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NAACP

December 2013

The Challenge of Credit Card Debt for the African American Middle Class

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ACKNOWLEDGEMENTS

The NAACP Economic Department thanks Dēmos for their research, design, analysis, and development of this report. We particularly thank Catherine Ruetschlin for her contributions to this report.

The NAACP Economic Department acknowledges the leadership of the National Board of Directors Economic Development Committee chaired by Leonard James, III and the Housing Committee chaired by Attorney Gary Bledsoe.

Catherine Ruetschlin would like to thank Amy Traub for her expert insights and editorial assistance.

ABOUT THE NAACP

The mission of the National Association for the Advancement of Colored People is to ensure the political, educational, social, and economic equality of rights of all persons and to eliminate race-based discrimination.

ABOUT DĒMOS

Dēmos is a public policy organization working for an America where we all have an equal say in our democracy and an equal chance in our economy.

DĒMOS MEANS "THE PEOPLE."

It is the root word of democracy, and it reminds us that in America, the true source of our greatness is the diversity of our people. Our nation's highest challenge is to create a democracy that truly empowers people of all backgrounds, so that we all have a say in setting the policies that shape opportunity and provide for our common future. To help America meet that challenge, Dēmos is working to reduce both political and economic inequality, deploying original research, advocacy, litigation, and strategic communications to create the America the people deserve.

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Key Facts

In the wake of the worst effects of the Great Recession, African Americans, like Americans as a whole, are getting their balance sheets in order and paying down credit card debt. But new research from Dēmos' *National Survey on Credit Card Debt of Low- and Middle-Income Households* finds that African Americans face challenges to their financial security that are unlike those of white households. In early 2012 Dēmos surveyed a nationally representative sample of moderate-income households carrying credit card debt for at least three months; this paper is part of a series of reports presenting our findings. The results reveal that, for many people, credit cards become a "plastic safety net" to replace dwindling incomes, private assets, and social investments, and to help families stretch their resources when paychecks and savings are not enough. We find that under difficult economic conditions many African American families rely on credit cards to make ends meet or invest in their future—despite paying high interest rates and suffering more negative consequences of debt than other groups.

Among moderate-income households carrying credit card debt:

The African American middle class is paying down debt but still relies on credit cards to make ends meet.

- African Americans carrying credit card debt owe less than they did in 2008, carrying an average balance of $5,784 today compared to $6,671 in our 2008 survey.
- Similar to white and Latino Americans, 42 percent of African Americans report using their credit cards for basic living expenses like rent, mortgage payments, groceries, utilities, or insurance because they do not have enough money in their checking or savings accounts.

The African American middle class—like the American middle class as a whole—uses credit cards to make critical investments in their future, including for higher education, entrepreneurship, and medical expenses.

- Fifty percent of indebted African American households who incurred expenses related to sending a child to college report that it contributed to their current credit card debt.
- Nearly all of the African Americans in our survey who incurred expenses from starting a new business charged those expenses to a credit card and have not been able to pay it off: 99 percent of African American

households still carry that expense on their credit card bill compared to 80 percent of whites.
- Forty-three percent of African Americans—similar to whites and Latinos—reported that out of pocket medical expenses contribute to their credit card debt.

The African American middle class reports worse credit scores and different causes of poor credit.

- When asked to identify their credit score within a range, just 66% of African American households report having a credit score of 620 or above, compared to 85 percent of white households.
- When asked to describe their credit score, only 42 percent of African American households reported having "good" or "excellent" credit, compared to 74 percent of white households.
- Among households reporting poor credit, African American households were more likely to report that late student loan payments or errors on their credit report contributed to their poor credit scores. White households were more likely to report that late mortgage payments and the use of nearly all existing lines of credit contributed to their poor credit scores.

Moderate-income African Americans have similar rates of default and late payments to moderate-income white Americans.

- There were no significant differences in the frequency of African American and white households declaring bankruptcy, being evicted, or having property repossessed.
- There were no significant differences in the number of times African Americans and whites were late on credit card payments.

African Americans are more likely to be called by bill collectors, and to have seen credit tighten.

- Seventy-one percent of African American middle-income households had been called by bill collectors as a result of their debt, compared to 50 percent of white middle-income households.
- Just over half of African American middle-income households reported having a credit card cancelled, seeing their credit limit reduced, or being denied for a credit card in the three years following the recession.

Introduction

Millions of Americans are still struggling with unemployment, lower incomes, and the loss of wealth as a consequence of the Great Recession. But the fallout of the financial crisis and the burst of the housing bubble hit people of color especially hard, exposing the relative vulnerability that persisted among African Americans in the years since the Civil Rights Movement. **Over the 5 years since the financial crisis African Americans experienced the greatest economic losses of any group in the country, including the highest unemployment rates and the biggest drops in annual income.**

In tough economic times like these, many families have to find a way to supplement their earnings just to maintain a decent standard of living. When the car breaks down or the furnace leaks, households straining to meet a tight budget may drain their savings accounts or borrow to make ends meet. But African Americans have fewer assets to fall back on than other households, owning just $1 in wealth for every $20 owned by whites.[1] And unlike white households, more than half of that wealth is held in housing, making it less accessible in times of emergency. Home equity was also subject to the massive devaluation associated with the housing bubble's collapse, resulting in a disproportionate loss of wealth among African Americans when the bubble burst.[2] **In this report, we look at how moderate-income African Americans are using credit cards in the aftermath of the Great Recession.** We find that under difficult economic conditions, millions of African American families rely on credit cards to make ends meet – despite paying high interest rates and suffering more negative consequences of debt than other groups.

Credit cards gained importance for household finances over the past generation as incomes stagnated and many families saw their buying power decline. In the 30 years from 1980 to 2010, while the size of the US economy more than doubled, the median American household saw income rise by just 10 percent.[3] Even in this post-Civil Rights era, the advance of racial economic equity was similarly stagnant. African American families saw almost no gains in income relative to whites over the period, barely climbing from earnings at 58 percent of white family incomes in 1980, to 61 percent in 2010.[4] At the same time, the wealth divide actually worsened: according to the Institute for Assets and Social Policy, between 1984 and 2009 the racial wealth gap nearly tripled.[5]

Over the same period, employment security began to wither as new trade rules increased competition for jobs and employers decreasingly offered benefits like health insurance and traditional pension coverage that used to be an essential part of hiring agreements. Offshoring in particular proved a severe blow to the African American middle class, who were disproportionately employed in manufacturing. The debilitation of organized labor, beginning with the policies of Ronald Reagan, further diminished the number of good jobs available to African American workers.[6] From 1980 to 2010, unemployment for African Americans consistently hovered around twice that of white workers.

