



## SECRET HISTORY OF THE CREDIT CARD

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## Interview Elizabeth Warren



A professor of law at Harvard University, Elizabeth Warren is an expert on bankruptcy and an outspoken critic of consumer lenders. She is the author of several books including, most recently, *The Two-Income Trap: Why Middle Class Mothers and Fathers Are Going Broke*. Here, she discusses the range of deceptive and unfair practices she says the credit card companies try to hide in the fine print of card agreements and she lays out the remedies that should be put in place to protect the consumer. She is especially outraged by those who argue that the debt problem facing Americans is really a tiny fraction of the overall economy and that such consumer spending has helped keep the economy afloat. "Seventy percent of American families last year said that they are carrying so much debt that it is making their family lives unhappy," says Warren. "Middle-class Americans, hard working, play-by-the-rules Americans

### You have been studying primarily bankruptcy for the last 20 years. Why bankruptcy?

Because bankruptcy is about financial death and financial rebirth. Bankruptcy is the great American story rewritten. We're a nation of debtors. Why do you think people left Europe to come to the United States? They left because they were in debt. We like to describe it as, "Oh, it was about religious freedom." No, it was about debt. They were looking for a way to escape their debts.

And so they founded this nation, and when they got into financial trouble, you know what they did? They moved west.

And they moved west, and they moved west. And by the end of the 19th century, there was no place else to move,

and creditors could pretty much reach their debtors ... anywhere around the country, and that's when we finally put our first national bankruptcy law into effect. And we've had one ever since. It's the way that people say: "I got out there; I borrowed the money; I did my best; I used that money to

"The reason they're making such extraordinary profits today ... is they have figured out that because the law has turned them loose, they can charge extraordinary interest rates and fees that they never would have been allowed to charge 25 years ago."

play-by-the-rules Americans, Americans who lost a job, who don't have health insurance, who are in the middle of a divorce -- those are the Americans who are carrying enormous credit card debts." This interview was conducted on Sept. 20, 2004.

start a small business or to keep myself going in my job. ... You rolled the dice with me. ... It didn't work. You can have most of what I own, and that's it, though. We'll stop there. We'll declare the default. You write off the part of the debt I can't pay, I'll take my human energy ... and go right back into the game again." That's the whole premise behind bankruptcy. It's about death and rebirth.

### **So that's why it's different here than it is in Europe, for instance?**

Here, unlike Europe, until very recently, we've had a huge consumer credit economy, because people could afford to take the chance. They could afford to get out there and spend next month's paycheck, knowing at some underlying level that if they got laid off or if they got too sick or got hit with big medical bills, that there really is ultimately a way out, that the creditors can't come, strip you down to naked, throw you back into poverty, leave you in the gutters; ... that there is some safety net.

For the same reason, we have a lot more businesses start up in the United States than we have in Europe. Entrepreneurs can get out there and borrow a little money and ... start a hot dog stand or go into consulting. ... They can take those risks, knowing that there is some safety on the other side. It's a big form of social insurance, not for the poor, but for the middle class, for people who are starting businesses, ... people [who] are trying to hold together their families, their jobs; hardworking, play-by-the-rules people. Those are the people ultimately who end up in bankruptcy; people who took the risks we wanted them to take, but for them, it didn't work out.

## And they're not faced by prison or servitude or social --

Not anymore. And you know why we don't put them in prison anymore, or why it is we don't put them in some kind of social servitude? We really want people out there working. We really want people to have a stake in their own futures. And the founding fathers, even before the Bill of Rights, put in a provision that says Congress will have the power to establish a uniform law of bankruptcies. ... It was all about how we want to make sure that people have ... the enthusiasm, the incentive, to get out there and try.

The notion was anyone whose complete income was going to be seized by his creditors, anyone whose farm was all going to be taken away, anything that was produced, wouldn't have very much reason to get up and go to work, wouldn't have very much reason to plough the fields.

So bankruptcy was a way to take the human beings who had gambled and lost and get them back into the game. Better that they be back in the game, working and starting their businesses, so that they earn taxes that help all of us. Better that America believes in a business sense, in rebirth, than in ... the taint of debt ... and some form of death following that.

