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Credit Cards and the Poor

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Abstract

We use data from four releases of the Survey of Consumer Finances, 1983 to 1995, to examine credit card use among the poor. The credit card market has expanded rapidly in the general population and, given the often transitory nature of poverty, more and more families may be using credit cards rather than welfare or other means to smooth consumption across income shortfalls. Indeed, from 1983 to 1995, the percentage of poor families holding a credit card rose from less than 20 percent to almost 40 percent, and the average real balance on these cards rose from about $700 to more than $1,300. In 1983 the proportion of poor families with a credit card balance more than twice its monthly income was less than 1 in 30, but rose to 1 in 8 by 1995. The growth in debt represents a new and increasingly important development in the nature of poverty since the mid-1980s, and may soon create a need for administrative policy responses in the form of credit and debt management counseling for at-risk families. Among the research questions are raised are (1) Why has the credit card market expanded to include more economically vulnerable households? and (2) Is the new existence of easy credit temporarily softening the impact of welfare reform?

Credit Cards and the Poor

I. CREDIT CARDS: AN OVERLOOKED PART OF THE SAFETY NET?

A credit card is a financial instrument that allows the cardholder to obtain funds at interest from a credit institution, at her own discretion, up to some limit. The funds usually can be used only to make purchases, but sometimes they can be obtained as cash. If repaid within a certain period, usually about a month, the loan is interest-free. If not, the loan may be carried for an indefinite period, always accruing new interest charges, by paying a minimum amount each month. In essence, a credit card is a preapproved loan with flexible repayment options; it is distinguished from other financial instruments by the freedom it gives borrowers to determine the size of the loan and the pace at which it is repaid. As a flexible and readily available source of funds for consumption, credit cards may be used by individuals as a shield against the hardships of income loss, much as they might use precautionary savings or the welfare system. Savings and welfare have both been subjected to far more academic scrutiny than have credit cards, however, especially when it comes to the poor. The purpose of this paper is to provide an overview of credit card use among the poor, using cross-sections of the Federal Reserve Board's Survey of Consumer Finances conducted in 1983, 1989, 1992, and 1995. In the introductory section we present a case for examining the issue. Section II describes the data, Section III presents results, and Section IV discusses new policy and research directions suggested by the findings.

A. The Growth of Credit

Credit card use among the population as a whole has risen significantly in recent years. All household debt as a fraction of disposable personal income has risen from about 50 percent in 1970 to over 80 percent today (Canner, Kennickell, and Luckett, 1995: Figure 1). Between 1983 and 1992, the percentage of all U.S. families holding some kind of credit card debt (which means not paying the

balance every month) rose from 37 percent to 43 percent (Kennickell and Shack-Marquez, 1992; Kennickell and Starr-McCluer, 1994). Although credit card interest rates typically exceed short-term, risk-free interest rates by a significant amount, there is little evidence that these new debt burdens are creating financial distress for the population as a whole. Delinquency rates on consumer debt have not risen (Canner et al., 1995), and while personal bankruptcy cases have risen dramatically in recent years, credit cards do not seem to be the main cause (*American Banker,* 1997).

Nonetheless, the rise in consumer debt in general and credit cards in particular has received some attention from policymakers, but for reasons other than those that motivate this paper. In particular, high interest rates on credit cards (usually 15–20 percent annually) have led some to suggest the possibility of a market failure (Ausubel, 1991; Calem and Mester, 1995), which might then justify government intervention of some kind. However, the high rates may be appropriate for suppliers given the costs of providing borrowers as much flexibility as credit cards do (Canner and Luckett, 1992); to enjoy such flexibility, borrowers might well be willing to pay high rates (Brito and Hartley, 1995). On the whole, the case for market failure seems too weak to justify policy concern.

On the other hand, there may be a reason for policy interest from a strictly normative point of view. As Brito and Hartley (1995) point out, credit cards can be used to smooth consumption across unexpected negative income shocks. As consumption insurance, they have the same immediate smoothing effect as would a fund of precautionary savings (Carroll and Samwick, 1995) or means-tested assistance monies from the state if the shock is bad enough or initial income is low enough (Bird, 1996). For some families, however, a credit card may seem the best alternative ex ante because it is a flexible, no-questions-asked loan that does not require prior consumption restraint (as would precautionary savings) or exposure to stigma and time-consuming hassle (as would welfare). Unlike savings and welfare, though, credit cards have the serious ex post consequence of leaving their users with a debt that must eventually be paid. Consumption is reduced involuntarily for a long period even after income

returns to normal levels. The burden can become very heavy in just a short time; a laid-off worker needs only a few months of living off credit cards to amass a debt several times greater than his normal monthly income. At interest rates of 15–18 percent, it can take years to recover. During those years, consumption is extremely low and there is no chance to build a precautionary savings fund or obtain access to more credit. A family in such a situation borders on consumption poverty and is extremely vulnerable to new economic shocks. From an ex post perspective, it would be better for families to rely more heavily on welfare and savings than on easy, immiserating loans by credit card.