In the years since 1980, as economic security for the middle class began to disappear, the social safety net became increasingly inadequate to cover the new burdens placed on household budgets. **For many people, credit cards became a "plastic safety net" to replace dwindling income growth, private assets, and social investments, and to help families stretch their resources when paychecks and savings were not enough.**

The Great Recession intensified both the need for social protections and their paucity as unemployment soared, incomes declined, and poverty hit record levels. Critical programs designed to cover workers when the economy fails could not compensate for the gap left by decades of policies weakening the middle class. **Unemployment insurance, for example, provided coverage for just 24 percent of unemployed African Americans and 33 percent of unemployed whites in 2010.**[7] The average insurance payment in 2010, 2011, and 2012 was just $300 per week.[8] Our survey found that in many cases, the hardship of unemployment pushed families to take on debt just to get by.

In early 2012, Dēmos conducted a nationally representative survey of Americans carrying credit card debt in order to better understand what the trends in borrowing mean for moderate-income households and for people of color today. The 2012 *National Survey on Credit Card Debt of Low- and Middle-Income Households* follows two previous Dēmos surveys, conducted in 2005 and 2008. Our results show that African American households have paid down their credit card balances since the beginning of the recession, yet still experience financial pressures that compel them to put critical expenses – like medical bills or the cost of education – on their credit cards. At the same time, these households were significantly more likely than other groups to see their credit tighten following the financial crisis. And the consequences of carrying debt fell harder on African Americans, too; **our study reveals that African Americans are far more likely to be called by bill collectors than white households, and far less likely to report a good credit score.**

The *National Survey on Credit Card Debt of Low- and Middle-Income Households* is a nationally representative survey of 997 currently indebted households who have carried a balance on their credit card for at least three months. This paper is part of a series of reports presenting our findings from the survey. African Americans make up 15 percent of the sample, yielding a margin of error of 11.3 percentage points.

We identified low- and middle-income households based on their relationship to the county-level median income for each respondent, with those earning between 50 and 120 percent of the local median included in the survey. The median income for African American households included in the indebted sample was $51,450—that is about 2 percent higher than the median household income of $50,045 for the US population overall in 2011. Relative to the total US population, the typical African American family in our survey is squarely middle class. In all, eighty percent of the African American households surveyed earned between $20,000 and $100,000 per year, placing them within the middle three quintiles of income distribution for 2011.[9] But due to a significant wage gap, high unemployment, and institutional barriers in the labor market, African Americans in general face the lowest incomes of all racial and ethnic groups in the country, with a median income of just $32,229, or less than two-thirds of the median for the total population. The majority of African Americans in our sample are high earners relative to the African American population as a whole.

According to the most recent Federal Reserve data, **79 percent of African American households with a credit card carry credit card debt.**[10] With a typical credit card debt burden of $5,784, the average African American household in our survey owes credit card companies as much as 13 percent of their annual income. This study tells their stories, examining the reasons why African Americans turn to credit cards and the repercussions for their household finances.

Methodology

In February and March of 2012, Dēmos and GfK Knowledge Networks conducted a survey of 1,997 households, including 997 households who had carried credit card debt for more than three months and 1,000 households who had credit cards but no credit card debt at the time of the survey. For our survey, moderate-income is defined as a total household income between 50 percent and 120 percent of the local (county-level) median income. All of our respondents were at least 18 years of age. In order to ensure that the indebted sample captures households who carry credit card debt, as opposed to those carrying a temporary balance, we only included households who reported having a balance for more than three months. The margin of error for the total indebted sample is +/- 3.9 percentage points.

An additional sample was used to obtain reliable base sizes for African American and Latino populations. The margin of error for the oversample of 152 African American households is +/- 11.3 percentage points. The margin of error for the oversample of 205 Latino households is +/-9.1 percentage points.

The CARD Act Provides New Protections for African American Borrowers

In 2008, the US Congress passed the Credit CARD Act, providing security for consumers by requiring that credit card companies comply with fair and transparent practices for billing and fees. The provisions of the CARD Act require that monthly credit card statements include key information about debts, including how long it will take to pay the entire balance if only paying the minimum amount due, as well as disclosure of charges from interest and fees. In addition, the CARD Act eliminated some practices that were harmful to consumers, like the retroactive application of higher interest rates on existing balances, and the administration of hair-trigger late fees. Since President Obama signed the CARD Act into law in May 2009, it has helped African American households in particular to pay down debt faster and save money by avoiding unreasonable charges.

Our survey found that more than 9 out of 10 indebted African American households noticed the change on their monthly statements. More than one-third adjusted their behavior because of the CARD Act to pay down their balances faster. **Thirty-seven percent of indebted African American households reported paying more toward their credit card balance as a response to information in their monthly statements mandated by the CARD Act.** (*See Table 1*)

Another way the CARD Act is helping households take control of their finances is through the reduction of fees for consumers who outspend their credit limits, or those who make a late payment. **Nearly one-third of African American households report being charged over-the-limit fees less often since the Act went into effect. One in four has been charged late fees less often.** (*See Table 1*)

The CARD Act also limits the ability of credit card companies to increase interest rates, protecting consumers' existing balances from retroactively-applied interest rate increases and ensuring that payments will be applied to the balance with the highest interest rate first. As a result, households are less likely to see hikes in their interest rates. **Since the passage of the CARD Act, 25 percent of African American households have experienced a drop in the interest charges on their credit card.** (*See Table 1*)

TABLE 1.

Impact of the CARD Act on African American Households

Paid more towards credit card balance in the typical month, as a response to information on credit card statements mandated by the CARD Act	37%
Charged over-the-limit fees less often	32%
Charged late fees less often	25%
Charged less interest on credit cards	25%

The achievements of the CARD Act for African American households revealed by our survey make it clear that credit card debtors need complete information and a fair shot at getting on their feet in order to make decisions that restore their balance sheets. The provisions of the CARD Act have helped move indebted African American households toward greater financial freedom and show how a well-designed policy can have real and positive impacts on peoples' lives.

The credit card debt basics of African Americans: balance, APR, and getting by on debt

The financial crisis of 2007-2008 began in the deregulated credit and securities markets, and reverberated into a global recession. As foreclosure rates escalated, unemployment rose, and credit markets constricted, Americans responded by tightening their belts and paying down debt. This study looks deeper into that trend, and finds that while Americans did indeed deleverage—reducing their average credit card balances in the three years following the Great Recession—many moderate-income households continue to rely on credit cards in order to make ends meet.

African Americans owe less than they did in 2008, carrying an average balance of $5,784 today compared to $6,671 in our 2008 survey. But though these households are paying down debt overall, more than 4 in 10 African American households with credit card debt have relied on credit cards to pay for basic living expenses when paychecks and savings were not enough. **Forty-two percent of indebted African American households report using their credit cards for basic living expenses like rent, mortgage payments, groceries, utilities, or insurance because they did not have enough money in their checking or savings accounts, a rate that is similar to white and Latino Americans (***see Figure 1***).**

Relying on debt to deal with emergencies or just stay afloat comes at a cost. In order to meet monthly payments and work toward reducing debt loads, **the average African American household spends $368 each month on all credit cards.** And over the years required for a household to pay down their credit cards entirely, interest charges accumulate. African Americans report steep annual percentage rates (APRs) adding to their balances and prolonging their debt. **Indebted African American households report an average APR of 17.7 percent on the card where they carry the greatest balance.** Although they carry lower balances, the high interest rate paid by African Americans results in greater total interest charges over the duration of a debt. An African American family carrying the average debt and APR, and that pays the average monthly payment, would be charged at least $100 more in interest than an average white family, even though they borrowed less.

