

Plastic Predicament

Credit-card debt has nearly tripled in the last two decades, leaving many Americans stuck in a sinkhole of fees and penalties. Who's to blame, irresponsible spenders or predatory lenders?

WEB EXCLUSIVE
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Aug. 16, 2006 - At the height of their debt, Delilah and Kevin Lewis, of Chattanooga, Tenn., had filed for bankruptcy twice, were nearly \$50,000 deep and were still spending on more than 25 credit cards. Though their yearly incomes had once totaled more than \$90,000, Delilah was laid off in 1996, the result of a downsizing effort by the local newspaper where she worked. Not long after, she suffered a stroke—and was hit with \$5,000 in medical fees. "By then, we were just sinking," the 53-year-old says. "I was working overtime to try to make back all this money, and I had a heart attack at age 45. I was a young healthy woman, but I was so highly stressed that I just made myself ill."

The Lewis' case is extreme—but it's far from rare. Americans are spending with plastic at a staggering rate. Consumer credit-card debt has almost tripled over the last two decades—from \$238 billion in 1989 to \$800 billion in 2005, according to an analysis of Federal Reserve Board data by Demos, a national research and consumer advocacy group. The average American family now owes more than \$9,000 in credit debt, according to Gail Cunningham of the Consumer Credit Counseling Service (CCCS) of Greater Dallas, a nonprofit financial-management group. And with credit companies mailing out a record 6 billion credit-card offers last year (according to Mail Monitor, a market research group), American families are averaging about seven cards. "It's a picture of America on the edge," says Cunningham.

How did so many families sink into this quagmire? The Lewis' are the first to admit that their spending habits were, at times, out of control. But there were also circumstances that were beyond them: Delilah's job loss. Then, the stroke—and the \$300-per-month medication she needed for her heart. Their case is not unlike millions of other middle-class Americans who in the face of stagnant wages and rising health and energy costs are using some form of credit to fill the gap between household earnings and the cost of living.

The Center for American Progress estimates the cost of medical, food and household needs has risen more than 11 percent over the past five years—with seven in 10 households using credit as a safety net to cover basic living expenses, reports Demos. Meanwhile, wages have simply not kept up, remaining virtually flat since early 2001. "The data shows that people are borrowing more money *not* because of overconsumption but because they're caught in a bind," says **Christian E. Weller, a senior economist at the Center for American Progress and author of a May report "Drowning in Debt."** He adds, "In that bind, the only escape valve for middle-class families is to borrow more money."

Some consumer advocates say these rising living costs have coincided with what they describe as predatory lending practices by credit companies. The way they see it, with fees and interest rates going up, increasingly easy access to credit and a general lack of financial understanding on the part of consumers, it's not a surprise that more and more Americans are spending beyond their means. About 7 percent of credit-card holders make only the minimum payment each month, according to Bankrate.com, while the percentage of Americans who are delinquent in their payments by 30 days or more is about 4 percent, according to figures from the American Bankers Association. "Decades ago, you had to be creditworthy to get a card," says Cunningham. "Now, credit offers are everywhere—and it's because the industry knows that, as consumers, we will likely charge more than we can pay, and they'll benefit by raising our interest."

James Chessen, chief economist for the American Bankers Association (ABA), the country's largest banking trade organization, says that the easy availability of credit—and the sometimes controversial marketing tactics—are simply a reflection of a competitive market. "There are 6,000 different issuers today all trying to provide a product that meets the needs of individuals," he says, arguing that consumers must use good financial sense to resist the "constant" hoard of solicitations. "Individuals have a choice." But many advocates say consumers aren't fully informed about their choices. For instance, many don't know that there's no federal limit on the interest or late fees a credit company can charge and that some rates are as high as 40 percent. Nor do many realize that even if they maintain a perfect payment record with a credit lender, some creditors still reserve the right to change the terms of that contract at any time.

Cunningham of CCCS breaks the situation into more manageable terms: take a family that is \$9,000 in debt on a card that has an 18-percent interest rate. Say they cut up the card and never use the account again. Even if they pay the minimum payment of 2 percent of the balance each month, plus interest, it will take them 47 years—and close to \$33,000—to pay off that \$9,000 debt. That, says Ed Mierzwinski, head of the consumer program at the U.S. Public Interest Research Group, is a concept that has gotten lost in a consumer climate that continues to emphasize the minimum monthly payment. And as the industry goes virtually unregulated, he says, "more and more people are sinking deeper."

