Crédit Mobilier & Other Scandals

I Think I Scam… I Think I Scam… I Think I Scam…

Three Big Things:

1. After the Civil War, American businesses became increasingly large, wealthy, and complicated. With this evolution came increased influence over all levels of government.

2. The Union Pacific was one of two railroads chartered by Congress specifically to complete a transcontinental railroad connecting east to west. They eventually completed the task, but along the way, Union Pacific management bilked taxpayers and investors for millions and millions of dollars (with the help of their allies in Congress and the Executive Branch).

3. Crédit Mobilier was only the first of numerous scandals during and after the Grant administration. Collectively, they left the general public feeling frustrated and helpless in the face of corrupt power and a general distrust of both big business and government for decades to come.

Prequel: The Phonic Menace

Let's start with the pronunciation issue, then we'll see what we can do about the rest. First, ignore the accent mark over the 'e'. The term is entirely Americanized; crédit = credit, as in union, card, or give-me-a-little.

Mobilier is pronounced as if with an exaggerated southern twang ("We'z headin' to Mo-BEEL, Alabammy"). Then just add "yer." "CRED-it mo-BEEL-yer." If you insist on trying to make it fancy, "CRED-it mo-BEEL-yay" works as well. Either way, say it with confidence, then push on.

Context and Background

Between the Civil War and the onset of the twentieth century, there were essentially three big themes driving most of American history:

1) The evolving rights of freedmen – the formerly enslaved. Was the United States finally going to live up to its whole "all men are… endowed by their Creator with certain unalienable rights" thing or not?

2) Westward expansion – homesteading, the postbellum "Indian Wars," the Transcontinental Railroad, and (my personal favorite) the development of barbed wire as the most revolutionary technology of the era.

3) The expansion and evolution of big business – the Second Industrial Revolution, "captains of industry" vs. "robber barons," the onset of the Gilded Age, and so forth.

Lost in the discussion of colorful characters like Andrew Carnegie, John D. Rockefeller, and Cornelius Vanderbilt is the fact that the very nature of big business and corporate structures and economic mechanisms for catering to the rich and powerful were being dramatically re-imagined and reshaped throughout the latter half of the nineteenth century and well into the twentieth.

It wasn't all dishonest. Most of it wasn't even illegal – at least not yet. But creations like "holding companies" (designed to protect rich people from the consequences of exploitative business practices) and "trusts" (created to get around laws against monopolies) which are first-year business school stuff today were brand new back then. America's elite were giddy as they cranked up the nation's income inequality, all the while congratulating one another on their service to the greater good.

You've no doubt encountered ideas like vertical integration, horizontal integration, and Frederick Winslow Taylor's "scientific management" approach to labor. It was during this same era that businesses (starting with the railroads) began thinking of their internal structure in terms of "departments." Rather than a simple pyramid of authority, it became common to have managers in charge of different sorts of tasks – one might run scheduling while another was in charge of maintenance and equipment and a third handled personnel and training. This allowed a new type of "specialization" while still requiring internal coordination – meaning a manager over the managers, as it were.

Corporate structures and financing were undergoing similar innovation and experimentation. Many of the procedures and mechanisms created in the late eighteenth century are still utilized today. Others were eventually outlawed, once Congress finally understood how they worked. We'd talk about them more in history class if most of us were all that clear on the details - which was, of course, the whole point.

In short, the late nineteenth century was a time in which economic policies and the legalities of big business were being hotly debated, both in terms of specifics and the larger question of whether the government should be regulating business or the economy to begin with. The industrial workforce expanded and became more diverse as a result of both domestic and international migration (including increased use of child labor). Workers and management argued about wages and conditions and the first labor unions began popping up here and there, unsure of their actual power or potential.

While many promoted a "New South" with a diversified economy – particularly in terms of increased manufacturing – the lower states remained largely agricultural, with sharecropping and tenant farming replacing slavery so neatly it was at times difficult to tell the difference.

It Is Not From Benevolence…

Capitalism at its most basic is founded on a simple idea: let the market decide. If there's a natural demand for something, someone will produce it. Price will be shaped by that demand vs. the available supply. Quality will be controlled by the same mechanism – if people aren't happy with the product, they'll quit buying it, or find another source. The "Invisible Hand" will ensure that everything works out just right, thanks to the sheer volume of enlightened consumers making rational choices about what they will or won't buy, just like they do about who they will or won't elect.

In reality, unfortunately, things don't always work out as planned. People find ways to subvert the assumptions and mechanisms of the system and to exploit the good intentions or natural ignorance of others for personal gain. Government adds a messy, illogical element to the equation – a major player with the power to regulate, participate, or otherwise interfere, but with nothing personally at stake. Any gains, they keep (or at least take credit for); any losses, they simply recoup from taxpayers.

"It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest." What Adam Smith didn't allow for as he wrote these words was the possibility that those same self-interests might lead many industries to seek the patronage of Congress rather than do the much harder work of producing better beef, beer, or biscuits.