TABLE 2.

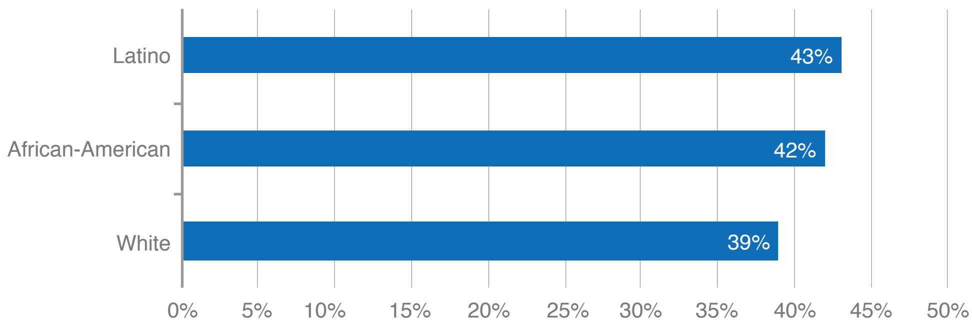
Average Debt and APR by Race/Ethnicity*

	White	African American	Latino
Average Credit Card Debt	$7,315	$5,784	$6,066
Total Monthly Payment on All Cards	$609	$368	$483
Average Annual Percentage Rate of Card with the Highest Balance	15.8%	17.7%	17.9%

FIGURE 1.

Households turn to credit cards to make ends meet*

In the past year, have you used credit cards to pay for basic living expenses, such as rent, mortgage payments, groceries, utilities, and insurance because you didn't have money in your checking or savings account?



**Information on the average credit card debt and APR by race is provided in order to illustrate the basic credit card debt burden for indebted households. However, the differences in total debt, APR, and use of credit cards for basic living expenses between African American households and white or Hispanic households fall within the margin of error for our survey and are not considered statistically significant.*

Credit cards fill-in when a public safety net or private assets are not available, leading households to turn to credit card debt to finance human capital and other investments

Household assets offer a resource for families to weather times of change or uncertainty, as well as the critical leverage required for families to invest in their futures. Right now African Americans are facing constraints with respect to both household assets and income, due to the legacy of discrimination in national asset-building policies that have left African Americans with just $1 in assets for every $20 owned by whites, and due to the disproportionate unemployment African Americans have steadily faced for the last 50 years.[11] African American households on average have lower incomes and greater rates of unemployment and underemployment and are less likely than whites to own the most common asset in the country—a home. The challenges of lower incomes, employment, and wealth make it more difficult for African Americans to leverage long-term investments; in many cases credit cards may be the best available option. African Americans are more likely than white households to have credit card debt from the expenses of starting a business, and they are highly likely to carry credit card debt from paying for a child to attend college and from visiting the emergency room.

Housing

For those who can afford the investment, the value of home equity opens a range of possibilities. It is a symbol of middle class success and the American dream, a secure asset that offers comfort and security when other problems arise, and a resource that provides the leverage necessary for making other kinds of investments at lower costs. **Yet according to our survey, just 55 percent of moderate-in-**

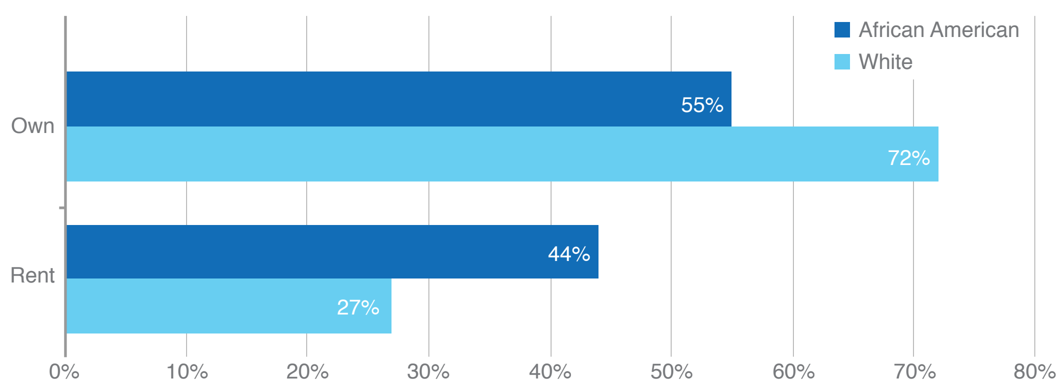
come indebted African American households are homeowners, compared to 72 percent of white households (*see Figure 2*)**.** The lower rates of homeownership among African Americans are both a cause and a symptom of racial asset inequality. During the post-war era, as the US made significant investments in the expansion of the middle class, millions of white families enjoyed the public benefits of subsidized housing, suburbanization, and the GI Bill. African Americans instead faced racially restrictive covenants in private real estate and lending. The practice of creditor redlining of majority-African American neighborhoods persisted through the 1980s and targeted predatory lending marred the 1990s and 2000s. Today, the disparity in homeownership that resulted from these policies continues to perpetuate racial differences in other areas, like wealth accumulation, financial stability, and access to high quality education and employment opportunities.

Recent research from the Institute on Assets and Social Policy has shown the racial disparity in homeownership to be the single greatest factor contributing to wealth inequality, explaining 27 percent of the difference in the growth of wealth between white and African American households over the 25 year period from 1984 to 2009.[12] The post-war era policies that offered whites greater opportunities to build wealth now make it more likely that white families will be able to pass down an inheritance or offer familial financial assistance. The disparity is further reinforced by differences in access to credit and the persistence of residential segregation that lowers the return on investment in African American neighborhoods.[13] As a result of whites' greater access to familial assets, higher employment rates, and higher incomes, a white family is likely to purchase a home earlier, with a larger down-payment and lower fees. The outcome precipitates the average white family earning equity years before their African American counterparts, and with higher returns.[14]

FIGURE 2.

African Americans in our survey are less likely to own their homes

Do you currently own or rent your home?