Sen. Robert Menendez of New Jersey recently introduced a bill he hopes will help prevent consumers from being taken advantage of. With average households now paying more than \$800 in penalty fees and interest payments each year—or \$90 billion annually, according to the Center for American Progress—Menendez's "Credit Card Bill of Rights" would establish public education programs aimed at financial literacy, designate 21 as the minimum age to nonvoluntarily receive credit-card solicitations and create industry standards related to excessive fees and interest rates.

The bill, he says, comes as studies show credit companies increasingly targeting people who are likely to default, such as teenagers, college students and those who've declared bankruptcy. "Credit has become much more universal and [regulation of it] a lot looser over the years," Menendez says. "[It's] given the industry more and more avenues to make a lot more money, not because they're expanding their card services but because they're expanding their reach into borrowers' pockets."

But deregulation of the lending industry over the last decades and the "democratization" of credit also has a lot to do with why the industry, and, by extension, commerce, has grown. Without the flexibility of risk-based pricing—providing low interest rates for responsible borrowers and high rates for those deemed "risky"—the industry would not be able to offer credit as widely as it does now. Credit cards provide instant access to funds that can be used at any time, anywhere in the world. They facilitate more than \$2.5 trillion in transactions each year and are accepted at more than 24 million locations around the world.

Restrictions on credit-card transactions, some economists contend, would have unintended effects that would hurt consumers and the overall economy. "What happens with any kind of price cap or ceiling is that there's an allocation of credit that ends up excluding the very people who may need the product the most," says Chessen of the ABA. "It used to be that only the wealthiest people had access to credit cards. But today, credit is available to anybody with a reasonable credit history that shows they can meet their payments."

Yet what defines a "reasonable credit history" is precisely what has many consumer advocates up in arms. James Scurlock, a finance expert and documentary filmmaker whose latest production, **"Maxed Out,"** won acclaim for its critical look at the lending industry, says his research has shown a vast manipulation of the young and poor. He contends that those consumers deemed "risky" are in fact the ones that bring in the most profit, and expressed concern over industry marketing tactics that often target young consumers. (According to a recent Junior Achievement poll, one out of every 10 teens is using credit cards today.) "We're in a totally different time now where we're deluged every day with offers of credit," says Scurlock. "College students are a really attractive market because they have parents who will bail them out, they love spending money, and they're not nearly as sophisticated as they think they are."

But Chessen argues that consumers need to think hard about the personal responsibility that comes with having a card. His advice: "When you go and buy anything with a credit card, you should say to yourself, 'I'm taking out a loan for this'—and there's a price associated with that loan. I often cringe when I see people buying their \$3 lattes with a credit card. Do you really need to take out a loan for that cup of coffee?" According to Cunningham, it could take years to pay off that \$3 latte, depending on balances and interest rates. She recommends looking for zero-interest cards, and always keeping some sort of emergency reserve that doesn't rely on credit "for that flat tire, that leaky roof—for that emergency that's *going* to happen."

But with individual bankruptcies rising to 2 million last year, it's clear that many Americans are not planning for that last-minute expense or managing their credit as well as they could. Proponents of the new bankruptcy bill, which went into effect in October 2005, making it more difficult and more expensive to file, believe that much of the blame for debilitating debt lies with the consumer. Writing about the bill for the Heritage Foundation last year, economist Tim Kane said the consumer-debt problem was not caused by excessive supply or demand for credit, but by a "lack of accountability" in bankruptcy laws. He added that he new bill would "restore balance and personal responsibility to U.S. credit markets."

For the Lewis family, the struggle for solvency lasted nearly a decade, as they refinanced mortgages, borrowed excessively and continued to dish out credit for counseling services they thought could help. But it wasn't until a trip home from Mississippi last year that they really made up their minds. Dave Ramsey, a radio-finance guru, came on the XM radio they'd bought for the trip (on credit) and they listened all the way home. "The thing is, as smart as we are and as old as we are, we didn't know what was happening to us," says Delilah, who has since bought a paper shredder to cut up the credit-card solicitations she receives each month. "You think, 'I'll work harder, I'm going to catch up.' But you just can't."

Today, the couple budgets everything—and doesn't spend a cent on credit. They've transferred their outstanding debt to three low-interest cards, and they operate on a cash-only system. They do their shopping in Georgia—because it's tax-free—and Delilah has begun to use a mail-order pharmacy to cut the cost of her heart medicine. In 16 months, they've paid off \$26,347. "Before, it was just out of sight, out of mind. We just couldn't figure out how to stop the cycle," Delilah says. "But now that I'm paying these things off, in baby steps, I smile to myself because I know that I will never, ever use a credit card again."

Next week we'll look at one of the most common sources of overwhelming consumer debt: soaring medical bills.

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