The contrast between the ex ante and ex post optimality of using credit cards as consumption insurance creates a potentially difficult issue for poverty policy. Poverty policy typically does not and usually should not dwell on the ex ante optimality of decisions that ultimately immiserate people. The hardships of elderly poor people are in no way diminished by reminders that it was they themselves who failed to save enough for retirement. The hardships of poor families burdened with heavy credit card debts are similarly real, from a normative and policy point of view. If credit card debt has become a significant aspect of the life of poor people, it is a source of real distress and deserves deeper examination. If nothing else, those who administer welfare reform might benefit from early warnings about changes in the kinds of economic distress they may have to deal with, involving new and heavy demands for debt management services.

B. Indirect Indicators of New Debt Problems among the Poor

Several recent trends suggest that we should explore whether credit card burdens have grown among the U.S. poor. As credit card usage has risen, so have wealth, income, wage, and consumption inequality (Wolff, 1994, 1995, 1992, 1987; Gottschalk, 1997; Danziger and Gottschalk, 1993; Cutler and Katz, 1992). How has the availability of credit affected those in the lengthening lower tail? Recently, welfare caseloads have fallen dramatically in advance of national welfare reform. While the trend

certainly can be explained by a combination of economic improvements, state welfare waivers, and anticipation effects, might it also be due partly to a greater reliance on credit cards to maintain consumption?

For the most part, the literature on wealth has not focused on questions such as these, being generally more concerned with concentration at the upper end of the scale (e.g., Wolff, 1994). A Federal Reserve Board (FRB) study has shown, however, that the percentage of low-income households (less than $10,000 annually) with consumer debt of any kind increased from 40 percent in 1983 to 45 percent in 1992 (Canner et al., 1995). The *median* amount owed by such households rose from $900 to $1,400, which would exceed one month's income for even those with the highest incomes in this group. The median ratio of debt payments to income among these low-income households rose from 10.1 percent in 1983 to 13.4 percent in 1989 before dropping to 11.6 percent in 1992. The FRB study does not report data specifically for credit cards, so it is not clear how relevant these patterns are for credit card insurance effects as opposed to durables consumption, home equity, and so on. Moreover the FRB study does not adjust incomes for family size, so only a poor correlation exists between the defined "low income households" and households that are poor according to the federal poverty guideline. Nonetheless, the patterns lend credibility to the idea that credit card debt is growing among persons at the lower end of the income distribution.

II. DATA

We use data from the FRB's Survey of Consumer Finances (SCF), which has been conducted every three years since 1983. To take account of the business cycle, we use data from the 1983 and 1992 surveys, both at the end of recessions, and from the 1989 and 1995 surveys, both during long growth periods. The structure of questions differs slightly among surveys, but we are able to construct

comparable measures across years for most of the variables of interest to us. Our analysis is based entirely on comparing cross-sections; we ignore for now the panel information available in the SCF.

The SCF is a household-level survey that obtains extensive information on assets, liabilities, and the usual household characteristics at the time of the interview, as well as recalled information on income, work patterns, and events over the past year or several years. Its information on credit cards includes the number of cards held by household members, type of card(s) (bank, gasoline, department store, etc.), amount of any balances, new charges, and frequency of payments. A "household" is a "primary economic unit" (essentially a head of household) and his or her dependents. Therefore household members are not necessarily related by blood lines, nor does a household include everyone living under the same roof. The SCF oversamples wealthier households; we use weights provided by the FRB to make the sample representative of the U.S. population as a whole. Unweighted, there are 4,103 observations for 1983, 3,143 for 1989, 3,905 for 1992, and 4,298 for 1995.

In previous work with the SCF, Wolff (1994) has noted some discrepancies between aggregate financial amounts in the Federal Reserve Board Flow of Funds (FOF) accounts and weighted estimates of these amounts in the SCF. On the asset side, these discrepancies are serious mostly with respect to financial securities and stocks, for which Wolff applies a proportional adjustment. On the debt side, the gross category of "nonmortgage debt" is underreported in the SCF by about half relative to the national FOF accounts. Fortunately, on the debt side the problem seems to lie with the FOF (for methodological reasons) and not the SCF. Wolff reports that adjusting the SCF debt to match the FOF gives 28 percent of the SCF sample negative net worth (!); the FOF amount thus seems to be an overestimate. This, coupled with the fact that most error on the asset side derives from holdings more typical of the wealthy (stocks and bonds), makes us confident that the SCF accurately reports credit card debt of middle- and lower-income households.

