## About Dēmos

Dēmos: A Network for Ideas & Action is a non-partisan public policy research and advocacy organization committed to building an America that achieves its highest democratic ideals. We believe this requires a democracy that is robust and inclusive, with high levels of electoral participation and civic engagement; an economy where prosperity and opportunity are broadly shared and disparity is reduced; and a strong and effective public sector with the capacity to plan for the future and provide for the common good. Founded in 2000, Dēmos' work combines research with advocacy—melding the commitment to ideas of a think tank with the organizing strategies of an advocacy group.

## About the Economic Opportunity Program at Dēmos

The Economic Opportunity Program addresses the widespread economic insecurity and declining opportunity that characterizes American society today. Our efforts focus on envisioning and ensuring the future middle class by promoting new ideas in the areas of higher education, income and asset-based policy. Our work examining the growth of personal debt among low- to middle-income households is indicative of the new challenges Americans face as they try to get by—let alone get ahead.

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# YOUNG ADULT ECONOMICS SERIES

# Generation Debt:
## Student Loans, Credit Cards, and Their Consequences



**Winter 2007**

Debt has become a generation-defining characteristic for today's young adults. The problem often begins with student loan debt, which today affects both community college and university students. In addition, today's young adults are relying more on credit to cover basic living expenses, particularly during those first few years in the workplace. As starting salaries have failed to keep pace with rising student loan bills, housing costs or health care costs, for many young adults the credit line becomes a life line. The ensuing debt is exacerbated by a host of credit card industry practices such as universal default and penalty interest rates, which make it exceedingly difficult to pay down the debt in a timely manner. Rising debt also threatens the ability of young adults to manage the costs of day-to-day living, build assets and save for retirement, and support a family.


A Dēmos Policy Brief (#3)
A Network for Ideas & Action

# Choked by Student Loans

During the 1990s, the percentage of students who borrowed money for college rose dramatically. In response to the economic pressure placed on families by the rapidly growing cost of higher education, in 1992 Congress established a new unsubsidized federal loan program open to all students, regardless of their family's income. The new loan program allowed middle- and upper-income students to borrow money for college, and student loan volume has grown quite rapidly in the ensuing years. Low-income students, however, are still more likely than their higher-income counterparts to borrow for college.

» In the 1992-93 academic year, just over 49 percent of graduates from 4-year state universities had taken out federal student loans. By the end of the decade, nearly 65 percent of college graduates had taken out such loans.[1] In the decade since the legislative change, inflation-adjusted student loan volume has risen by 137 percent.[2]

Statistics from the Department of Education confirm that rising tuition and the relaxation of loan eligibility mean that more students are borrowing, and are doing so at higher amounts.

» Since 1992-93, the average college graduate's student loan debt has grown from $12,100 to $19,300 in 2003 inflation-adjusted dollars. Over a quarter of graduates had debt higher than $25,000, up from 7 percent in 1992-93.[3] Today, one-third of community college students borrow to pay for school, with an average debt of $8,700.[4]

» Student loans pose an even greater challenge for borrowers who leave school in debt, but without any diploma. One out of five students who borrow money for school drop out before getting their diploma.[5] These borrowers are more likely to be employed in low-paying jobs, which make paying off student loans even more challenging: 22 percent of borrowers who drop out default on at least one of their loans.

As students borrow more for college, they face a growing debt load once they graduate. This increased debt can influence decisions about where to live and can have an impact on career and family choices. According to a survey conducted by the Nellie Mae Corporation, the average college graduate spends $180 a month to repay student loans.[6] The first two years after college are particularly difficult, with about 16 percent of earnings going toward loan repayment during those years.

» In 2002, 14 percent of young adults reported that student loans caused them to delay marriage, up from 7 percent in 1991.[7] One in five said their debt has caused them to delay having children, up from 12 percent in 1991. Seventeen percent changed careers as a result of their student debt, about the same as in 1991.

