

## Con Games: Past and present



*In A Nation of Counterfeiters (2007), Stephen Mihm takes account of the seamier side of capitalism in the early republic: the corner-cutting, get-rich-quick ways mirrored in a vast economy of counterfeiting. Common-place asked him: if American capitalism has always been “a confidence game,” as A Nation of Counterfeiters makes plain, why are we so frequently conned and so surprised by the experience?*

As the recent financial crisis entered its final months, news of a stunning fraud blew through the canyons of Wall Street and reverberated throughout the global financial system. Acclaimed financier Bernard Madoff had been arrested for running a massive Ponzi scheme, defrauding investors of tens of billions of dollars. It was the largest fraud of the sort ever perpetrated.

Or was it? The losses inflicted by Madoff were small potatoes next to the exploits of the banks, hedge funds, and other institutions that make up the global financial system. While they rarely broke the letter of the law, these institutions mocked the spirit of it, practicing a brand of corner-cutting capitalism similar to Madoff's. Over the years, they created a system of debt-fueled bets and counter bets that skirted regulatory boundaries, ethical constraints, and just plain common sense. Madoff's fraud may be stunning, but plenty of kindred spirits perpetrated their own cons on incredulous investors throughout the world. As Nobel prize-winning economist Paul Krugman observed last year, “How different, really, is Mr. Madoff's tale from the story of the investment industry as a whole?”

Sadly, all of this is a familiar tale. Each of the speculative booms and busts that have hit this country over the centuries had its share of outright cons, but these have been overshadowed by the more dangerous confidence game that flourishes under legal and social sanctions. So yes, swindles in western lands preceded the panic of 1837; a stunning embezzlement brought down the Ohio Life

Insurance and Trust Company in 1857, and with it, much of the global economy; the Credit Mobilier Scandal foreshadowed the collapse of 1873; shadowy dealings in the copper market helped trigger the panic of 1907; the list goes on. But in all of these cases, fraudulent transactions paled in comparison to the rotten, if nominally legal, schemes that simultaneously percolated throughout the financial system and the larger economy. Sometimes banks deliberately circumvented regulations aimed at curbing their risk taking; in other cases, the forerunners of today's "financial engineers" devised new instruments to mask risk while promising unprecedented returns. Other times, speculators resorted to shady practices to pump up the prices of stocks and bonds. In almost every case, a stampede of investors joined the spectacle, sinking their life savings into the market in the hopes of striking it rich.

Why do these scenes recur over and over in the nation's history? Why, in other words, are we so readily drawn to cons of all stripes? I think the economist Charles Kindleberger got it right when he observed that "commercial and financial crises are intimately bound up with transactions that overstep the confines of law and morality, shadowy though those confines be." He sadly concluded that "the propensities to swindle and be swindled run parallel to the propensity to speculate during a boom." In boom times, "fortunes are made, individuals wax greedy, and swindlers come forward to exploit that greed." Sometimes those swindlers hail from the ranks of outright criminals; more often, they straddle what Kindleberger called the "wavery" line that separates moral from immoral, legal from illegal.

But the concept of greed alone does not fully capture the impulses that lead people into the hands of swindlers of various stripes. After all, it's quite possible to be greedy and still hew to the Protestant ethic of hard work, discipline, and deferred gratification. Instead, what is fully exposed during these boom times is the antithesis of that ethic, the spirited pursuit of what historian Jackson Lears called "something for nothing," which derives its power from dreams of overnight riches and wealth without work.

This has been a perennial theme in the nation's history. Take, for example, the curiously prescient words of a British visitor to the United States named David Mitchell. "Speculation in real estate has for many years been the ruling idea and occupation," he observed in 1862. "Clerks, labourers, farmers, storekeepers, merely followed their callings for a living, while they were speculating for their fortunes. Everyone of any spirit, ambition, and intelligence (cash was not essential) frequented the National Land Exchange ... By convenient laws, land was made as easily transferable and convertible as any other species of property. It might or did pass through a dozen hands within sixty days. Millions of acres were bought and sold without buyer or seller knowing where they were, or whether they were anywhere."



As always, fraud flourished in this environment. Shady land speculators sold lots in cities that had yet to be built and quite often never were; banks issued vast quantities of paper money backed by little more than the illusory promise of future profits; and speculators knowingly unloaded dud properties on credulous buyers without remorse. In all of this the fine line between bona fide con men and the rest of the populace became pretty blurry. Indeed, in times like the ones that Mitchell witnessed, people become not only the victims but the perpetrators of cons in their rush to become rich.

And so it remains today. Everyone conned everyone else. Mortgage applicants lied about their income and their assets in order to take out the biggest loans and make the biggest profits; mortgage lenders knowingly sold those toxic mortgages to banks, falsely claiming to have vetted applicants; banks bundled those mortgages into opaque and impenetrable securities that deliberately disguised just how rotten the underlying assets remained; ratings agencies blessed securities with AAA ratings with almost no questions asked, pocketing a fee for turning a blind eye; and investors chasing high returns gladly bought up bottom-of-the-barrel tranches of collateralized debt obligations, buying into the bogus belief that real estate was a safe investment and that housing prices only go up. There were cons aplenty; Madoff was but the beginning.

Whether we're talking about the current crisis or something that happened well over a century ago, there's a pervasive inclination to rationalize what's going on as a reasonable response to market forces in which demand creates its own supply. In the same way that bankers and counterfeiters of the antebellum era justified both their sanctioned and clandestine additions to the money supply as an act of public service, delivering what one criminal termed "an essential benefit"—cash for a cash-starved society—contemporary apologists for "financial innovation" voiced much the same sentiments. As Alan Greenspan told a still worshipful audience in 2005, the wild growth of securitization had led to the best of all worlds: a "rapid growth in subprime mortgage lending, fostering

constructive innovation that is both responsive to market demand and beneficial to consumers." If there's a demand for something, Greenspan argued, the market must be met, preferably without regulation or interference. It's a sentiment that the crooked bankers and counterfeiterers of yore would have applauded.

One would hope that some lesson could be taken from all of this, but it's unlikely. After all, just a few years before the housing bubble, we had the high-tech bubble, complete with hundreds of companies that traded at astronomical prices, despite having no business plans, no profits, and in many cases, no obvious means of making one. Aside from a halfhearted observation that the markets showed signs of "irrational exuberance," Greenspan did nothing as the bubble inflated. That colossal con ended with the NASDAQ (which, in a perverse twist, Madoff chaired in an honorary capacity for many years) losing almost 80 percent of its value, wiping out day traders and long-term investors alike. If the experience of living through a boom-and-bust cycle a mere decade ago did nothing to deter people from joining the mania for real estate speculation, it's safe to say that what happened one hundred and fifty years ago is even less likely to make an impression.

Indeed, anyone who thinks that we've seen the last of booms and busts in our own lifetime—much less confidence games large and small—should read what David Mitchell wrote of the mania for land speculation in the 1850s. "The whole domestic history of the time, which ended in the panic, affords a striking illustration of the ... tendency to seize upon some project or idea, to dwell upon it, inflate it, make it into a mania, run it into the ground ... and then forget all about it."

Will we be surprised next time we get conned? It's a safe bet we will.

This article originally appeared in issue 10.1 (October, 2009).

---

Stephen Mihm is an associate professor of history at the University of Georgia. He is the author of *A Nation of Counterfeiterers: Capitalists, Con Men, and the Making of the United States*, published by Harvard University Press in 2007. He is presently at work on a history of the dollar.