We base much of our analysis on contrasts between all households and poor households. To determine poverty status, we apply the household's reported income in the given year to that year's official federal poverty line for families of the size of the responding household. Then we remove from the poverty sample all households with nonhousing wealth of over $100,000 in real 1995 dollars.

III. PATTERNS OF CREDIT CARD USE

Overall we find significant movement in several key indicators of credit card use between 1983 and 1995. Some of the movement is related to the business cycle, but much of it, particularly among the poor, seems to represent long-run change. These movements can be summarized as follows: During the growth period of the 1980s, poor households expanded their access to credit but lowered their debt burdens, while nonpoor families acquired both more credit and more debt. During the 1990–91 recession, while nonpoor households moderated their growth in credit and debt, poor households greatly increased both. After the recession, however, the usage patterns did not return to their mid-1980s form; in the growth period of the 1990s, both poor and nonpoor families have dramatically increased their access to credit cards and the average debt balance. Much of the growth in credit card use at the low end of the income distribution seems to be secular rather than cyclical.

A. General Patterns

Table 1 presents overall statistics from the SCF related to credit card use. In 1983 nearly two-thirds of U.S. households had at least one credit card; by 1995 more than three-fourths did so, and among these the average number of cards held was more than five. The increase in the percentage holding cards from 1983 to 1995 among all households (from 65 percent to 77 percent) was smaller in both absolute and relative terms, however, than the increase for poor households, from 18 percent in 1983 to 39 percent in 1995. The number of cards held appears to be cyclical, rising during the growth periods (1983–89 and

TABLE 1

Patterns of Credit Card Use

Credit Card Usage	All Households			
	1983	1989	1992	1995
% owning at least 1 card	65.4	69.7	74.3	76.6
Among them:				
Average number of cards	5.0	5.7	5.1	5.4
% carrying a balance	56.6	57.9	59.0	61.9
Average balance	751	1362	1366	1852
Average charges per month	—	554	429	618

Credit Card Usage	Poor Households			
	1983	1989	1992	1995
% owning at least 1 card	18.4	22.5	36.6	38.9
Among them:				
Average number of cards	2.5	3.0	2.9	3.1
% carrying a balance	58.7	54.1	71.7	68.1
Average balance	723	352	917	1347
Average charges per month	—	219	121	192

Source: Federal Reserve Board, Survey of Consumer Finances.

Notes: "—" indicates data were not available in that year. All money figures are in real 1995 dollars. Poverty is determined by applying the federal poverty line definitions of the survey year to reported household income that year, then removing households with more than $100,000 in nonhousing net worth.

1992–95) but then falling during the 1990–91 recession. Yet the overall trend is upward. If each card has roughly the same limit, an increase in the number of cards indicates an increased availability of credit.[1] In an era of increasing income inequality, the U.S. poor were becoming relatively worse credit risks over this period, making the increased willingness of companies to extend credit to this group all the more striking.

Among all card-holding households, the growth period of the 1980s resulted in a near doubling of total credit card balances, which rose from $751 in 1983 to $1,362 in 1989 (all figures in real 1995 dollars). Among card-holding poor households, however, balances fell from $723 to $352 in the same period; apparently to some extent the poor use an economic upturn to restore their credit, while the nonpoor use it to exploit theirs. Opposite patterns emerged during the recession. By 1992 the balances of the poor had more than doubled to $917, while those of all households had risen only slightly to $1,366. In 1992 about the same number of households overall carried a balance as in 1989, but the percentage of poor households carrying a balance had risen from 54 percent to 72 percent.[2] Moreover the recessionary slump caused all households to reduce average new charges. Once growth resumed, however, new patterns emerged. While the nonpoor resumed the increase in balances (as in the 1980s), the poor now also built up balances instead of paying them down as before.

Vulnerability is not limited to the very bottom of the income distribution, of course; indeed the lowest-income household is no longer vulnerable since it has already been subjected to all of the worst events. Real economic risk is the probability of significant income losses and a decline into poverty; it is

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[1]The SCF does not provide information on the cards' limits over time, so it is impossible to observe directly the amount of credit available. The credit per card could have gone down over the 1980s. In that case, however, average balances could not have risen substantially, as in fact they did. The rise in balances leads us to conclude that the number of cards is an adequate proxy for total amount of credit.