**So the credit card industry says ... "We provide the credit, in many cases, for people to start businesses ... to buy more, to live a better life, to do things that they could never do any other way." So what's the problem?**

There is no problem if they would do it on terms that are fair and if they would make their contracts transparent so

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In this excerpt from Elizabeth Warren and Amelia Warren Tyagi's book , *The Two Income Trap: Why Middle-Class Mothers and Fathers Are Going Broke*, the authors lay out their argument against the "predatory" lending practices of the mortgage and credit card industries and their effect on American families.

that the person who's borrowing the money is borrowing it in a way that he or she understands and appreciates the risks.

I believe in free markets. I teach contract law; I believe that value is created when two people come together, and they understand a contract, and they say, "I think if I borrow this much money at this interest rate, I can do better than that; I can start a business; I can buy something I want to buy that's going to be important to me, and I can make money out of this proposition." That is a good use of credit. It's a use of credit we've had in the United States since colonial times.

What's changed is [that] when credit was deregulated in the early 1980s, the contracts began to shift. And what happens is that the big issuers, the credit card companies who have the team of lawyers, started writing contracts that effectively said, "Here are some of the terms, and the rest of the terms will be whatever we want them to be." And so they would loan to someone at 9.9 percent interest. That's what it said on the front of the envelope. But it was 9.9 percent interest ... unless you lost your job, or 9.9 percent interest unless you applied for a couple of other credit cards, or 9.9 percent interest unless you defaulted on some other obligation somewhere else that doesn't cost me a nickel. And at that moment, that 9.9 percent interest credit suddenly morphs to 24.9 percent interest, 29.9 percent interest, 36.9 percent interest. Well, you know, ... nobody signs contracts to buy things that say, "I'm going to pay you \$1,200 for the big-screen TV unless you decide, in another month or two months, that it should really be \$3,600 or \$4,200 or \$4,800." But that's precisely how credit card contracts are written today.

**But they would say: "We are trusting you, the consumer, with our money. And we're not asking you what you buy; you can do anything you want with that money. This is not an installment plan, and therefore, in turn, you've got to trust us that the terms have to be profitable to us, in case you do something crazy or ... really unprofitable, and you're going to go bankrupt."**

Well, you see, it's not that "What we want to do is protect ourselves if you become unprofitable for us"; in fact, it's just the reverse. The game now is that people who are borrowing at 9.9 percent interest make only modest

profits for the credit card companies. The really profitable folks are the folks who are right on the edge of bankruptcy, the people who are making those minimum monthly payments, who are late every now and again, who occasionally bounce a check, who have missed some payments on some of their other bills.

...Why are they so profitable? They're so profitable because they're no longer charged 9.9 percent; [now] they're charged 24.9 percent. And as long as they'll make minimum monthly payments, skipping one here, making one there ... that's the single most profitable customer in the credit card portfolio. They're not pricing against risk, as we call it; that is, taking those few customers that they're shocked to discover that they're in financial trouble and maybe behind on their bills, and trying to find a way to inch the price up a little ... to cover the risk. ...

What they're doing is, they've figured out the way to maximize profits for the credit card company. And the best way to maximize profits for the credit card company is lend to everyone at 9.9 percent. And as soon as you think you've got someone who won't be able to go somewhere else to borrow the money, change the price, and move that price way, way up, hit them with \$29 late fees and \$35 fees and \$50 fees, and collect, collect, collect. That's how it is that credit card profits have been rising every year over the past 20 years at the very same time that bankruptcy losses and bad-debt defaults have also been rising.

So think about what that means: Bad debts are going up; that is, the number of dollars they have to write off. Bankruptcies are going up, the number of dollars they have to write off. But credit card profits have gone up even more. Why? Because those people who are going into bankruptcy and the people who look just like them ... are little golden profit centers for the credit card companies.

**But they would say they're just making capital or money available to people in a convenient way.**

Well, in a convenient way, and changing the price after people borrow it. You know, that's a heck of a deal. I don't know any merchant in America who can change the price after you've bought the item except a credit card company. After you have borrowed the \$5,000, they can change the interest

rate from 9.9 percent to 29.9 percent. I just don't know anyone else who can do that.

Hey, listen ... you make exactly the point that the credit card companies keep trying to make: "Hey, ... we don't make anybody take the money." And they're right; they don't hold a gun to anybody's head when they borrowed that money. But they did the much, much slicker way, and that is, they just put it all into contract papers. They put it all in clauses that people can't read. They put it all in things like "universal default terms" and "15 days to change the terms of this contract" and arbitration agreements that [say] "We will hold the arbitrator to see if we have abided by the terms of the contract." ... They have teams of lawyers to figure out just the way to write the contracts that will maximize the profits for the credit card companies and minimize the likelihood that any customer will quite figure out what has happened when he or she uses that credit card.