Such an approach probably didn't *begin* during the Civil War, but we have to start somewhere – so…

Do You Have These In Blue?

As it became clear the war would not, in fact, be settled in ninety days or less (as both sides had initially anticipated), the Union government began ordering uniforms for its soldiers. The contractors supplying those uniforms quickly figured out that while they could certainly make a reasonable profit by providing decent woolen shirts and pants, they could make far *more* by using what were essentially scraps – used, worn out wool. By the time the material began falling apart, it was being worn by soldiers in the field, and who cared what happened to them?

This cheap, deceptive material was known as "shoddy." The word quickly entered the general lexicon as meaning something cheap but presented as far better than it actually is – the same basic meaning it holds today. The lesson was clear - there was serious profit in exploiting opportunities as they arose, particularly when time was of the essence and most people could be kept in the dark about what you were actually doing. It helped a great deal if you could secure the cooperation of a few folks with a little political power.

The Crédit Mobilier scandal was one of these shoddy deals – maybe the shoddiest of its era. And that was a high bar.

Who's Keeping Track(s)**?**

In 1862, Congress passed the Pacific Railroad Act which created two railroad companies – the Union Pacific and the Central Pacific. It would be another decade or two before railroads would effectively become public utilities, subject to extensive government regulation in the name of the larger good, but the boundaries between railroads as a private industry and railroads as an extension of the federal government were already a bit fuzzy.

The Pacific Railroad Act established a specific, new relationship between Uncle Sam and these sorta-kinda-private companies. The railroads would lay tracks and establish routes as directed by Congress, and in return receive payments in the form of extensive land grants along the new routes, as well as plenty of nice, shiny thirty-year government bonds. Once completed, the railroads would maintain and operate the routes just like any other company, as long as they stayed open and available to support westward expansion and interstate commerce and the like. The project would be financed by tax dollars supplemented by private funding - and few investments seemed quite so reliable in the mid-nineteenth century as railroads.

The primary assignment of these freshly chartered companies was to build a transcontinental railroad. The Union Pacific folks would begin around Omaha, Nebraska (which was a brand new baby city at the time) and head west. The Central Pacific would start from Sacramento, California (which had become an "American" city thanks to the Gold Rush), and build east. Hopefully, they'd meet somewhere along the way. *(They did. This was the line famously completed in Promontory, Utah, in 1869 – with the golden spike and everything.)*

By now, however, many in the choo-choo business had figured out that the real money was in *laying* the tracks rather than *running* the actual routes once built. Established routes through major cities, hauling people and freight, were still big money-makers; it was well worth an initial investment to secure an ongoing, long-term payoff. But this "transcontinental railroad" project wasn't going through major cities or likely to carry much freight right away. It was aspirational. Long-term.

Americans don't do well with "long-term." It's too… *long-term.*

Owners didn't mind the brutal labor required to actually build it. That's what the Irish, Mormons, and freedmen were for – and it's not like they were risking their own money along the way. Then again, the results wouldn't be all that profitable once completed. All they'd get out of the deal were the usual profits and an extensive route which had cost them nothing to build but which they could operate as they saw fit until the end of time. This was unacceptable!

A few of the uppermost uppity-ups decided to modify their business model a bit.

Building the Paperwork Labyrinth

Thomas Durant was vice president of the Union Pacific Railroad. His primary confidant in these shenanigans was George Francis Train (yes, his real name), an eccentric but successful figure who preferred to be known simply as "Citizen Train." Their first step was to create Crédit Mobilier of America, a company owned and operated by Durant and associates but which appeared on paper to be an entirely separate enterprise. Union Pacific "hired" Crédit Mobilier to lay tracks and provide other services, then paid them with government funds and investor dollars after taking a nice cut for themselves. Crédit Mobilier, in turn, hired actual crews to do the real work – at far less than what they were receiving from Union Pacific for the job.

Since the same men ran both organizations, they could bid on work at inflated prices, accept their own bids, then pay themselves (twice) for satisfactory completion as judged only by themselves. On the surface, it appeared a respected railroad company was bidding out work to a subcontractor who only got paid if the railroad was happy with the results. In reality, it was fortunate the tracks were laid at all.

Durant also took advantage of recent changes in business law. Traditionally, investors were liable for business losses or internal fraud up to the full amount of their personal worth. At the dawn of this new age of big business, however, the concept of "limited liability" was born. The maximum any investor could lose was whatever they'd put into a business, dramatically reducing risk and encouraging increased investment.

Durant and his partners would later argue that nothing they'd done was technically illegal, and they may have been right – at least in part. Erring on the side of caution, however, they wrapped up their transactions in multiple transfers between different corporate entities and (seemingly) unrelated accounts, creating the sort of paperwork pretzel most of us only encounter in John Grisham novels and spy movies.