[2]The results reported by Kennickell and Shack-Marquez (1992) and Kennickell and Starr-McCluer (1994) do not match ours exactly because they examine all households while we generally look at card-holding households only. Among similar populations, our numbers are very close to theirs. For example, among all 1992 households we find that 41.4 percent carry some credit card balance; they report that 43.4 percent do.

highest among the near-poor (defined here as 100–150 percent of the poverty level) and the lower middle class (defined here as 150–200 percent of the poverty level) and is not negligible even among upper-income households (defined here as greater than 200 percent of the poverty level) . Table 2 shows that reliance on credit cards has risen throughout the income distribution. By 1995, 39 percent of poor households held at least one credit card, as did 58 percent of near-poor households, 71 percent of lower middle class households, and 89 percent of richer households. Among those holding credit cards, the distribution of the number of cards is fairly flat given the distribution of resources: the poor have 3.1 cards, the near-poor 3.9 cards, the lower middle class 4.2 cards, and upper income 5.9 cards. Among nonpoor households, the distribution of balances, and hence credit, is very flat, as near-poor households carry balances of about $2,000 while richer ones carry about $1,400–$1,900. Overall, the near-poor and those with higher incomes have about the same credit situation in 1995; based on "% carrying a balance" and "average balance," the near-poor households make greater use of credit cards.

This was not the case in 1983, however. In 1983 the average balance held by households just above the poverty line was only 56 percent of that held by upper-income households; only 40 percent of the near-poor had credit cards while 81 percent of upper-income households did. In this and the middle group (150–200 percent of the poverty level), the 1980s were a period of rapid increase in credit availability and use. Interestingly, the 1989–92 recession exposes the same differences in the reasons for having credit as described above. The upper-income groups respond to the recession by decreasing the number of cards held, decreasing the percentage holding a balance, and decreasing or holding constant the average balance; overall this seems to be a pattern of using credit cards as a payment vehicle, so that when a recession reduces consumption, the households use their credit cards less. The near-poor and the poor, by contrast, respond to the recession by increasing the frequency of positive balances and the average balance held; overall this seems to be a pattern of using credit cards as consumption insurance, increasing the borrowing aspects when a recession lowers incomes.

TABLE 2

Credit Cards in the Income Distribution

	1983	1989	1992	1995
Income Below Poverty Line				
% owning at least 1 card	18.4	22.5	36.6	38.9
Among them:				
Average number of cards	2.5	3.0	2.9	3.1
% carrying a balance	58.7	54.1	71.7	68.1
Average balance	723	352	917	1347
100–150% of Poverty Line				
% owning at least 1 card	39.9	50.4	61.9	58.3
Among them:				
Average number of cards	3.2	3.7	3.8	3.9
% carrying a balance	52.6	61.9	65.8	75.8
Average balance	449	948	1100	2070
150–200% of Poverty Line				
% owning at least 1 card	52.7	60.8	73.6	71.3
Among them:				
Average number of cards	3.1	3.9	4.0	4.2
% carrying a balance	56.7	62.0	69.6	63.2
Average balance	488	1291	1098	1409
Above 200% of Poverty Line				
% owning at least 1 card	80.5	85.9	87.7	89.4
Among them:				
Average number of cards	5.4	6.2	5.7	5.9
% carrying a balance	56.8	57.4	55.0	59.8
Average balance	797	1473	1494	1937

Source: Federal Reserve Board, Survey of Consumer Finances.

Note: All money figures are in real 1995 dollars.

A comparison of 1983 to 1995 (Table 2) shows that the use of credit cards rose for everyone on all dimensions. The richer households increased the average balance from $800 to $1,900 in this period, while the near-poor and lower middle class raised their average balances from $450–$500 to $1,400–$2,000. Whether as a payment vehicle for the well-off or as consumption insurance for the poor and near-poor, credit cards are becoming increasingly important throughout the income distribution.

B. Consequences

The mere fact that a household exited the 1990–91 recession poor and with a credit card balance does not immediately imply any extended hardship. Is the balance large relative to income? Table 3 shows the growth in the percentage of households (card-holding or not) with balances larger than monthly incomes. In 1983 only 3.6 percent of all households were in this situation; only 1 percent had balances greater than twice their monthly incomes. Over the next decade these percentages rose dramatically, so that by 1995 almost 16 percent of households had debt-to-income ratios above 1.0 and 8 percent had debt-to-income ratios above 2.0. The incidence of these heavy burdens is as one would expect—the poorer the household, the more likely it is to have a heavy debt relative to income. In 1983 poor households were nearly five times more likely to have a debt twice their monthly incomes than were upper-income households (3.4 percent vs. 0.7 percent). In 1995 they were over two times more likely, but with an overall rate of this heavy debt of 13 percent. That is, in 1995 more than one in eight poor households had *credit card* debt greater than twice as large as monthly income. More than one in six (17.1 percent) had credit card debt as large as monthly income or larger.

The growing incidence of heavy debts, especially among the poor, raises questions about the growing availability of credit. Table 4 presents some indices of credit problems among all households and among the poor. Clearly, credit cards are an increasingly important source of debt. Among all households, the share of debt held in credit cards rose from 27 percent in 1983 to 39 percent in 1995.

