Borrowing to Make Ends Meet

The Growth of Credit Card Debt in the '90s

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EXECUTIVE SUMMARY

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$4,126
Average credit card debt for an American family in 2001

Overview

The mid and late 1990s will always be remembered as an era of unprecedented prosperity. But for most American families, the roaring '90s had a dark underbelly—it was also the Decade of Debt.

Between 1989 and 2001, credit card debt in America almost tripled, from $238 billion to $692 billion. The savings rate steadily declined, and the number of people filing for bankruptcy jumped 125 percent.

How did the average family fare? During the 1990s, the average American family experienced a **53 percent increase** in credit card debt, from $2,697 to $4,126 (all figures measured in 2001 dollars). Low-income families saw the largest increase—a 184 percent rise in their debt—but even very high-income families had 28 percent more credit card debt in 2001 than they did in 1989.

$2,697
Average credit card debt for an American family in 1989

Credit card debt is often dismissed as the consequence of frivolous consumption. But an examination of broad structural and economic trends during the 1990s—including stagnant or declining real wages, job displacement, and rising health care and housing costs—suggests that many Americans are using credit cards as a way to fill a growing gap between household earnings and the costs of essential goods and services. Usurious practices in the credit card industry, in the form of high rates and fees, have taken advantage of the increased need for credit. As a result, a growing number of American families find themselves perpetually indebted to the credit card industry, which—despite claims of losses and chargeoffs—remains one of the most profitable sectors of the banking industry.

During the 1990s, the average American family's credit card debt rose by 53 percent.

Key Findings

Average Credit Card Debt Increased by 53 Percent. American families in all income groups rapidly accumulated credit card debt in the 1990s. According to 2001 data from the Survey of Consumer Finances, 76 percent of American families hold credit cards, 55 percent of those with cards carry debt, and the average amount of debt is $4,126.

Average Debt of American Families, by Income Range

Family income group	*Families holding credit cards in 2001*	*Cardholding families reporting debt in 2001*	*Average household credit card debt in 2001*	*Percent increase 1989–2001*
All families	76%	55%	$4,126	53%
< $10,000	35	67	1,837	184
$10,000–$24,999	59	59	2,245	42
$25,000–$49,999	80	62	3,565	46
$50,000–$99,999	90	56	5,031	75
$100,000 or more	98	37	7,136	28

Dēmos's calculations from the Survey of Consumer Finances, 1989, 1992, 1995, 1998 and 2001.

As the previous table shows, between 1989 and 2001:

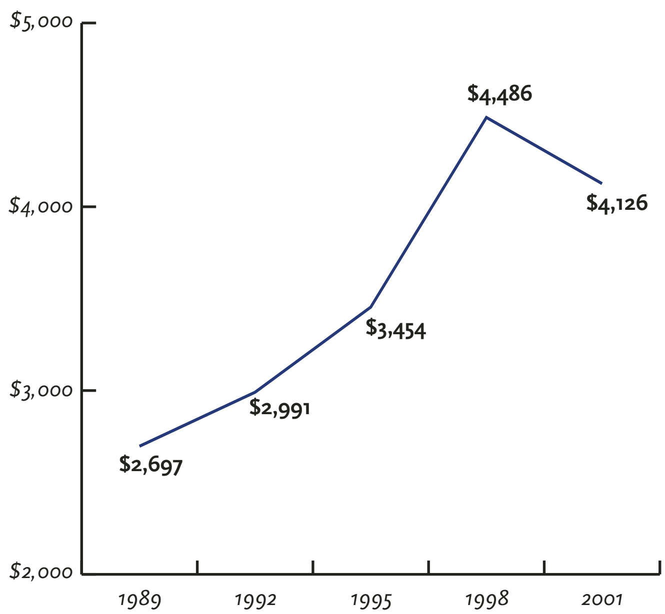
- Credit card debt among **very low-income families** grew by an astonishing **184 percent**. But **middle-class families** were also hit hard—their credit card debt rose by **75 percent**.
- **Very low-income families** are most likely to be in credit card debt: 67 percent of cardholding families with incomes below $10,000 are affected. Moderate-income families are not far behind: 62 percent of families earning between $25,000 and $50,000 suffer from credit card debt.

It is important to note that these figures may be substantially underreported. The absolute figures (for example, $4,126 of average debt) are based on data that consumers reported about themselves in surveys. Aggregate data on outstanding revolving credit reported by the Federal Reserve puts the average credit card debt per household at about $12,000—nearly three times more than the self-reported amount. Although the survey figures may underestimate the severity of credit card debt, they can be compared accurately from year to year, showing us a clear trend: debt skyrocketed for all income groups in the last decade.