Despite the costs and the side effects, most young adults do believe that the personal growth and career opportunities of a college degree make the debt worthwhile. Student loan debt, however, is only part of the story. Over the last 10 years, young adults have also incurred record levels of credit card debt. Prior to the 1980s, credit card debt was virtually nonexistent. According to data from the Federal Reserve, in 1983, the median consumer debt for 25-to-34-year-olds was $3,989 (in 2001 dollars).[8] By 2001, the median consumer debt for households under 35 had tripled to $12,000.[9] Consumer debt consists of all debt other than mortgages, so it includes things like student loans, car loans, and credit card debt.

# The Plastic Safety Net

Credit card debt among young adults cuts across many demographic categories—college-educated, non-college-educated, male, female, African American, Latino and white. During the 1990s, credit card debt among those under age 34 grew by 47 percent and, according to findings from the 2004 Survey of Consumer Finances, young adults are more indebted than previous generations were at the same stage of life.

» Young adults between the ages of 18 and 24 have 11 percent higher credit card debt than those who were that age in 1989. Today, the average debt of the youngest adults is $2,305. Young adults between the ages of 25 and 34 are also deeper in debt. In 2004, 25-to-34 year-olds averaged $4,358 in credit card debt—47 percent higher than it was for Baby Boomers who were in that age group in 1989.[10]

Additional survey research conducted by Demos of low- to middle-income households found that, in 2005, the average indebted adult under age 34 had just over $8,000 in credit card debt. According to these households, the most common reasons for their credit card debt were car repairs, loss of a job, and home repairs. Forty-five percent of those under age 34 reported using credit cards in the last year to pay for basic living expenses, such as rent, mortgage payments, groceries and utilities.

The rise in credit card debt, coupled with the surge in student loan debt, is the main reason why today's young adults are spending much more on debt payments than the previous generation. On average, 25-to-34-year-olds spend nearly 25 cents out of every dollar of income on debt payments, according to the Federal Reserve's data.[11] That's more than double what Baby Boomers of the same age spent on debt payments in 1989. The fact that young adults are already spending a quarter of their income on debt is particularly worrisome because most in the 25 to 34 age group aren't homeowners. So that 25 cents is going to nonmortgage debt: primarily student loans, car loans, and credit cards.

The growth in debt has even led to an increase in bankruptcy among young adults. By 2001 nearly 12 out of every 1,000 young adults aged 25 to 34 were filing for bankruptcy, a 19 percent increase since 1991.[12] Young adults now have the second highest rate of bankruptcy, just after those aged 35 to 44.

The two-decade-long rise in credit card debt has coincided with the deregulation of the credit card industry, which has been a mixed blessing for borrowers. It has expanded the availability of credit, but at the same time ushered in an era of higher costs, particularly for lower-income households who often rely on credit cards to make ends meet.

# Credit Card Industry Practices

Deregulation of the credit card industry began with a 1978 Supreme Court decision, *Marquette National Bank of Minneapolis v. First Omaha Service Corp*, which allowed a national bank to charge its credit card customers the highest interest rate permitted in the bank's home state—as opposed to the rate in the state where the customer resides.[13] As a result, regional and national banks moved their operations to more lender-friendly states, such as South Dakota and Delaware, where there were no laws limiting the amount of interest that banks could charge for credit card loans. A second decision by the Supreme Court, in 1996, determined that the same rules that apply to interest rates also apply to fees. The average late fee is now $32, which in 2004 provided $10 billion in revenue for credit card companies.[14]

Today, deregulation of the credit card industry has created an environment where borrowers have little protection from unfair or capricious practices. As the typical solicitation for credit cards now states, the credit card company has the right to change the terms of the account at any time, for any reason. Today, all major credit card issuers engage in the following practices:

» **Rate and fee hikes for late payments.** Although credit card companies often offer low introductory rates, they routinely increase these rates to 29 percent or higher and add fees for a late payment. Late is defined as even one minute past the specified time on the due date.

» **Universal Default.** Credit card companies routinely scan their cardholders' credit scores and raise their interest rates for problems with other creditors, even if the cardholder has never been late or missed a payment.