College Education

The rapid rise in tuition over the past 30 years exposed a shift in the American vision of higher education from a public investment to a private expense —one that many households can only finance by going into debt. College enrollment among people of color grew over the same period, so that African American and Latino students increased in number just as state spending per pupil declined. The result is a debt-for-diploma system that lays a greater student debt burden on African Americans than any other group of college graduates. What's more, students are not the only ones who end up carrying the burden of the high cost of attendance. Student debt often spills over onto parents, eating into savings accounts or destabilizing other assets. **African Americans are more likely to avoid placing higher education debt on parents' credit cards than white Americans, yet our study found that still 50 percent of indebted African American households who incurred expenses related to sending a child to college report that it contributed to their current credit card debt.**

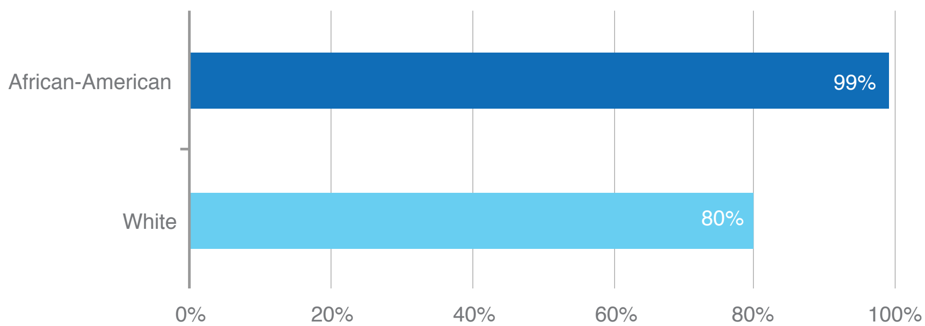
Young African Americans are more likely to take on debt in order to attend college, and among those who graduate with student loans African Americans have the highest balances, with student loan debts thousands of dollars higher than those of white college graduates. **In 2008, student loan debt affected 15 percent more African American graduates than white graduates. Eighty percent of African American college grads took out some amount of loans in order to attain a higher education, compared to 65 percent of whites. In the same year, the average African American senior leaving college with student loans owed $28,692, compared to $24,742 for whites.** [15]

Running a Business

Even before the recession stalled incomes and depleted consumer demand, asset inequality made it much easier for whites to open and run a business than for African Americans.[16] The latest Census of small business owners occurred in 2007, before the recession and its associated challenges for entrepreneurs. That survey showed that between 2002 and 2007 African American-owned businesses grew at triple the overall rate of business ownership.[17] But despite this rapid increase, African American business ownership is still disproportionately small. In fact, at the last count African Americans ran just seven percent of all small businesses in the country, and just 2 percent of those with paid employees. [18] Experts who study the inequality in small business ownership point to a lack of start-up capital as a significant factor in African Americans' disparate rates of business success.[19] Moreover, poll after poll of business owners in the US show that access to capital remains a challenge for small businesses in general, even 5 years after the recession's end.[20] The credit crunch prompted many banks to shift their small business lending from financing through loans to small business credit cards, which can carry a much higher interest rate than traditional loan options.[21] In addition, these cards are exempt from the provisions of the CARD Act, leaving business owners vulnerable to the abuses that the legislation aimed to curtail, such as retroactively applied interest charges and unfair late fees. Our survey shows that African Americans are taking out credit card debt in order to finance their business ventures, even though it is more expensive than forms of credit available to populations with more assets to leverage. **We found that 99 percent of indebted moderate-income African American households who had expenses related to starting or running a business in the past three years still carry that expense on their credit card bill, compared to 80 percent of whites (*see Figure 3*).** Nearly all of the African Americans in our survey who incurred business expenses charged those expenses to a credit card and have not been able to pay it off.

FIGURE 3.

Business expenses contribute to credit card debt (percentage of households that reported expenses related to starting or running a business in the past 3 years) *Did starting a new business or running an existing business contribute to your current credit card debt?*



Health Expenses

Barriers to affordable health care, like the skyrocketing cost of services, make the possibility of health emergencies a significant source of economic insecurity for most Americans. Everyone is at risk of an unplanned health problem, and without the resources to cover the expense a hospital bill can be a burden on finances long after patients recover. Among the moderate-income households we surveyed, most incurred some out-of-pocket medical expense such as the cost of a doctor's appointment or hospital stay, prescription medication, or a dental expense. Seventy-six percent of indebted households experienced an out-of-pocket medical expense in the past 3 years, and most of those families continue to carry the charge on their credit cards (*see Figure 4*). **The median credit card balance from health expenditures among African American middle class households that carry the expense on their credit card is $933.** The median indebted African American household with medical debt on their credit cards carries 11 percent of their total credit card debt due to medical expenses.

FIGURE 4.

Medical expenses contribute to credit card debt*

Did out-of-pocket medical expenses in the past 3 years contribute to your current credit card debt? How much of your current credit card debt is due to out of pocket medical expenses? (Median dollar amount)

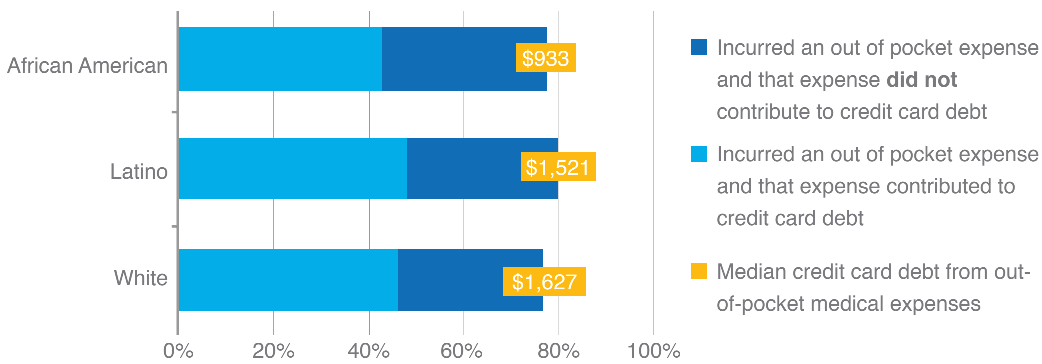
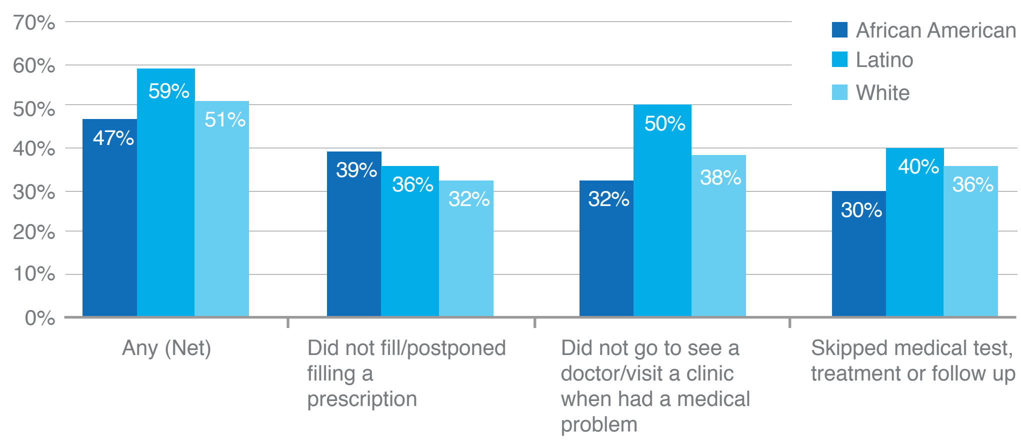


FIGURE 5.

