as low as \$20 a barrel in 2001, reached \$100 in late 2007 and peaked at \$145 a barrel in July 2008.

Optimists who thought incomes would grow turned out to be wrong, deeply wrong.

Lenders love to promote themselves as sober-minded guardians of credit. The lending industry wraps itself in the high-minded mantle of meeting the aspirations and desires of ordinary Americans through the steady march toward a "democratization of credit." What many lenders actually did in the 2000s is abandon reason and ethics. Jamie Dimon, chief executive officer of JPMorgan Chase, squarely puts the blame on lenders for allowing consumers to borrow far too much. "We gave them the weapons of mass destruction to borrow too much," said Dimon at a global economic forum. "I don't blame them. I blame the CEOs."

In the background of the lending boom was one of the most significant and heartening transformations in history: globalization. In essence, that means the closer integration of India, China, Vietnam, and other emerging markets into the rest of the world economy. One result was a dramatic increase in global savings, which, in turn, helped drive down interest rates. John Maynard Keynes once quoted Walter Bagehot, the legendary nineteenth-century editor of the *Economist*, that "John Bull can stand many things, but he cannot stand 2 per cent." In search of higher yields, British investors were eager to invest huge sums in railroads and other risky but potentially lucrative ventures in nineteenth-century America.

The same desire for high-yield debt dominated the action in the global capital markets of the 2000s. Financiers found plenty of eager buyers for riskier securities that paid significantly better rates than low-yielding U.S. government bonds. Lenders learned that Wall Street's appetite for consumer loans was insatiable and meeting the demand profitable. Wall Street's math whizzes became increasingly creative at making securities from home mortgages, student loans, auto loans, and credit cards. Financial alchemists transformed risky loans into triple-A-rated securities.

Financiers were making so much money that no one wanted to stop. Why take away the punch bowl when the party's going strong? Predatory

lenders trolled through poor neighborhoods taking advantage of unsophisticated borrowers. Banks did business with speculators eager to own and flip several homes. Don't want to report your income? We got a loan for you— at a higher interest rate, of course. Can't put any money down for that home? How about an interest-only mortgage that resets at a higher interest rate in a couple of years? Your daughter is heading off to college and you're carrying too much in credit card debt? Consolidate all your debts into a home-equity loan. You're a student without an income? Here's a credit card.

It was open season for shoveling all kinds of credit at people. That is, until the borrowing boom went bust.

### *This Time Is Different*

Memories linger. We remember dramatic economic events long after the underlying environment has changed. Those memories shape our financial behavior. However, our memories are selective and tend to focus on the downside. "The memory bank we carried forward from the 1920s was filled with the anguish of the Great Crash and then the Great Depression, not the revolutionary technological innovations of the automobile, electric power, and the radio," wrote financier Peter Bernstein. The generation that lived through the Great Depression steered clear of equities in the 1950s even though stock market values were incredibly attractive, he added. The generation that lived through the Age of Inflation learned it was smart to borrow. They continued to borrow big even after inflation was tamed. The Great Recession has taught all of us that it's financially dangerous to carry too much debt. It's a lesson that will shape our finances for years. Bankers and regulators have memories, too. The financial system was bailed out by the federal government, and lenders wrote off billions and billions of dollars in bad debts. Bankers are demanding more conservative financing from potential borrowers, and regulators are frowning at any signs of loose lending practices.

The Great Recession vividly demonstrated how vulnerable indebted

Americans are to a setback. Jobs and incomes are less secure than ever with restructurings, downsizings, reengineering, rightsizing—pick your favorite euphemism—a routine part of management's strategic toolkit. Management during the Great Recession controlled costs by adopting pay freezes, furloughs, and pay cuts. Employers reduced their financial support of worker pensions, too. The typical employer matches 3 percent to 5 percent of employee contributions into a 401(k) plan, but many companies suspended their matching program during the Great Recession. Cost-cutting initiatives like these will become routine, just as layoffs did following the severe recession of the early 1980s. "My view is that Americans, from the working poor to the reasonably rich, are in danger of taking steep financial falls from which they have a terrible time recovering; that the fraction of Americans facing this danger is on the rise and now constitutes a majority; and that the size of the fall we may take is also growing," writes author Peter Gosselin in *High Wire*, a thoughtful examination of the heightened risk of financial trouble faced by ordinary families. The only way to offset that financial exposure is to save more and borrow less.

That said, saving won't be easy. Incomes will stagnate or grow slowly. Certainly that's been the long-term trend. For example, real median hourly wages have eked out a mere 8 percent gain since 1979. Of course, we own bigger homes, more cars, and more stuff overall than we did in the late 1970s. We're clearly a wealthier society, and not all the gains are from a debt-financed mirage. What happened is that many families boosted their incomes as women entered the workforce. In 1968, 38 percent of married women ages twenty-five to fifty-four with children worked out of the home. That figure is now over 70 percent. Mom and dad also work about 20 percent more hours than in 1968. But the money push from the rise of two-income couples has petered out. No one else can leave home to bring in a wage. It's hard to imagine parents can put in any more hours at work, either. And, sorry, you can't send the kids off to work.