TABLE 3

The Incidence of Heavy Credit Card Debt

Percentage of Households with High Ratios of Credit Card Debt to Household Income	1983 (%)	1989 (%)	1992 (%)	1995 (%)
All Households				
Debt to income ratio > 1.0	3.6	8.9	11.9	15.8
Debt to income ratio > 2.0	1.0	3.5	5.7	8.1
Income Below Poverty Line				
Debt to income ratio > 1.0	6.0	6.8	14.9	17.1
Debt to income ratio > 2.0	3.4	4.3	10.7	13.0
100–150% of Poverty Line				
Debt to income ratio > 1.0	4.7	11.9	15.7	22.2
Debt to income ratio > 2.0	0.7	6.4	6.8	14.3
150–200% of Poverty Line				
Debt to income ratio > 1.0	3.1	14.9	13.0	17.4
Debt to income ratio > 2.0	—	7.5	5.4	8.8
Above 200% of Poverty Line				
Debt to income ratio > 1.0	3.0	8.1	10.2	14.3
Debt to income ratio > 2.0	0.7	2.2	4.1	5.9

Source: Federal Reserve Board, Survey of Consumer Finances.

Note: "—" indicates less than 0.5%.

TABLE 4
Indicators of Credit Problems

Questions Regarding Credit Availability	1983	1989	1992	1995
All Households				
Credit card share of all nonmortgage debt (%)	27.2	28.3	32.2	38.6
% of households with new charges this month greater than average monthly income	—	9.8	11.6	15.4
% who have been rejected for credit any time in the last 5 years	12.5	18.5	7.8	7.9
% who at some time in the last 5 years did not apply for credit because of anticipated rejection	8.5	14.8	13.4	17.2
% more than 2 months delinquent on any form of debt at least once in the past 5 years	—	31.4	37.3	32.0
Income Below Poverty Line				
Credit card share of all nonmortgage debt (%)	17.1	17.4	30.4	39.0
% of households with new charges this month greater than average monthly income	—	5.7	11.0	17.1
% who have been rejected for credit any time in the last 5 years	6.0	19.0	24.7	17.7
% who at some time in the last 5 years did not apply for credit because of anticipated rejection	12.8	23.1	21.2	26.6
% more than 2 months delinquent on any form of debt at least once in the past 5 years	—	54.3	49.3	39.0

Source: Federal Reserve Board, Survey of Consumer Finances.

Notes: "—" indicates data were not available in that year.

Credit card debt is equally important among poor households (at 39 percent of all debt), but this is a new development. In 1983, credit card debt was only 17 percent of the poor's nonmortgage debt. Most of the increase occurred during the 1989–92 recession, but it did not stop then. By 1995, in any given month more than one in six poor households made new charges greater than their monthly incomes.

The data in Table 4 also indicate that more vulnerable households than ever are interested in obtaining credit. The percentage of all households that had been rejected for credit in the previous 5 years fluctuated between 8 percent and 19 percent over the business cycle from 1983 to 1995, but the percentage of poor rejectees rose from 6 percent to 25 percent in 1992 before falling to 18 percent in 1995. The percentage of households hesitating to apply because of anticipated rejection rose nearly continually for both groups.

Despite the increase in credit balances, delinquency has not risen dramatically. Indeed, the percentage of poor families with delinquent payments, though high, has fallen since those data first became available in 1989. This is consistent with outside information that the recent rise in personal bankruptcies has not been related to credit card debt. The level of debt keeps rising, but even poor households seem able to reduce consumption sufficiently to make their payments on time.

Overall these patterns raise interesting issues. Despite the heavy burdens they impose, credit cards remain in heavy demand, especially among the vulnerable households at the lower end of the income distribution. Despite the high rate of payment problems, the credit-worthiness of poor households actually seems to have improved. In any case, the intensity and incidence of debt burdens among the poor have been rising.

C. Credit Cards and Marriage, Employment, and the Life Cycle

Table 5 presents credit card information by poverty status and marital status. The frequency of positive balances among all married households, for example, rose from 1983 to 1989, fell from 1989 to

TABLE 5

Credit Cards, Poverty, and Marriage

	All Households				Poor Households			
	1983	1989	1992	1995	1983	1989	1992	1995
Credit Card Usage by Married Households								
% owning at least 1 card	71.9	80.4	83.5	84.4	16.9	28.8	45.1	47.0
Among them:								
Average number of cards	5.3	6.0	5.4	5.8	2.6	3.0	2.6	3.2
% carrying a balance	58.4	60.1	59.3	63.0	71.7	55.1	77.5	69.9
Average balance	844	1477	1513	2070	1091	395	1447	1404
Credit Card Usage by Unmarried Households								
% owning at least 1 card	53.6	55.0	61.8	65.8	19.5	20.5	33.3	35.5
Among them:								
Average number of cards	4.1	5.0	4.5	4.5	2.4	3.0	3.0	3.1
% carrying a balance	52.4	53.5	58.4	60.2	50.8	53.7	68.6	67.0
Average balance	526	1132	1099	1459	497	332	629	1315

Source: Federal Reserve Board, Survey of Consumer Finances.