**But the other side of the coin is that [Federal Reserve Board Chairman] Alan Greenspan and others say that the debt that you are worried about, the debt that people are piling up, the unsecured liabilities, are a really tiny fraction of our overall income. And on the other side, it has helped to, if you will, promote production in the United States, consumption, and kept the economy afloat.**

You know, I love the argument that it's only a tiny fraction of total American income. ... It is a little like saying that we're all sitting around in a bar having a drink, and [Microsoft Chairman] Bill Gates walks in, and we glance over and say: "Hurrah! Average income in this bar just jumped to \$500 million a year."

... For the families who don't carry any credit card debt, you're right; credit card debt is not an issue. But that's where Mr. Greenspan, with respect, is getting a lot of his averages. For the families who are carrying credit card debt ... it's not the richest 20 percent in the United States; they're paying off their cards in full, by and large. It's actually not the bottom 20 percent in the United States; they don't have as much access to credit, and they tend not to run up as much debt in credit cards. It's the middle; it's that heart of the middle class that's carrying substantial credit card burdens.

Right now, for the family carrying a credit card debt, the total is, on average,

more than \$8,000 that they're out there trying to balance and make payments on over time. ... That's a huge rock to carry on your back when you're trying to swim across a river, when you're trying to make it from week to week, to keep groceries on the table and still make the mortgage payment.

Seventy percent of American families last year said that they are carrying so much debt that it is making their family lives unhappy. The number one New Year's resolution for 2004 was [to] try to reduce the debt load. That's the first time something has beat "try to lose weight" in more than 20 years. Middle-class Americans, hardworking, play-by-the-rules Americans, Americans who lost a job, Americans who don't have health insurance, Americans who are in the middle of a divorce, Americans who are trying to take care of elderly parents, ... those are the Americans who are carrying enormous credit card debts. Those are the ones who are handing over every eighth paycheck just to make the interest payments on their outstanding credit card bills. That's who's paying the real price of a deregulated credit industry and unleashing a monster that says 9.9 percent interest for most of you guys, but once you're in a little trouble ... 29.9 percent.

**What I don't understand is, I bought a car on time many years ago; I bought a home and had a mortgage. I fill out all this paperwork. There's all this disclosure; it tells me how much it really will cost if I pay, make all these payments to the end and so on. But when I open up a credit card bill, I see the minimum monthly payment, but it doesn't tell me ... how long it will take me to pay it off.**

That's exactly the right question. How can that be? The mortgage lenders have to tell you how much you borrowed, what it's going to cost in interest and when you'll pay it off. The car lenders have to tell. But the federal regulations say the credit card issuers don't have to tell. The credit card issuers want to claim: "Hey, this is just a contract. We put it out there. You didn't have to borrow it. Here are the terms. ... We want to rely on and enforce our contract." But they want to have a contract where they don't have to tell you how long it's going to take to pay it off, and if they decide [to], they can change the price on the credit that you have borrowed. There is no lender in America that can get away with that, I guess ... except the back-alley boys.

## **But it's the most profitable sector in the financial community. ...**

Yes, they're a profitable sector of the financial community. They're a profitable sector by hiding what they charge and by changing what they charge.

Up until the early 1980s, we had consumer regulations that protected us against credit cards that jumped from 9.9 percent to 29 percent interest rates. We had regulations that prevented people from taking out \$2,000 worth of credit card debt and discovering, eight years later, that they had now paid back more than \$7,000 to the company and still [hadn't] paid off the loan.

## **But it's not legislation that started this. It was a federal court decision that said you could export your interest.**

No, it was a federal court decision interpreting a piece of legislation. Well, what it said was ambiguous, and some states thought it said one thing, and some states thought it said another thing. The Supreme Court said, "We decided it means 'export.'" Congress could have changed three words in the statute and said, "No, it doesn't mean ... that one state can export its interest rates to all the others." ...

## **But Congress didn't.**

That's why I lay this at Congress' feet. ... When the court said, "The language that you used effectively turned the credit card companies loose on interest rates and whatever it is they want to charge," Congress had no enthusiasm for stepping up to the plate and saying, "No, ... that's not what we meant. We never intended to deregulate the credit cards." Because Congress is stupid?