Households sacrifice necessary medical care to reduce expenses*

Have you or a member of your household tried to reduce medical expenses by doing any of the following?



**African American, Latino, and white households are using credit cards to pay for medical expenses. They are also all forbearing treatment in order to cut down on health costs. The differences by race and ethnicity for carrying medical debt on credit cards and forbearing care are within the margin of error and not considered statistically significant. The data are included here in order to illustrate the contribution of medical expenses to household debt and the household response to onerous costs across the population.*

Across demographics, the majority of households with medical debt are turning to credit cards in order to pay for those expenses. Even households that have insurance coverage can find it difficult to afford medical care as the cost of premiums, co-pays, and deductibles rise with health care costs overall. Almost half of all households in our survey do rely on credit cards to finance out-of-pocket health care bills like doctor's appointments, hospital stays, and prescription medications. In addition to paying for medical expenses through a credit card, half of those surveyed are forbearing health care to cut costs. **Among indebted moderate-income African American households, 47 percent have skipped a medical test, treatment or follow-up, did not fill a prescription, or did not visit a doctor when necessary in order to reduce medical expenses** *(see Figure 5)*.

According to the Department of Health and Human Services, the average emergency room visit costs $1349. For the uninsured that price tag is even higher, at $1843.[22] For lower income and low wealth individuals this type of cost can be financially devastating. The cost burden is particularly problematic for groups like African Americans, who have higher rates of chronic conditions, like asthma, that send families to the emergency room, making hospitals an important resource for critical care.[23] Credit cards can provide the immediate liquidity that a family needs when faced with an emergency, but the high balance builds with each month that the debt goes unpaid.

African Americans report having worse credit scores

Changes in the American economy since 1980—including the stagnation of household incomes, escalating expenses as declines in public investment shifted costs onto families, and the loss of workplace benefits, wages, and job security as public policy failed to support the voice of labor—resulted in credit cards taking on greater importance for family finances. Today even middle class households are forced to rely on credit card debt in order to make ends meet when their budgets cannot cover basic needs. At the same time, borrowing history has become more important to non-financial opportunities, as the use of credit reports and scores expands to encompass areas only loosely, if at all, related to standard lending, including hiring practices and the provision of essential utilities and medical services. As credit reports and scores gain importance for non-financial purposes, new barriers arise for families trying to take control over their household budgets.

Lower wealth, low rates of homeownership, and higher unemployment rates put African Americans at a disadvantage for building a solid credit history. Moreover, discriminatory practices—like the predatory lending that targeted communities of color and contributed to the most recent financial crisis—reinforce this racial economic inequality and exacerbate the credit problems of African Americans overall. As a result of these factors and others, credit scores are significantly correlated with race. Our survey asked indebted households to self-report their credit scores to the best of their knowledge. We found that African American households are much less likely than whites to report a good or excellent credit score (*see figure 6*). Those reporting bad credit cite a range of issues that contribute to their low credit scores, and African Americans with poor scores are significantly more likely than white households with poor scores to report late payments for their student loans, as well as errors on their credit reports as a cause of bad credit. African Americans are less likely to report that making late mortgage payments or maxing-out their available credit contributed to poor scores (*see Figure 7*). The results of our survey showing disparities in credit scores and the causes behind them are part of a growing body of research that suggest a need for significant reforms in credit reporting and the widespread use of credit reports and scores for non-lending purposes.

When asked to identify their credit score within a range, just 66% of African American households report having a credit score of 620 or above, compared to 85 percent of white households *(see Table 3)***.**

TABLE 3.

African Americans are less likely to report a credit score of 620 or above

What range is your credit score?

	White	African American
620 And Above	**85%**	**66%**
Between 580 and 619	9%	25%
579 And Under	6%	9%

When asked to describe their credit score, only 42 percent of African American households reported having "good" or "excellent" credit, compared to 74 percent of white households. More than half of African Americans report having "fair" or "poor" credit (*see Figure* 6).

FIGURE 6.

African Americans are less likely to report good or excellent credit scores.

Which Best Describes Your Credit Score?

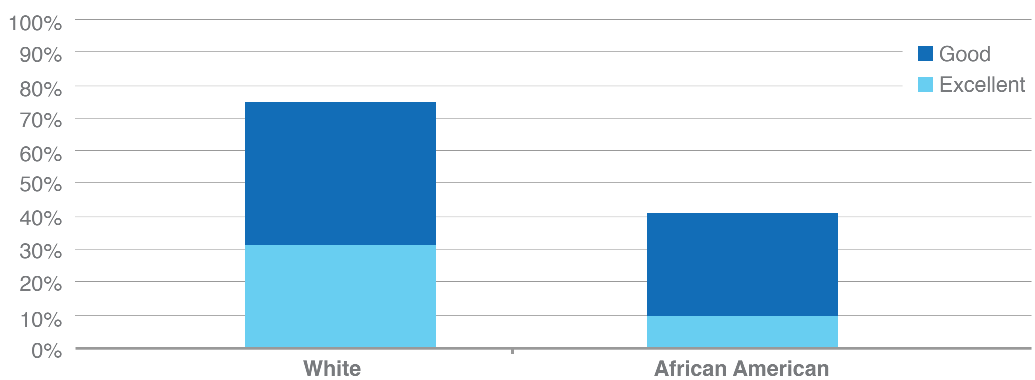
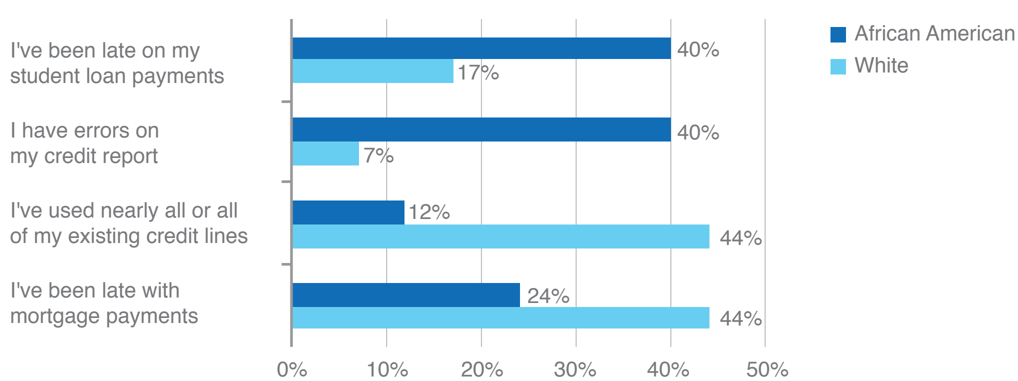


FIGURE 7.