Note: All money figures are in real 1995 dollars.

1992, and rose again from 1992 to 1995; so did the average number of credit cards. Among poor married households, the pattern is reversed. In the growth years of the 1980s, more households obtained credit cards, but fewer carried balances and the balances carried became smaller. The 1990–91 recession, however, caused balances to rise significantly in this group; in the ensuing 1992–95 growth period, balances declined again. Among married households, the poor use credit cards to smooth consumption while the nonpoor use them as a payment vehicle, and this pattern holds both before and after the 1990–91 recession.

Recall from earlier tables, however, that among poor households overall, this pattern seems to be broken in one respect: after the recession, poor households in general continued to *increase* credit card debt. Table 5 shows that this trend is largely caused by a huge increase in credit card borrowing among unmarried poor households, from $600 in 1992 to $1,300 in 1995. Since this group includes unmarried parents, these figures lead one to suspect some connection between credit card use and the welfare system (a point we consider in the conclusion).

Table 6 repeats the exercise by employment instead of marriage. Again, all households with working heads increased the number of cards and the frequency of holding a balance from 1983 to 1989, decreased them from 1989 to 1992, and increased them again from 1992 to 1995. Working poor households generally did the opposite. Among households with nonworking heads, frequency of positive balances followed patterns similar to those of all poor households, falling in good times and rising in bad, but average balances rose almost continually.

TABLE 6

Credit Cards, Poverty, and Employment

	All Households				Poor Households			
	1983	1989	1992	1995	1983	1989	1992	1995
<u>Credit Card Usage by Households with Working Heads</u>								
% owning at least 1 card	74.9	77.1	81.6	82.5	23.9	34.4	41.1	44.4
Among them:								
Average number of cards	5.2	6.1	5.4	5.7	3.4	3.3	2.9	3.5
% carrying a balance	63.7	65.9	64.9	68.4	65.3	61.6	86.5	75.7
Average balance	873	1654	1627	2200	704	505	1141	1705
<u>Credit Card Usage by Households with Nonworking Heads</u>								
% owning at least 1 card	47.9	54.3	60.6	64.6	16.4	17.2	34.2	35.7
Among them:								
Average number of cards	4.4	4.5	4.3	4.3	1.9	2.7	2.9	2.8
% carrying a balance	36.1	34.4	44.3	44.8	55.0	47.5	62.0	62.6
Average balance	398	507	721	940	735	215	771	1090

Source: Federal Reserve Board, Survey of Consumer Finances.

Note: All money figures are in real 1995 dollars.

Finally, Table 7 presents credit card usage patterns by poverty and age.[3] The patterns are generally as anticipated, with virtually all age groups, poor and nonpoor, showing an increase in credit card usage from 1983 to 1995. Some evidence indicates that the most stable households (aged 46–65) decreased their use of credit from 1989 to 1992, especially if one focuses on the number of cards per households and the frequency of positive balances. However, in general the pattern is of advancing credit usage for all ages, with continually rising average balances for virtually everyone. The most striking patterns occur at the ends of the age distribution. In 1983, the average balance held by the oldest households was only $198; in 1992 it was $539, 2.5 times larger. In 1983, 14 percent of poor households headed by the youngest adults (below age 25) had a credit card; in 1995 the figure was 36 percent. Eighty-three percent of these households carried some debt in 1992, 62 percent in 1995. Among all households in 1995, 77 percent of the youngest households carried a debt while only 33 percent of the oldest did so. In general the frequency of carrying a balance declines with age. Evidently the young rely more heavily on credit cards as a financial instrument, probably because of the absence of a stock of savings.

In summary, the statistics point to the broad-based nature of the growth of credit card use in the U.S. Since 1983 the practice of carrying large debt balances on credit cards has risen significantly for households of many demographic types. The most interesting aspect of the increase is its generality. In the 1980s the flexibility of credit card borrowing became newly available to many people who had not

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[3]The 1983 SCF sample appears to have fewer observations on the poor than the other samples. Some of the statistics we tabulate (e.g., average number of cards) are conditional on having at least one credit card. Thus the right three columns of the table consist of poor households with credit cards, which, when broken into exhaustive age categories, result in relatively small samples in the cells. The precise number of observations behind the value in each cell is more difficult to determine than it is usually, for a technical reason. The SCF imputes missing data using a process that involves some randomness. To improve the accuracy of the imputations, they are repeated five times, so that each observation in the data is actually listed five times. For some real observations, fewer than five of the imputed-value observations are usable, so in the end a cell-sample size of 27 imputed-value observations may be derived from anywhere from 6 to 27 real observations. Given the ambiguity, we simply note for the reader here that the bottom three panels of the 1983 poor-households column in Table 7 contains cells whose real-observation sample size may be below 25. They are certainly less reliable than the figures elsewhere in the table and in the other tables.