No, because it's credit card companies who make big political contributions; it's credit card companies who have been the number one givers in Washington. Not big oil, not big pharmaceutical -- big consumer financial services. They're giving money in Congress; they're giving money in presidential campaigns. Why would they be giving so much money? What they want to be sure to protect is their ability to go out and sell credit cards when they don't have to tell what the terms are, and they can change the

terms after someone has taken out the debt.

**Bankers who we talked to say in the old days, it was your local bank, your local finance company, they had a monopoly, if you will, on lending to consumers. [Establishing credit cards] was a way to democratize credit and also to break down local monopolies and put some competition into the area of consumer financing. Otherwise, it would have been very hard for a working person to get a loan, and that's why they went to a loan shark.**

Well, I'm glad to hear that they described themselves as just out there to try to help the American consumer, but what they've been helping the American consumer out of is billions of dollars. Last year alone, the credit card companies collected more than \$90 billion from middle-class families. Interest, fees, ... charges of various kinds that they billed into credit cards. Now, I'm all for their making a profit, but the reason they're making profits that are such extraordinary profits today compared with what they were making 25 years ago is that today, they have figured out that because the law has turned them loose, they can charge extraordinary interest rates and fees that they never would have been allowed to charge 25 years ago.

**Some of your critics would say that you are looking at the consumer out there, and you say they're uninformed, and you have to help them. And they're saying, "You're underestimating the intelligence of the American consumer."**

Underestimating the intelligence of the American consumer because I think that they can't read a contract that I've got to tell you I can't read? I teach contract law at Harvard Law School, and [also] commercial law and bankruptcy ... but if you put me under oath right now, I tell you, I don't know what the effective interest rate will be on my credit card next month, because I can't read it in my contract.

**They say that the reason this document is so complicated is because of the regulations the banking industry has been forced to comply with -- the lending industry -- that are on the books in states and nationally,**

**and it's so confused [that] they have to have this ... complex agreement, and they would love to have a shorter, simpler form.**

Oh, no one has forced them to put terms into their contracts that permit them to change their prices after they have lent money. No regulation has forced them to withhold from consumers information about how long it will take to pay off your credit card bill. No one has forced them not to tell what the effective interest rate will be if you make those minimum monthly payments to pay off this bill. ... They want to hide behind regulation. It's all a matter of regulation.

**What they're saying is yes, it's a free, deregulated market, and if you don't like your credit card ... you can go somewhere else; you can get another credit card.**

... You can go somewhere else, but at 35 percent or at 40 percent interest. In other words, once there's a ding on your credit record, for whatever reason, including that a credit card company just wanted to jack up the price, ... that's it. You've now moved from prime to subprime, and that means you'll pay what it is that the credit card companies demand in the subprime market.

If we had had credit regulation, interest rate regulation as we had had from colonial times until the early 1980s, there would be room to differentiate among customers. The best customers could get the lower prices, and customers that weren't as good would be charged a little bit more. What's happened, though, now is not that there's some difference; it's that there's huge difference between ... the people who are getting it at prime and the people who are getting it at subprime, and that means subprime then creates its own problems. The debts start doubling in two and three years, so that people can pay and pay and pay and discover that they owe as much as they owed years earlier.

**But again, what ... the industry would say is that, until they came along, there was no place for these people to turn at all. They wouldn't have gotten a loan.**

But they were getting loans. That's what's so troubling about this. The industry has no evidence that people were being turned down for loans in

the early 1980s. What they have is evidence that people more often in the early 1980s preferred to pay cash than to pay on credit. And the industry has gone through a multibillion-dollar ad campaign saying: "Put it on your credit card, put it on your credit card, put it on your credit card. And if you don't have quite enough dollars to pay for it today, put it on your credit card and pay over time." They've been selling debt, and now they're shocked to discover people have taken on ... the debt. And they now treat that debt as an absolute necessity. How could Americans survive if they weren't taking on the more and more and more debt that we're out there marketing? ... This is a crazy game that they have under way.

**Well, they say that's not true. They say that ... there were usury laws; there were caps. For example, if the Federal Reserve raised interest rates nationally to a point beyond usury laws ... they would have to go out of business.**

Hey, there's no doubt about it: It's possible to write stupid usury laws so that in an inflationary period, you've got a usury law that's too low. But we're not talking about whether or not stupid regulation is a bad idea. If interest rate caps move with the inflation rate, then there's plenty of room for credit card companies to make good profits -- lending at lower prices to people who are prime credit risks, and lending at somewhat higher prices to people who have besmirched credit.