We're going to have to live off what we earn. It will take years for us to make up for the ground lost during the Great Recession. Imagine a pendulum hanging high from a ceiling swinging slowly from side to side

in a wide arc. At one end of its swing it's all debt, and at the other extreme it's all savings. The pendulum in the 2000s swung way too far in debt's direction. It's now working its way back toward savings. Eventually it will come to rest somewhere in the middle, between all-savings all-the-time and borrowing-as-much-as-possible. But it takes a long time to pay down that borrowed money. That is what we have to do.

### *Sustainability Goes Mainstream*

Of course, Americans don't like donning economic hairshirts. Words like "frugality" and "savings" seem to signal the embrace of extreme denial and shrunken ambition, with images of sixteenth-century theologian John Calvin and seventeenth-century Puritan minister Colton Mather stalking American households. But the New Frugality isn't something to glumly embrace. No, it means we're going to live a better way and have fun at the same time.

For one thing, what we're spending our money on is changing. Think back on some of the conversations you had with friends and colleagues during the Great Recession. A common thread of discussion was how much we appreciated experiences with friends and family over buying stuff at the mall and the downtown chain store. The downturn brought that message home. We started putting a high value on a home-cooked meal, an over-fifty hockey game on a frozen pond, and a thirty-mile bike ride with thousands of strangers to raise money for a cause. For many of us, our homes suddenly looked cluttered with too much stuff. Fact is, we have plenty of cars, TVs, shirts and other goods. Nobel laureate Robert Fogel in *The Fourth Great Awakening & The Future of Egalitarianism*, a magisterial economic history of America, notes that "we're approaching saturation in the consumption not only of necessities, but also of goods recently thought to be luxuries or that existed only as dreams of the future during the first third of the twentieth century."

Despite the trauma of the Great Recession, we're a rich society that

can afford nurturing activities that “broaden the mind” and “enrich the soul,” says Fogel. He’s right. Indeed, the meaning of the American Dream, that famous phrase historian James Truslow Adams came up with during the dark days of the Great Depression, is changing. It has always had something of a dual meaning. The emphasis in recent decades was more on the material side of the idea. Yet the concept has always carried with it the notion of trying to live a good life, engaged in the community, expanding our minds and enriching our souls.

For another, the shift in our outlook and emphasis will get an important impetus from the green revolution. Going green is emotionally satisfying and financially frugal. The personal economics of sustainability will make the transition toward financial conservatism practical and enjoyable. That’s right, enjoyable. We’ll feel good about ourselves and the actions we take to save more and borrow less while pursuing quality and simplicity. Frugal is the new chic.

Americans have long been concerned about nature and the environment. The list of ecological activists includes President Teddy Roosevelt, John Muir, Rachel Carson, and David Brower. The Environmental Protection Agency was set up in 1970, and despite many bitter fights over green regulations between business and environmentalists, a desire for clean water and air often attracted bipartisan coalitions. Still, the dramatic change over the past two decades has been the science of global climate change. Today, especially because of heightened concern over global warming, the greening of America is apparent in every aspect of our lives. Federal, state, and local governments have all launched various green initiatives. So have schools and colleges. Sustainability is taken seriously by business, too, from Silicon Valley venture capitalists to the CEOs of major multinational corporations. “First of all, we believe sustainability is critical, absolutely key,” said John Brock, chairman and chief executive of Coca-Cola Enterprises in an interview at the Wharton School of the University of Pennsylvania. “It’s not a niche anymore. It’s not just something you kind of do when you’re thinking about it. It’s something we take seriously, and it has to be done all the time.”

Sustainability isn't only a business and government priority. It's something most of us increasingly try to take into account in our actions at home and at work. For those of us trying to save more, an ethos of sustainability provides another screen for being mindful with our money. Being energy conscious at home, buying clothes at yard sales and vintage stores, and similar thrifty actions both save money and reduce our impact on the planet. It's time to simplify.

What's more, embracing sustainability is optimistic. Sure, there are plenty of doom and gloom forecasts about global warming. But at home and in our communities, to be financially frugal and socially sustainable reflects a basic faith that the effort will pay off in a better future for us and our children. Like borrowing in the early postwar years, it's an



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Spend money on services—everything from repairs to education—and not on things

Eat less and more healthy food

Exercise more

Don't just drive less, get rid of the car

Spend more time with family

Spend less time commuting: Live closer to family and friends, work and school

Reduce business travel

Get higher-quality, better-designed products you don't replace, the "Montblanc pen" approach to life

optimistic set of beliefs and behaviors. Unlike borrowing, there's no whiplash of debt payments if we stumble. We just pick up and start the journey again. In conclusion, while Sir John Templeton would roll his eyes at me, I believe this time is different. America is entering a new era. The transformation in what we do with our money and how we manage our finances is profound and long-lasting.