TABLE 7

Credit Cards, Poverty, and Age

	All Households				Poor Households			
By Age of Head of Household	1983	1989	1992	1995	1983	1989	1992	1995
% owning at least 1 card								
Age 25 and younger	43.2	48.3	57.7	57.6	13.8	16.7	38.7	36.2
Age 26–35	65.3	66.6	74.1	77.0	14.9	18.0	30.5	35.5
Age 36–45	73.9	76.8	75.3	77.8	17.7	16.9	26.7	35.7
Age 46–55	72.1	76.6	80.3	82.1	17.8	17.4	37.8	40.0
Age 56–65	76.7	70.1	77.8	80.2	26.7	30.4	41.6	38.4
Age above 65	53.9	67.3	71.5	74.2	21.4	30.0	44.0	44.3
Average number of cards[a]								
Age 25 and younger	3.3	4.2	4.1	4.6	2.5	4.5	2.7	3.2
Age 26–35	4.5	5.9	4.9	5.0	2.3	2.3	2.9	2.8
Age 36–45	5.3	6.4	5.4	5.6	2.4	2.1	2.8	3.6
Age 46–55	5.3	5.8	5.9	6.4	3.7	2.3	1.6	2.8
Age 56–65	5.7	5.6	5.2	5.3	3.2	3.8	3.6	2.6
Age above 65	4.8	4.8	4.5	4.7	1.7	2.9	2.9	3.3
% carrying a balance[a]								
Age 25 and younger	62.2	66.2	77.1	76.9	29.4	42.9	82.6	61.5
Age 26–35	68.8	73.9	72.7	75.6	81.3	55.4	85.5	86.6
Age 36–45	68.6	67.4	66.8	73.4	51.8	49.7	92.9	83.9
Age 46–55	61.5	64.6	60.3	66.0	65.7	69.4	64.0	85.6
Age 56–65	47.1	47.8	47.9	52.0	79.9	53.6	48.9	60.2
Age above 65	23.8	26.4	36.8	33.1	48.4	54.5	63.3	50.7
Average balance[a]								
Age 25 and younger	533	1016	1073	1713	250	286	679	504
Age 26–35	932	1888	1545	2212	330	633	980	2989
Age 36–45	1009	1750	1757	2608	476	210	1243	2035
Age 46–55	858	1653	1859	2200	919	358	632	1135
Age 56–65	647	961	968	1496	1977	370	685	755
Age above 65	198	370	631	539	521	253	1049	806

Source: Federal Reserve Board, Survey of Consumer Finances.

Notes: In the 1983 sample, some of the age cells for poor households with credit cards contain fewer than 20 observations. All money figures are in real 1995 dollars.

[a]Conditional on having at least one credit card.

had it before: the young, the old, the unemployed, and especially and more generally the poor. The revolution in credit has been remarkably equitably distributed.

IV. DIRECTIONS FOR FUTURE RESEARCH AND POLICY REFORMS

Statistics from the SCF, 1983–95, have indicated a broad, strong increase in the use of credit cards throughout the income distribution and across many different demographic groups. Most surprising is the intensity of the growth in credit card debt among the poor. In interpreting the pattern of the results, we are inclined to divide the world into two distinct types of credit card users. Some families use their credit cards as a payment vehicle, usually paying off the balance every month but taking on debt when income seems to be secure and rising. These families generally increase their use of credit in good times and decrease it in bad. Another type of family adopts credit cards as a form of consumption insurance, using good times to acquire new cards and to pay off large balances acquired during bad times when income is low. Although our purely descriptive data cannot provide conclusive results, they tend to support such a dichotomy.

For example, this dual explanation is consistent with the idea that poverty is not a permanent state (Ruggles and Williams, 1989). Many of the poor at a given time have not been poor for long; a poor person in 1992 is someone who has probably become poor only as a result of the recent recession, while a poor person in 1989 has become poor despite the recent economic growth. Keeping this in mind, the high postrecession balances among the poor in 1992 fit well with the view that those facing economic risks use credit cards to insure their consumption in hard times. The recession made them poor; they used credit cards to survive; by 1992 they had large balances to pay off. Because of the debt burden, consumption had to fall, as indicated by the 1989–92 decline in average monthly new charges from $219 to $121. Thus credit cards seem to have been an important element of the safety net in 1992.