The problem here is that the profits are so extraordinary for lending at three times and four times ... the interest rate and the original cost of money, and because those profits are so extraordinary, the companies are all moving into subprime. They're out there competing for customers who are already in financial trouble; only the way they're competing is competing to get them in, and then hit them with 29, 35, 40 percent interest rates; \$29 fees, \$49 fees, \$79 fees. ... Those people are like machines that just keep turning out money for the credit cards. Once they're trapped, they can't get out of it.

**So what you're saying is that the profit center are the people in trouble, and the people in trouble are the ones who need the most consideration, if you will, and they're just turned into, in a sense, addicts; they have to keep going.**

It is worse than addicts, because they don't have any option. They get the bills every month whether they borrow any more or not. Most of the people who are in real financial trouble with their credit companies aren't doing any more borrowing, but their credit card bills are mounting because they can't even manage to pay the interest rates on a monthly basis.

**But we live, as you said, in a country where ... if you get into debt, if you do that rationally and you're not creating fraud at the same time, or practicing fraud, you go bankrupt. The credit card company has to take that risk in their fees, in their costs, and that's an intangible; that's one of the reasons why they charge these things.**

Yes, bankruptcy is there, and it's a safety net in the system, but it's a very painful safety net for a lot of people to take. We interviewed more than 2,000 families for our most recent bankruptcy study, and about 85 percent of those families described their feelings about bankruptcy as something they were trying to hide. They were hiding it from their own parents; they were hiding it from their brothers and sisters; they were hiding it from their neighbors; they were hiding it from ... their employers; in some cases, they were trying to hide it from their own children. They were doing that because bankruptcy is still a humiliating experience for many people to declare.

**But the people who go bankrupt, our image of them is that they're deadbeats, that they're people who have used their credit cards profligately, buying whatever they cared to buy, and then they decide, "I'll take my flat-screen TV, and I'll go bankrupt."**

Credit card companies ... refer to deadbeats as the people who pay off their bills every month, the ones who aren't generating those big profits for them. So the folks who go bankrupt aren't the deadbeats from the credit card company's point of view. They're the people all the way at the other end of the spectrum; they're the people who produced the billions of dollars in revenue for the credit card companies, until they finally just gave up in exhausted resignation to people who said there's just ... no more blood left.

The families who file for bankruptcy file mostly in the aftermath of job problems. They keep making those minimum monthly payments, except for two out of every three [who have] had an extended period of unemployment,

or they've lost their small businesses, and they just can't make it anymore.

About half of the families who file for bankruptcy have serious medical problems. Sometimes it's ... Mom or Dad; sometimes it's a child; sometimes it's an elderly parent that they've been trying to support. And for about 20 percent of the families in bankruptcy, it's divorce; it's ... family breakups that land them in the bankruptcy courts. Now, if you added that up, you saw it added up to way more than 100 percent, and that's because, for many of them, it's two out of those three, or even for a lot of them, three out of three ... that are just more blows than they can take, and that's how they end up in bankruptcy.

**But let's assume they didn't have credit cards. What would they do? How would they make their medical payments? Doesn't it give them a chance ... to at least, if you will, avoid bankruptcy for a while? Doesn't it allow them some, if you will, social relief for a while, to try and get their lives together?**

It puts off the day of reckoning, but it puts it off at such a high price ... that it increases the chances of an eventual crash. Many of those people would still borrow money. Some of them would take out second mortgages on their houses; some of them would take some cash advances; some of them would still have some access to credit cards. And if those were at 10 percent interest, at 12 percent interest, many of those families, when they got back to work, when the medical problems were over, when they stabilized in their two households where they had had one, might be facing three or four years of real trouble, but they'd have a chance to fly out the other side.

When these people are hit with credit cards, and the interest rates are running at 29 percent or 35 percent, they don't have any chance. I had someone in my office not long ago who explained to me that he had filed for bankruptcy, and I had asked him what had gone wrong. And he said, "Well," he said, "I'm a cameraman, and I fell and hurt my shoulder." And he said: ... "The real problem I guess started long before I fell. I used to work for one of the big news agencies, and now I'm an independent contractor. When I fell, that meant no more income." And he said: "My wife is already at work. We carefully watched what we borrowed on credit cards ... while I was out of work for several months.