African Americans and whites report some different causes of poor credit

Earlier you mentioned you have a poor credit score, which of the following contributed to your poor credit score?



FAIRNESS AND ACCURACY IN CREDIT REPORTS AND SCORES

Credit history is increasingly important to the economic opportunity of American households, and credit scoring and reporting products are a big industry, earning billions of dollars per year. Landlords, lenders, and insurance providers look to credit reports to individually tailor their eligibility and terms of provision. What's more, these products are no longer used only to assess individual credit risk; their use has crept into practices for a number of non-financial purposes, such as health care or employment decisions. But credit scores and reports make poor tools for appraising non-financial liabilities, and the lack of fairness and accuracy in the products make them unsuitable for many of the functions for which they are used.

Our study found that moderate-income African American households with credit card debt are less likely than similar white households to report good or excellent credit, a finding that aligns with other research identifying racial biases in credit scoring, including research from the Federal Reserve Board, the Federal Trade Commission, and the Brookings Institution.[24] Dēmos' recent report, *Discredited: How Employment Credit Checks keep Qualified Workers Out of a Job*, also notes that the credit histories of Latinos and African Americans have suffered as a result of discrimination in lending, housing and employment itself.[25] The poor credit scores of African Americans relative to whites reflect broader conditions of economic inequality in the US, including the greater likelihood of unemployment and inadequate insurance coverage among African Americans, and disparities in wealth accumulation that persist from post-war era policies that favored whites, as well as more recent discriminatory practices focused in African American communities, such as redlining and predatory lending. The effects of the Great Recession, which fell disproportionately hard on African American households, exacerbate this racial economic divide.

The racial bias in credit histories further undermines the economic opportunities of African American families as their use grows to encompass areas unrelated or loosely related to standard lending. Credit reports may dictate the availability and conditions of acquiring a job or essential services. Employers may eliminate applicants with credit problems from hiring consideration, even though there is no evidence for a link between poor credit and poor job performance. Hospitals and health care providers may examine their patients' credit reports in order to evaluate their ability to pay, sometimes even pressuring them to charge medical bills to credit cards instead of negotiating for better prices. Often, decisions about the terms of service and deposit required for basic utilities like heat, water, or electricity depend on credit reports and can create significant barriers for families trying to meet their basic needs.

Biases and inaccuracies in credit reports, and the expansion of the industry to encompass non-financial opportunities, reveal the growing need for policy to address the problems concerning the use of credit history. Targeted solutions should include reigning in the use of credit reports and scores for non-lending purposes such as hiring, medical charges, and utility services; removing information in credit reports that reveals little information about the responsibility of the borrower such as medical debt and payment history on high-risk financial products; and increasing the accuracy and transparency of the credit reporting industry. The Dēmos report *Discrediting America* examines these issues in greater detail.[26]

A system of credit reporting and scoring that reproduces racial and economic inequality serves neither lenders nor consumers and increasingly undermines the economic security of households in areas unrelated to credit. The findings of the Dēmos *National Survey on Credit Card Debt of Low- and Middle-Income Households* reinforce the urgent need for reform.

African Americans are more likely to be called by bill collectors, and to have seen credit tighten

A poor credit score can lead to worsening terms, higher fees, and reduced availability of credit. In the most drastic cases it can lead to harsh consequences for families, like having property repossessed, being evicted, or declaring bankruptcy. While a few members of our survey were vulnerable to each of these complications, we found that moderate-income African Americans are far more likely than other groups to be called by bill collectors as a result of debt. In addition, when faced with higher interest rates, African Americans were less likely to shift away from credit card use, possibly because they have fewer assets to leverage for necessary spending.

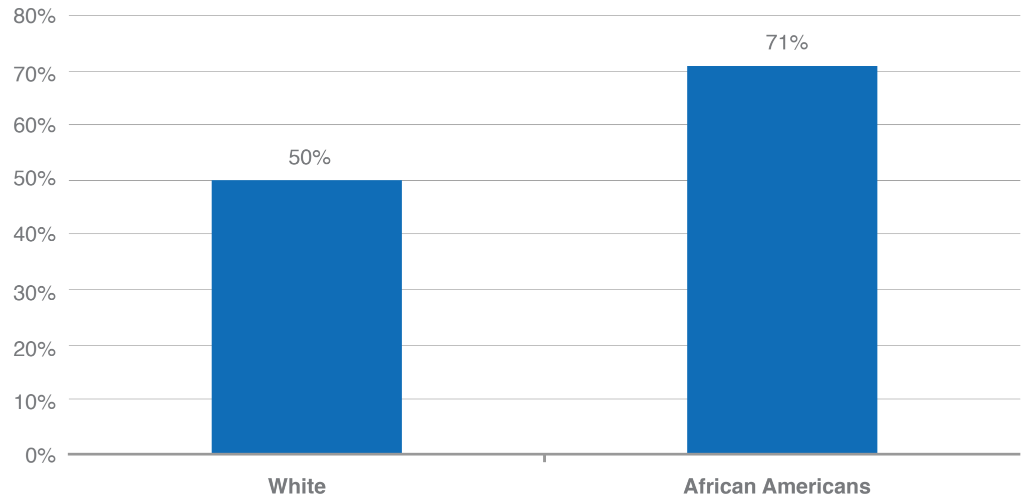
When credit dries up in the economy, consumers with poor credit will feel the effects first. After the financial crisis froze credit markets in 2007, lenders tightened the amount of credit available, cutting lines of credit and imposing higher standards for lending. Those moderate-income families who depend on credit cards to make ends meet were doubly impacted —facing a severe recession that both destabilized the households with the lowest incomes and shrank the availability of credit in the economy. Our survey found that credit-tightening practices hit African American households hardest; more indebted African American households reported feeling some effects of the credit squeeze on the availability of credit than indebted white households.

In our survey of moderate-income households who carried credit card debt for at least three months, **there were no significant differences in the frequency of African American and white households declaring bankruptcy, being evicted, or having property repossessed. African American households were far more likely than whites to be called by bill collectors as a result of their debt. We found that 71 percent of African American households had been called by bill collectors, compared to 50 percent of white households** (*see Figure 8*).

FIGURE 8.

African Americans are more likely to be called by bill collectors

Yes responses to 'Have you ever been called by bill collectors when dealing with debt?'