What are the consequences of credit cards as consumption insurance for the economically vulnerable? Extrapolating the growth we have measured in credit card debt, more than half of all poor families will have credit cards by the year 2002, and the average balance they carry will be more than $1,700 in real 1995 dollars. This represents about 14 percent of the 1995 poverty line for a family of three ($12,158). At interest rates of 15–20 percent, these burdens are heavy and would depress consumption for a long period. At an interest rate of 18 percent, a household with $10,000 annual post-tax income and a credit card debt of $2,000 would take fully 14 months to pay off the debt if it devoted 20 percent of its income—$167 of $833 monthly—to the task. If instead the household made a minimum payment of $50 monthly—6 percent of its income—it would have to do so for more than 5 years to be debt-free. Some households can refinance at lower interest rates, but such options are limited for a poor household.[4] Ex ante it is probably difficult for a poor household to voluntarily save 6 percent of its income for a rainy day; with credit cards, ex post the household becomes committed to setting aside amounts of this magnitude for many years.

The impact of credit cards on the well-being of the poor thus depends on the reasons they are used, and it becomes important to determine why some vulnerable households rely on cards rather than savings or welfare. We suspect that the decisions are explained by aspects of the absolute level of risk aversion, driven by the higher utility consequences of consumption losses among the poor. Faced with dire consequences of an immediate income loss, a poorer household may be much more willing than a richer one to commit itself to a long-run but manageable decline in consumption. A full exposition of these decisions would require a model with transactions costs, since one presumes that many households use credit cards simply as a convenient means of payment. The appropriate model could reveal important

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[4]Recalling the mobility of income, we assume that most poor households obtained their credit when they were not poor; in the 1980s the ability of near-poor households to obtain credit greatly increased. Once a household becomes poor and debt-ridden, obtaining new credit becomes very difficult (as the difference in card-holding frequency at any point in time clearly shows).

theoretical and empirical information about the likelihood that a household becomes permanently immiserated by the use of credit cards. We would like to know how many income shocks are required to put a lower middle class household that relies on credit cards into bankruptcy or long-run consumption poverty.

The results also indicate that the credit card market is growing more by expanding into economically vulnerable populations than by intensifying the use of credit among the economically secure. Given rising wealth inequality in the U.S., it cannot be the case that the credit-worthiness of the poor has improved relative to that of the middle class. One wonders what has changed to make these once-shunned groups into attractive credit consumers. We speculate that the nature of credit risk reporting may offer an explanation. Absent solid information about what other banks are doing, any one bank may be willing to extend credit to a marginally risk-worthy applicant. But if all banks do this, the individual acquires access to credit far beyond his means to repay. In effect the banks overexploit the credit-worthiness of the applicant and deplete the value of the resource he represents. A more careful exploration into credit-reporting technology may reveal that better reporting has allowed banks to avoid the collective-damage problem, freeing up resources to exploit the marginal corners of the market. Better reporting would also open opportunities for more effective and creative price discrimination.

Finally, our results raise interesting questions for welfare policy. Vulnerable households may be treating their credit cards as rainy-day funds. If the political support for means-tested transfers depends to a large extent on their income insurance effect for the middle class, then the increase in credit may explain part of the falling popularity of these programs. We are also intrigued by the time correlation between rising credit and the falling welfare caseload. Is the new access to credit cards allowing people to avoid welfare? Is it easing their transition off the rolls? Even the latter has become more possible than it once was; in our 1995 data 33 percent of welfare recipients had a credit card, up from 15 percent in 1983. If credit cards do play a role, it would be to soften the short-run consequences of welfare reform

while lengthening and hardening its long-run consequences. In particular, a great increase in credit card debt may become a significant hurdle to the new welfare-to-work policies, since they may greatly reduce the disposable income that can be generated from regular gainful employment.

Credit card debt is already a significant item on the balance sheet of poor U.S. households, and all indications are that its importance is growing rapidly. If the trend continues, it will eventually create a need for new services for at-risk households, in the areas of debt management and credit counseling. Policy reforms in this direction have been proposed before, in the context of asset-based anti-poverty programs (Haveman, 1988; Sherraden, 1991). Efforts to provide poor families with manageable assets and opportunity accounts would always have to be accompanied by financial services, since the poor, like the nonpoor, will have much need of counseling from brokers and financial planners. The irony is that while no policies have been adopted with the explicit aim of redistributing assets to the poor, the poor seem to have availed themselves of important consumption-insuring assets through the credit card market. At a minimum, this reveals an interest and willingness among poor families in managing their affairs using net worth accounts instead of current flows. Responding to credit card crises with financial planning services might be a first step on the road to more comprehensive asset-based welfare reforms.

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