"When I went back to work, we took every penny we could, and we paid back on those credit cards, and at the end of a year, we had paid back every dollar that we had borrowed, and we still owed more than we had paid back." And he said: "I went to see a lawyer and said, 'How can this be so?' And the lawyer mumbled on about how, 'Well, the interest rate went up to 39 percent, and they hit you with \$50 and \$75 late fees.'" And he said, "What can I do?" And the lawyer said, "There's nothing to do but go bankrupt."

Now, the credit card company would describe that fellow as having discharged more than \$15,000 in debt, but that guy had paid back more than \$15,000 in debt. What he had discharged were interest and late fees and other penalty payments that the credit card company had loaded on and loaded on and loaded on.

**But statistically this year, it appears that people are turning away from credit cards towards debit cards. The bankruptcy rate may be flattening or going down slightly. So isn't it an indication that the consumers aren't so dumb; that they are figuring out there are better places to go to get financing, and that the credit card industry may have to adjust, because of the marketplace, to more rational behavior?**

I hope you're right. But this is a little like saying people have glanced left and glanced right and seen their neighbors and family members burst into flames, and they have decided that credit cards are a whole lot more dangerous than they thought they were. You're right: Some people ... are going to inch away from that.

**And the companies say that what they're really trying to do is rationalize lending practices and credit cards nationally. The one reason you have all these complex agreements and all these problems is the states get in the act, and they pass certain laws; ... that there's a need, really, to have uniform regulation of the credit card industry rather than this hodgepodge around the country.**

What the credit card industry wants is uniform deregulation, uniform protection from any state regulator that might move in and say, "What you're doing is an unconscionable contract, or a violation of our own usury laws, or

our own consumer protection laws." The credit card companies are trying to maximize their profits. And in an era in which interest charges and fees are effectively deregulated around the country, the best way to maximize their profits is to change the interest rate after you've borrowed the money, to load on the maximum number of fees, and to write contracts in a way that will conceal rather than reveal how much this credit will really cost and what kinds of risks it runs.

**But people in different states, for instance, know, in Florida, in Texas, that they can, in a sense, protect their homes ... completely in bankruptcy, so they'll go to a credit card company and use credit so that they can discharge in a bankruptcy proceeding as opposed to, let's say, taking out an equity loan. It's free money to them, in that sense, and they keep their asset. And what the companies are saying is that the consumers are not stupid; that's why they have high fees, high interest rates in certain cases, and why, in fact, they need to reform the bankruptcy laws themselves.**

What credit card companies are saying is that the consumers are being just as rational and profit maximizing as we are.

You know what the problem is? There's no evidence that that's so. Consumers in Texas and Florida who could take out a lot more in credit card debt and then waltz into the bankruptcy courts, in fact, are not doing it. The academic studies on where credit card debt is being taken out and where default rates occur and how much people are paying in interest shows no difference between states like Texas and Florida, which would protect the debtors, and states like Massachusetts and Illinois and Arkansas, which would not protect the debtors.

Why is that so? It's because most people, when they take out money on a credit card, do their dead level best to pay it back. They don't sit and rationally calculate: "Well, now, let's see: If I maxed out on how much I could make on this and take out the maximum amount, I could declare bankruptcy in just 24 more months and ... enrich my wealth." That is a dream of the credit card companies, or maybe it's their nightmare, or maybe it's just their best public relations ploy. There is absolutely zero empirical evidence to back up this claim from the credit card companies. In effect, the credit card companies are sitting around saying, "That's what I'd do if I had

the option." But it's not what American consumers are doing. They borrow the money, and they kill themselves trying to pay it back.

Why have credit card profits risen sharply year after year after year, when all those laws are out there protecting people at least in a handful of states? And the answer is, because Americans borrow the money; they do their best to pay it back, and somebody tells them they have to pay it back at 39 percent interest. Their response is to say, "Who are you kidding?" No. Their response is to say, "I'll do my best. Would you take \$50? Would you take \$75 this month?" and to pay and to pay and to pay.

**I hear you, but then I look at the realities. The companies want to reform the bankruptcy laws because they say they're being abused.**

No, the companies want to reform the bankruptcy laws because it's a way to further increase the profits. It's a way to cut off the last exit door for middle-class families in financial trouble.

**Congress doesn't agree with you. They uniformly vote in favor of the bankruptcy bill. Democrats, Republicans, liberals, conservatives ... they all see it as a great reform, and one the country needs.**

Well, let's be clear about Congress and who's had a chance to talk to Congress. The consumer financial services industry has been the single biggest contributor in the 2000 election cycle, in the 2002 election cycle, and they're on target to do it again in the 2004 election cycle. George W. Bush's single biggest contributor to his [2000] presidential campaign was MBNA, the second biggest credit card issuer in the country.