It should be noted that while debt substantially increased between 1989 and 2001, average credit card debt fell between 1998 and 2001 for all income groups. Preliminary research and data suggests a portion of credit card debt was transferred using cash-out refinancing, home equity loans, and credit lines—taking advantage of 40-year lows on interest rates during this period. Other factors contributing to the decrease in credit card debt, which is mostly observed in families with incomes less than $50,000, are low unemployment rates and increases in wages during the 1998 to 2001 time period.

However, the declining trend in credit card debt between 1998 and 2001 should be observed with caution, due to the lingering recession that began in March 2001 and the continued rise in unemployment rates.

Average Credit Card Debt in the 1990s



Source: Dēmos

Average Debt by Race/Ethnicity. Though they may be less likely to have credit cards, the black and Hispanic families who do use them are more likely to have credit card debt than white families. The higher reliance on credit cards among black and Hispanic families may reflect the lower than average incomes, savings, and wealth among these groups.

Race/Ethnicity	*Percent holding credit cards in 2001*	*Cardholding percent reporting debt in 2001*	*Average credit card debt in 2001*
All families	76%	55%	$4,126
White families	82	51	4,381
Black families	59	84	2,950
Hispanic families	53	75	3,691

Dēmos's calculations using 2001 Survey of Consumer Finances.

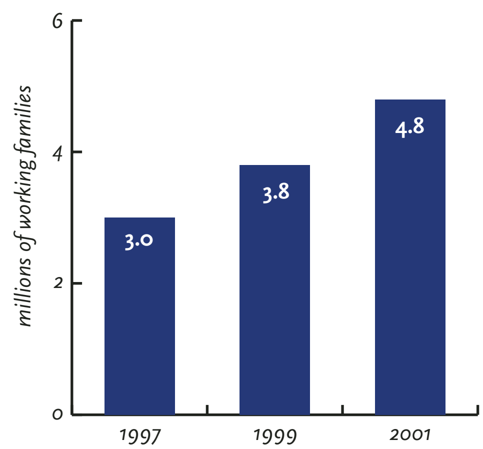
What's Driving the Rise in Debt?

Families with credit card debt are often thought to be shortsighted or ill disciplined, guilty of "living beyond their means." While materialistic pressures or desires are part of the story, major trends in wages, housing costs and health care costs strongly suggest that structural economic factors helped fuel the Decade of Debt.

As the data below indicate, the 1990s saw health care and housing costs rise for many segments of the population, while real wages stayed flat or decreased.

Housing Costs. The number of working families with severe housing burdens—those spending more than 50 percent of their income on housing—grew dramatically in the late '90s. From 1997 to 2001, that number increased by nearly 60 percent, jumping from 3 million to nearly 5 million working families (see graph at right).

Housing Crisis Increased



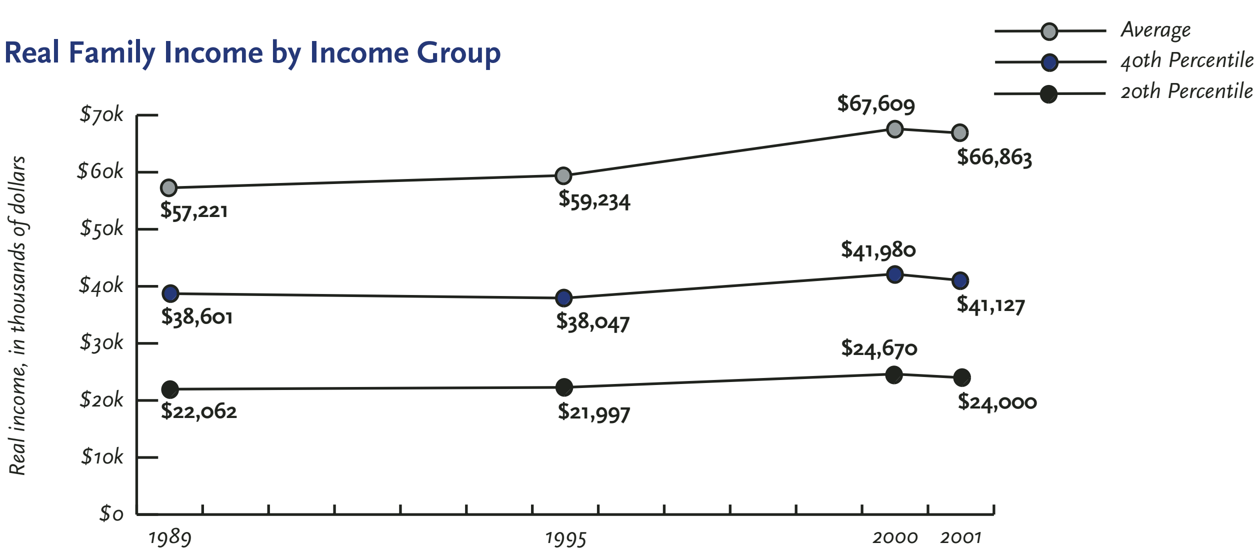
Source: America's Working Families and the Housing Landscape

Health Care. Health care premiums consistently increased over the decade. Between 1989 and 1990 alone, they jumped 18 percent; between 2000 and 2001, they jumped another 11 percent. In addition, the proportion of individuals whose employers paid the full costs of health coverage fell significantly.