» **Retroactive Rate Increases.** Credit card contracts typically permit the lender to change the terms of the card agreement at any time for any reason. When credit card companies increase the rate on the card, the new APR is applied retroactively to the existing balance, not just to the purchases made after the rate was increased.

## Aggressive Marketing on Campus

College students are one of the credit card companies' prime targets, and hundreds of schools receive money from credit card issuers in exchange for the right to market on campus to college students. According to Robert Manning, author of *Credit Card Nation*, these types of deals yield the 300 largest universities about $1 billion a year.

Recently, some states have restricted these practices. According to a 2001 GAO report, at least 24 states had introduced legislation to contain credit card marketing on campus. So far, only Arkansas, Louisiana, New York and West Virginia have actually passed legislation.[15] Even if the credit card companies are forbidden to table on campus, however, they have persistently pursued other methods of reaching students.

» Credit cards have become common on college campuses, and in 2002, the average college senior had six credit cards and an average balance of just over $3,200. One in five students has credit card debt between $3,000 and $7,000, and student credit card debt increases with each successive year, more than doubling between freshman and senior year.

While some credit card debt certainly stems from frivolous spending, many students also use credit cards to relieve some of the financial pressures of higher education. For example, about a quarter of students report using credit cards to pay for tuition and books. After graduation, the need for credit often persists as survival debt, particularly for young adults with substantial student loan debt who are unable to turn to their parents for start-up money.

## Saving for the Future

Despite being in credit card debt, many young adults do put at least some money into savings in an effort to build up an emergency fund and save for retirement. Unfortunately, it often isn't until they enter their thirties that they're able to do both. Young adults, however, are not alone in their struggle to save. Over the last 20 years, our nation's personal saving rate has plummeted from about 8 percent through the 1980s and early 1990s to zero in 2005—its lowest point since the Great Depression.[16]

Since the majority of young adults struggle just to pay back their loans and monthly bills, it's not too surprising that most of them aren't saving for retirement. But, contrary to popular opinion, young adults actually are more likely to be saving for retirement—and at higher levels—than were there Baby Boom counterparts.

» According to the Survey of Consumer Finances, in 2004 about 40 percent of workers under 35 were saving for retirement.[17] Compared to young adult Baby Boomers, Gen X is doing a better job planning for retirement: Only 27 percent of under-35s had retirement savings in 1989. The typical Gen Xer has also saved more for retirement by this age than had their predecessors: The median value of Gen Xers' retirement accounts was $11,000 in 2004, up from $5,900 in 1989 (2004 dollars).

## Policy Recommendations

While many young adults understand the need to save for the future, too few young people are able to do so and are actually moving in the opposite direction—toward long-term burdens of personal debt, often at very high interest rates. To contend with rising student loan debt, slow wage growth, prolonged unemployment and higher prices for housing, gasoline and other essentials, more people are financing their young adult years on credit. In a companion policy brief, we outline strategies for reducing student loan debt burdens. The following policy recommendations are aimed directly at helping young people build savings and wealth, and providing a fair chance of paying off their debt.

» **Better regulation of the lending industry** is necessary to curb widespread abusive lending practices that strip income and wealth from young adults, making it nearly impossible for many to pay off their debt.

» **A Borrower's Security Act** would address the most egregious and abusive lending practices of the credit card industry. Credit card companies now routinely triple or quadruple the interest rate for a tardy payment or for any payments made late to other creditors. Congress should stop the excessive profits that come from bilking consumers rather than responsible lending. Universal default should be prohibited, and if a card company wants to raise the interest rate on a credit card, the new rate should only apply to future purchases on the card, as opposed to retroactively applying the new rate to the existing balance.

» Legislation is necessary to **remove the credit card companies from college campuses**, and more states should enact legislation curtailing free giveaways on public campuses.

» Creating a **universal, easily accessible, portable, and equitable savings vehicle**. The accounts should be offered to everyone and should offer progressive incentives to save. The federal government could provide a match through a refundable tax credit that is directly deposited into the workers' accounts.

# Endnotes


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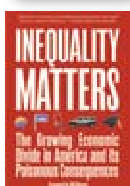


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