And let's be clear who's on the other side: It's a bunch of middle-class families who are in financial trouble. They don't give money to political action committees; they don't hire a bunch of lobbyists; they don't take out a lot of newspaper ads; they don't get a big public relations campaign going. ... This is about as lopsided as you can get in Washington. Sen. [Russ] Feingold, of McCain-Feingold, once remarked that the bankruptcy bill should be the poster child for why we need campaign finance reform in America. It's a great big multibillion-dollar industry talking to Congress, whispering in their ear. ...

## **You believe that the bankruptcy bill ... its heaviest weight is on women? What do you mean?**

Well, it falls on women for two reasons. The first is that women often show up as creditors in bankruptcy. When ex-husbands file for bankruptcy, they tend to owe alimony and child support, and they owe MasterCard and Visa. And what the bankruptcy bill is designed to do is to let MasterCard and Visa have a few more legal perks that will let them elbow straight on against women trying to collect their child support. And frankly, I believe, in any head-on-head competition between MasterCard and Visa and some woman trying to get her child support ... I put my money on MasterCard and Visa. And I think MasterCard and Visa would do the same; that's why they want to see the changes in the bill.

Now let me be clear: The bill sponsors were really appalled when some people pointed that feature out, and so they made a ... visual change to the bill saying, "We're going to increase the priority of child support collections listed right now as seventh in the list, and we're going to move it up to first in the list." And that really sounds terrific ... unless you really know what bankruptcy law is, because what they did is, they moved it ahead of things like American fisheries and American granaries and payments that have to be made to your employees; ... in other words, not the sort of things that ex-husbands are ordinarily paying. They made a big show of changing a number ... while they let the credit card companies in the back door so that they could elbow [out] women who were trying to collect child support and alimony.

...What really matters for women trying to collect child support is what's going to happen to them post-bankruptcy. Are they going to have a clear shot at their ex-husbands because their debts survived bankruptcy, or are they going to be competing with MasterCard and Visa, who are also going to have a clear shot at the guy?

... But when you get right down to the fine print, it's all about helping the people who gave the political contributions. It's all about helping the people who have the real muscle in Washington, and that's the consumer financial services industry. There's not a single women's group, there's not a single consumer group that thinks that this bill is going to help women. They're all

opposed it.

### **And Sen. [Hillary] Clinton?**

Sen. Clinton, when she was first lady, [was] responsible for stopping the proposed bankruptcy legislation. The White House had been quietly supporting it, and it was First Lady Clinton who talked with her husband and persuaded him that the bankruptcy bill was hard on women, hard on families, hard on older Americans, and was a bad idea in general. And the last act that President Clinton took with Congress was to veto the bankruptcy bill. Mrs. Clinton took credit for that in her autobiography, and by golly, she deserves it. She stood up --

### **And today?**

Sen. Clinton, when she was elected, the financial services industry brought this bill back. And so one of the very first bills that came up after Sen. Clinton had taken office was the bankruptcy bill. Oh, [there were] a couple of cosmetic changes to it, ... but it was the same bill that had been there at that point already for four years. And Sen. Clinton voted in favor of the bill.

### **Better bill?**

No.

### **Why?**

The financial services industry is a big industry in New York, and it's powerful on Capitol Hill. It's a story of how much influence this industry group wields in Washington that ... they can bring to heel a senator who obviously cares, who obviously gets it, but who also obviously really feels the pressure in having to stand up to an industry like that.

### **Today, the bankruptcy bill seems to be on hold, and what we**

**understand is that it will not come back up before Congress until after the election. Will it pass?**

Anyone who is a sensible gambler would say of course it's going to pass. Just look at the facts: All the money is on one side, and the bill is complex and technical and difficult to read. ... Of course it will pass. But it hasn't so far. There are just enough in the Senate and the House who take one more look at that bill and say: ... "How can we do this to American families? How can we do this at a time when job insecurity has risen, when millions of middle-class families have no health insurance, when family savings have plummeted to almost zero ... and families are using debt to put groceries on the table? How can we ... take the last escape route, the last little bit of a safety net for middle-class families and just rip it out from underneath them?" So far there's always been just enough in the House and in the Senate or in the White House ... to keep the credit industry's bankruptcy bill from becoming law.