Still, there was always the chance Congress might start poking around and asking too many questions, so Durant and his trusted confederates began offering bargain shares of stock in the company to key Representatives and Senators, most of whom were more than happy to play along – especially when guaranteed annual returns of 300% or more. Eventually, nearly two dozen members of Congress, as well as Vice President Shuyler Colfax, owned stock in Union Pacific.

Growing Suspicions

Generally, when you're doing shady stuff, you should avoid drawing unnecessary attention to yourself or your organization. Internal squabbles among insiders, however, kept drawing the attention of both government officials and curious reporters. Any Congressmen who grew curious were simply brought into the scheme or otherwise pressured to look the other way. The occasional reporter was largely dissuaded by the sheer complexity of the legal and economic webs which had been so carefully woven from the start. They may have suspected shenanigans, but you can't prove something you don't understand to begin with.

It wasn't until 1872, as President Grant was running for reelection, that bits and pieces began coming to the attention of the general public, largely due to the efforts of a paper called the *New York Sun*. *The*

Sun opposed Grant's reelection and gleefully laid full blame for the scandal at his feet. Even then, most folks weren't clear on what, exactly, had been exposed – let alone which parts were demonstrably illegal.

What *was* clear was that the public was shafted while those already in power were getting even richer at their expense. That part, everyone could clearly understand.

Impact and Aftermath

Only Oakes Ames and James Brooks (the only Democrat in the mix) received an official congressional censure. No criminal charges were filed, and the rest of those involved (mostly Republican Congressmen) were free to keep doing whatever they were doing. The public was outraged, but they'd been outraged before and probably would be again. Besides, you can weather a LOT of public rumbling when you're pulling in 500% or more on your insider investments paid for by taxes you control for work your own legislation has mandated.

The specific crisis would pass, but a general distrust of the federal government and Congress in particular would linger until the twentieth century when the requisite patriotism of two world wars would wash away everything else (at least for a generation or two). Railroads continued to exploit their favored status with Congress, taking in millions from taxpayers while establishing themselves as one of the dominant powers in the nation for the rest of the century. Money ran so freely through the informal partnerships between Congress and big business, in fact, that historians often refer to this era as "the Great Barbecue" (with taxpayers as the main course).

More immediately, Crédit Mobilier reinforced the growing perception that the entire Grant Administration was corrupt. It didn't help that there were at least two other major scandals during his time in office. "Black Friday" involved Jay Gould and other insiders - including the President's own brother-in-law - attempting to corner the world gold market. Essentially, they figured if they controlled enough of the total amount of gold in existence, its value would go up. (They weren't wrong about that part.) The "Whiskey Ring" scandal involved bribes accepted by federal officials to protect whiskey producers from paying their taxes. Eventually over 300 people were arrested as part of this one.

Grant himself, by all accounts, had no idea any of this was going on. Then again, that was sorta the whole problem with Grant as president – he rarely did. Whether this was a personal failing or simply bad luck doesn't matter. Grant was great on the battlefield, but his presidential administration will forever be remembered as one of the most corrupt in history.

Name: ____ Hour: ________

Crédit Mobilier & Other Scandals - *Please respond on your own paper. Staple this page to the top when finished and make sure your name and correct hour are filled in above.*

1. This article claims that between the Civil War and 1900, there were essentially THREE big themes driving most of American history. Which one did the Crédit Mobilier scandal most directly involve?

2. What were the other two "themes" of this half-century, according to this article?

3. Just in case we're NOT already familiar with the terms, briefly define IN PLAIN, SIMPLE ENGLISH, each of the following: (a) vertical integration, (b) horizontal integration, and (c) Frederick Winslow Taylor's "scientific management" approach to labor.

4. Large companies began internally organizing themselves into "departments" in the late 19th century. Why was this necessary and what was the primary benefit of this approach?

5. The article suggests that many of the financial structures created in the late 19th century were rather sketchy. Why weren't more of them outlawed immediately?

6. How is capitalism SUPPOSED to work? (Make sure you use plain, simple English.)

7. What's ONE thing that sometimes goes wrong with this system (at least according to this article)?

8. Briefly explain what "shoddy" means and where the term comes from.

9. What were the Union Pacific and the Central Pacific railroads supposed to get in exchange for laying all those miles of track across the middle of the country?

10. What was Crédit Mobilier of America and what did it do that was so very naughty? (Plain, simple English please!)

11. What is "limited liability" and how did it encourage corruption in the late 19th century?

12. How did Durant and Train ensure that members of Congress wouldn't get too curious about all the money they were making from Crédit Mobilier?

13. How much involvement did President Grant actually have in Crédit Mobilier?

14. How were the men primarily responsible for Crédit Mobilier punished?

15. Explain the term "the Great Barbecue."

16. At its most basic, what was the "Black Friday" scandal about?

17. At its most basic, what was the "Whiskey Ring" scandal about?

18-19-20. There's a lot of information in this article. If you had to boil it down, what are THREE big things you should probably remember from it? Number your responses 18, 19, and 20.