Real Income. Real incomes for low- and moderate-income families were stagnant or declining. Family incomes for the bottom 40 percent of the income distribution finally rose in the last half of the 1990s, but quickly declined between 2000 and 2001 with the onset of the recession.

Although more research would be needed to establish a causal relationship between these trends and the concurrent rise in credit card debt, the preliminary data suggest a meaningful association.

Real Family Income by Income Group



Source: State of Working America, 2002

Industry Practices in an Unregulated Market

Since the late 1970s, America's credit card industry has enjoyed a period of steady deregulation. Two Supreme Court rulings, the first in 1978 and the second in 1996, effectively hobbled state usury laws that protected consumers from excessively high interest rates and fees. The rulings allowed national banks to charge the highest interest rate permitted in the bank's home state—as opposed to the rate in the state where the customer resides.

Taking advantage of this deregulatory climate, the credit card companies ushered in a wave of unscrupulous and excessive practices in the 1990s—all aimed at keeping consumers in debt. Some of these practices include:

Aggressive Marketing. Direct mail solicitations jumped from 1.52 billion in 1993 to over 5 billion in 2001.

Relentless Credit Extension. Between 1993 and 2000, the industry more than tripled the amount of credit it offered to customers, from $777 billion to almost $3 trillion. The average cardholding household now has six credit cards with an average credit line of $3,500 on each—for a total of $21,000 in available credit.

Amount of Time and Money It Takes to Pay Off Debt at New "Monthly Minimum" Rates

Credit card balance	*Interest rate*	*Years to pay off debt*	*Interest cost*
$5,000	15%	32	$ 7,665
$5,000	18	45	13,531
$8,000	15	37	12,581
$8,000	18	52	22,260
$10,000	15	39	15,857
$10,000	18	56	28,079

Most credit cards assume a minimum payment of 2 percent of the balance or $10, whichever is higher. Source: Dēmos's calculations.

Lowering of Minimum Payment Requirements. Minimum payment requirements—the amount of their balance customers can pay without incurring a penalty—dropped from 5 percent to only 2 or 3 percent, making it easier for consumers to carry more debt. Assuming an interest rate of 15 percent, it would now take more than 30 years to pay off a credit card balance of $5,000 by making the minimum payment.

Skyrocketing Late Fees and Penalties. Late fees have become the fastest growing source of revenue for the industry, jumping from $1.7 billion in 1996 to $7.3 billion in 2001. Late fees now average $29, and most cards have reduced the late payment grace period from 14 days to 0 days. In addition to charging late fees, the major card companies use the first late payment as an excuse to cancel low, introductory rates—often making a zero percent card jump to between 22 and 29 percent.

The credit card industry's punitive practices have paid off. Despite the industry's complaints about sharp increases in delinquencies and charge-offs, credit cards are continually one of the most profitable sectors in the banking industry. Pretax return on assets, a key measure of profitability, averaged 4.2 percent in 2002, the highest level since 1988.

Policy Recommendations

New legislation is needed to protect consumers from abusive industry practices, including excessive interest rates and fees. Additionally, it is important that policymakers acknowledge the growing economic insecurity facing low- and moderate-income families by addressing the lack of savings and assets, low or stagnant wage growth, rising unemployment and soaring housing and health care costs. The following policy recommendations are aimed at jumpstarting a conversation with policymakers, economic security advocates and asset building organizations.

Addressing Industry Practices

- Enacting a National Usury Law
- Regulating Late Payment Policies
- Increasing the Minimum Payment Requirement
- Improving Disclosure of Cardmember Terms

Expanding Asset Building and Access to Credit

- Scaling up Individual Development Accounts
- Increasing Access to Alternative Forms of Short-term Credit
- Expanding Financial Literacy Education

Addressing Economic Insecurity

- Maintaining Bankruptcy Laws for Families in Severe Economic Distress
- Closing the Gap between Earnings and Costs:
  - Increasing the Minimum Wage
  - Bolstering Unemployment Insurance
  - Expanding Health Insurance Coverage and Access to Quality Early Childhood Education and Care