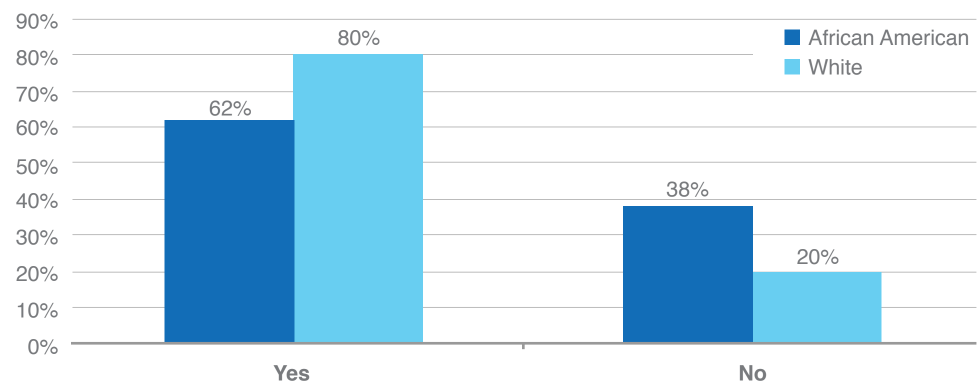


We also found no significant differences in the number of times African Americans and whites were late on a credit card payment or faced a higher interest rate as a result. However, African American and white households responded differently when faced with higher interest rates. Looking at comparable populations who were equally likely to pay their credit card bills on time, **African Americans were less likely to change the frequency of their card use when their interest rate increased because of a late payment. While 80 percent of white households changed their card use, only 62 percent of African American households made the same change (***see Figure 9***).** The greater likelihood of white households responding to an increased interest rate by changing their credit card use suggests that white families are more likely to be able to turn to other options for short-term liquidity. African American households, in contrast, may not decrease their credit card use when interest charges climb because other sources of liquidity are not available or are even more expensive – like payday loans, for example.

FIGURE 9.

Despite similar rates of late payment, African Americans are less likely to change card use when facing a higher interest rate due to late payment

Has getting your interest rate increased because of a late payment changed how frequently you used the card?

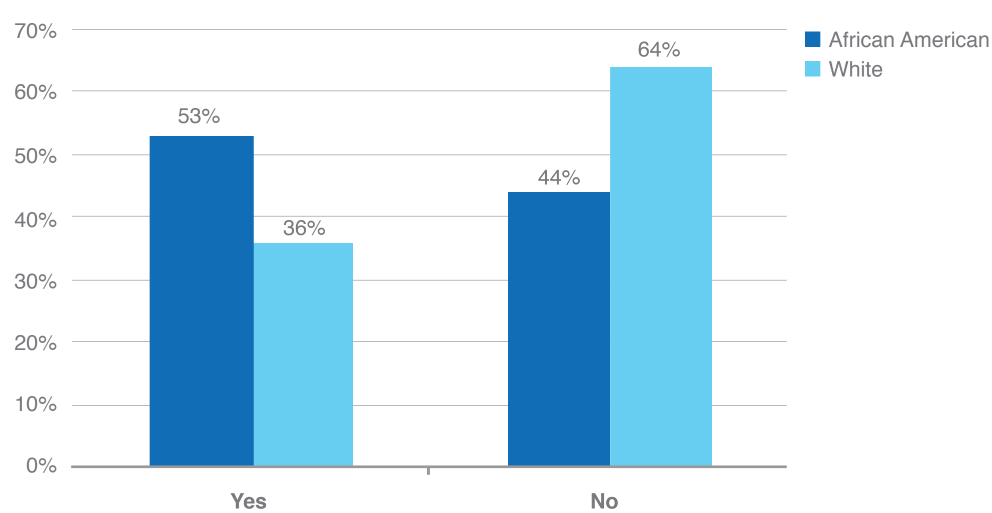


As a response to the financial crisis, credit card companies curtailed the amount of credit they would extend and households faced a sudden reduction in credit availability in the economy overall. Many households who applied for new credit cards were denied, others had existing credit limits reduced or cards cancelled altogether. **Our survey found that African American households are more likely to have felt some impact from credit tightening since 2008. Just over half of African American households reported having a credit card cancelled, credit limit reduced, or being denied for a credit card in the three years following the recession (***see Figure 10***).**

FIGURE 10.

African Americans were disporportionately impacted by the credit crunch

In the last three years, have you had credit cards cancelled, credit limit reduced, or applied for and been denied a credit card?



Policy Recommendations

The American middle class has endured decades of rising costs while income gains lagged behind. Facing household budget shortfalls for essential spending that expanded over time, families turned to credit card debt in order to maintain a middle class standard of living. Our survey reveals that the struggle to make ends meet under diminishing income growth, private assets, and social investments has led 4 out of 10 households with credit card debt to rely on their credit cards just to get by.

The economic challenges facing all Americans are only compounded in African American households, who over the same period bore the outcomes of racial discrimination, including slow gains toward equality in income, persistent disparities in employment, and a widening gap in wealth ownership. While this study focuses on the particular circumstances of African Americans, the difficulties facing low- and middle-income Americans are widespread and require renewed consideration of how the nation deals with debt and credit.

The establishment of the Consumer Financial Protection Bureau and the implementation of the 2009 CARD Act are positive steps toward providing greater protection for America's weakened middle class. In addition, state-level policies like those regulating the use of credit checks for hiring decisions have the capacity to limit unnecessary and harmful barriers to employment. Protections that establish fair, non-predatory credit practices relieve an already overburdened and increasingly insecure middle class from the high cost of debt.

The results of our study point to three areas where new policies are required: medical debt, financial regulation, and credit scores. We also identify industry practices that were not addressed by the CARD Act but which remain critical to the fairness and security of consumer credit.

Medical Debt

MEDICAL DEBT PROTECTION

Emergency health expenses can run into the thousands of dollars and burden families for years after they have recovered from the physical trauma. In the decades since the 1970s employers shed health care benefits as a provision of employment and households turned to debt to finance critical health expenditures. After decades without a policy response, the Patient Protection and Affordable Care Act (ACA) finally offers a solution that can lower the individual cost burden for health care. Yet medical debt will not cease to exist, and the rising cost of health services and lower insurance rates among people of color make it difficult to guarantee adequate coverage and quality of care. Since medical debts continue to accrue, there must be fair and non-discriminatory practices for their collection. Medical lending practices should not be permitted to use evaluations of the total credit available to patients. The appropriate financial services guidelines for health care facilities should be under the purview of the Consumer Financial Protection Bureau (CFPB). Moreover, as unexpected medical expenses offer little information about the character of the consumer, medical debt should excluded from credit scores altogether.

Financial Regulation

BORROWER SECURITY

Many moderate-income African American households rely on credit to make investments in their futures and often just to meet their basic needs. Because credit plays an essential role in the financial security of Americans, it should be governed by fair and responsible practices. The CARD Act began the industry reforms necessary to establish prudent guidelines and accountability for credit card companies. Federal legislation protecting borrowers by setting national usury limits, indexed to a federal rate, would complement the provisions of the CARD Act. Such legislation would provide borrower security by eliminating unjustifiably high interest rates on credit products ranging from credit cards to student loans and limiting late fees to $15 per late payment. Several states have already enacted reforms that cap the interest rates of high-cost payday loans (See State-level policies for a fair credit market), showing the possibilities for state and local legislation to regulate the industry and protect consumers.

FAIRNESS IN BANKRUPTCY

Indebted moderate-income African American households need reasonable and straightforward options as they work toward restoring their balance sheets. As a last resort, declaring bankruptcy should provide the opportunity for families to reconcile their debts, including mortgage and student debt. In order to make bankruptcy a fair option to consumers, bankruptcy law should be amended in two ways. First, courts should be permitted to restructure the debt on home mortgages by setting interest rates and principal at commercially reasonable market rates and permitted to extend repayment periods. Secondly, judges should be allowed to discharge student loan debt. Our survey found that 40 percent of African American households that have poor credit scores have seen their scores drop due to late student loan payments and that half of parents who helped pay for a child's tuition still have credit card debt from the expense. Incorporating student loans into bankruptcy policy will make it possible for families to work for a better future without being crippled by the cost of education.

DISPARATE IMPACT

As this report notes, African American households with credit card debt face worse consequences of debt than other groups, including a greater likelihood of calls from debt collectors. The different experiences of African Americans and whites in the credit market could indicate disparate impact, in much the same way disparate impact appears in mortgage and auto loan markets. The results of our survey suggest a need for investigation of predatory lending in the credit market by the CFPB for evidence of disparate impact.

Credit Scores

FAIR AND ACCURATE CREDIT SCORES

Our survey found that African Americans are far less likely than whites to report a good or excellent credit score, aligning with a larger body of research showing that credit scores are correlated with race. Moreover, a startling 40 percent of those with poor credit scores have identified errors on their credit report that contribute to the low score. A stronger role for the CFPB could begin improvements in the transparency, validity, and appropriate use of credit reports and scores to ensure accuracy and accessibility of credit reports and the regulation of reporting information. In addition, all medical debt, disputed claims, and unsafe credit products should be excluded from the report. The improvement of reporting and access would reduce the biases in credit scores and improve the economic security of both borrowers and lenders.

BAN EMPLOYMENT CREDIT CHECKS

Today, employers commonly look into the credit histories of job candidates as part of the hiring decision. While there is no evidence linking credit reports to trustworthiness or dependability, credit reports have repeatedly been shown to have race and income biases that make the practice of employment credit checks highly discriminatory.[27] Using credit reports as criteria for hiring exacerbates the economic hardships facing households that may have had a medical emergency, a divorce, a layoff, or for those that experienced the most severe fallout from an economic downswing. Ten states have already passed legislation limiting the use of employment credit checks because of these issues (see State-level policies for a fair credit market). We suggest that the US adopt the Equal Employment for All Act, a federal law establishing uniform restrictions on credit checks for employment.

Extend the Successes of the CARD Act

The CARD Act is working for American households by standardizing best practices industry-wide. Our research and recent data from the CFPB show that consumers are better equipped to make informed choices and less subject to abuses in the areas addressed by the legislation—such as fair and transparent pricing.[28] The provisions of the CARD Act include protections that grant consumers better knowledge and control over their finances, including requiring credit card providers to make the due dates for payment the same each month, allocating payments made above the monthly minimum to the highest interest rate balance first, and eliminating high-fee over-the-limit spending unless customers explicitly opt-in to the service. American households have seized this opportunity to pay down balances and avoid fees.

Some card issuers responded to the legislation with voluntary product improvements, including an increased commitment to customer service and attention to received complaints.[29] Yet problems of inadequate transparency and injurious costs remain. In their evaluation of the CARD Act, the CFPB identified a number of areas where credit card companies could promote higher standards of service. The best practices would treat add-on products, such as supplementary protections and credit monitoring, with the same standards of transparency and disclosure as are required for lines of credit, even when provided through third-party contracts. Application fees—currently excluded from the standard imposed by the CARD Act that states fees cannot exceed 25 percent of the total credit line in the first year—would be included in the first-year calculation of fees to ensure that the ratio of costs to credit remains reasonable. Moreover, a high standard for clear disclosure related to rewards programs, grace periods, and products that defer interest for an introductory period would complement the practices already covered by the CARD Act.

STATE-LEVEL POLICIES FOR A FAIR CREDIT MARKET

In the absence of effective federal legislation, consumer groups and citizens organizations have shown a way forward for curbing abusive debt collection practices at the state level, imposing limits on the interest rates charged by non-traditional lenders and banning employment credit checks.

FAIR DEBT COLLECTION

Industries that thrive on abusive debt collection practices but have escaped federal legislation can and should be regulated at the state level. In many cases, consumer debt purchased by third-party companies is litigated in state courts for automatic settlement without proper notification and transparency for the buyer. The process results in debtors, often unknowingly, faced with financial penalties and damaged credit reports that can sabotage their economic security for years. A 2011 study by the New Economy Project showed that in many cases the collection process deprived the consumer of their due process rights when debt buyers brought cases that lacked legal substantiation but either did not provide proper notification to the consumer or intimidated them into settlement.[30] Following a spate of unfair collection actions in New York, the Senate enacted the Consumer Credit Fairness Act in 2013. The law requires official notice of any legal collection action, including detailed information regarding the debt in question, and introduces a 3-year statute of limitations for collection. Similar provisions are included in the Model Family Financial Protection Act, proposed by the National Consumer Law Center, and extended to a diverse range of lenders including banks, credit card issuers, and non-traditional lenders.[31]

REGULATING NON-TRADITIONAL LENDERS

The exorbitant interest rates that accompany payday loans—with rates as high as 400 percent annually—can trap consumers in a spiral where low income requires increasingly high borrowing, even for small loans.[32] Although more than 12 million Americans turn to this source of credit each year, the industry preys on borrowers in the weakest financial positions who use the loans for basic living expenses like rent, utilities, food, and emergency repairs.[33] Strong usury laws at the state-level can prohibit payday lending entirely, or restrict it with double-digit caps on the allowable interest rate. To date, 17 states and Washington DC have enacted legislation capping the allowable interest rate on payday loans. Other laws limit the maximum amount and length of borrowing in the industry; according to the Center for Responsible Lending, one such law has already saved consumers more than $122 million in fees.[34] In addition to direct regulation of non-traditional lenders, states should encourage affordable alternatives for the populations most likely to rely on last-minute emergency loans.

BAN EMPLOYMENT CREDIT CHECKS

Ten states have already passed legislation limiting the use of employment credit checks. Unfortunately, none of the existing state laws fully addresses the problem because all include unjustifiable exemptions that allow the discriminatory practice to continue in many job categories. Since one in five borrowers has a material error on their credit report, and since poor credit histories are more likely to be associated with low incomes than personal trustworthiness, the exceptions can undermine the job prospects of even the most responsible applicants.[35] Those states with legislation that falls short should move to tighten the laws so that exemptions only exist where there is a proven link between credit history and job performance. In June of 2013, the New York State Assembly passed one of the nation's strongest bills on employment credit checks, leaving no inappropriate exemptions. The New York bill provides a guide for state-level action in the future.

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