You know, in 2002, a lame-duck Congress came back to try to ram through the bankruptcy bill led by someone who had already lost his seat in part because of his support for the bankruptcy bill, [Pennsylvania] Congressman [George] Gekas.

And they went down to the last night of the last ... hour that they were in session in this lame-duck [Congress], and at the last minute, the deal broke apart, and so ... no bankruptcy bill passed in 2002. Now, they came back in 2003, and the first thing that happened is the House passed another bankruptcy bill, but ... so far, not the Senate.

**Because they say ... when we talked to them, the bankruptcy bill got set aside because what they wanted to do was to have federal preemption of state regulations on credit card companies that were being passed. And that became their high priority in Congress.**

I was just going to say ... part of the reason the bankruptcy bill wasn't [run] through this year is that the consumer financial services industry found something it wanted even more than the bankruptcy bill, and that is, it wanted to use federal regulation -- and I use that word advisedly -- to block off any attempts by state attorney[s] general and state regulators to regulate the credit card companies. So they regarded getting a "get out of jail free"

card in every state in the union as a higher priority than getting the bankruptcy bill that would allow them to continue to collect from families forever. Doesn't mean that they won't still go for the bankruptcy bill; they've just ... made it second on their list for now.

[What they want is] once they have settled on the state where they have put their nominal headquarters, that state's interest rate should govern for the other 49.

**OK.**

So state-law interest rates for the state they choose should regulate what interest rates will be, but from there on out, only federal law should put any restriction on what they're able to do, and if the federal law doesn't have any restrictions on what they can do, then the law becomes [such that] no one in any of the states is permitted to impose any restrictions.

**So they want it both ways?**

That's exactly right. That's how you maximize profits.

**So ... people like myself who pay their credit card bill off every month, are we, in a sense, being subsidized by the people who don't pay their bills off completely, but pay these interest rates, make these payments?**

The top 20 percent of the income spectrum, the folks who use credit cards as a convenience, they go out there and use them all around the world and all around the country. And they use them [for everything from buying] pizzas to buying tennis shoes to ... buying cars now. Those people take advantage of what is ... a system that costs many, many millions of dollars to run, and that's that credit card system. They take advantage of it, but they don't pay for it.

...So who's making all the money for the credit card companies? All the money is being made by the middle-income folks, the ones who are using their credit cards and then making minimum monthly payments and paying the extra fees and the extra charges that are ladled on. ... They're the ones

who both make the system overall profitable, and they're the ones who make sure that there are credit card outlets, [that] people will take credit cards all over the country; indeed, all over the world. In other words, you are being subsidized in this credit card world by people who make one-tenth as much money as you make.

### **And by the way, do you have a credit card?**

Of course I have a credit card. Who wouldn't have a credit card today?

### **What kind of credit card do you have?**

I have an L.L. Bean MBNA [Visa card]. I get free points at L.L. Bean, so I can pay for my mukluk boots or whatever they are. ...

Eighty-five percent of the credit card company's profits come from people who are making payments over time. It comes from interest and fees. ... It doesn't come from something that the merchant is paying or ... annual fees ... that the top 10 percent [pay], because they're not paying it.

The money is coming from middle-income folks, the people who pay a little now and a little more next month and a little more the next month. People like you and me, we're just freeloaders in the system. We pay off our bills in full every month, and the card companies, why do they even leave us with cards? Do you remember the big dustup a few years back [when] they were going to take the cards away from us? And we as a group, people who pay off their cards in full every month, got quite outraged about that.

So much for free markets. They decided that was a very impolitic thing to do, that it's good to have high-income people using credit cards and attached to credit cards and seeing credit cards as a good thing. And besides that, there's always just the chance that you'll lose your job, that someone will get sick, or that you'll end up divorced and that you'll stumble. And if you stumble, they really do stand at that point to make a real profit on you. So ... they hand out those credit cards up and down the line, but they count on people in trouble to make those minimum payments that build up those profits.

## **So what do you want? Do you want to get rid of the credit card industry?**

Certainly not. I like my credit card. Don't take my credit card away from me. I just want ... some minimum regulation, just like the consumer product safety regulation, and that is the regulation that says you can't change the terms after I borrowed the money, and there are caps on what kind of fees can be imposed and what kind of interest can be imposed. They can be high, but they can't be that high.

And you've got to have right there on every credit card statement, "If you make the minimum monthly payment, here's how long it's going to take you to pay it off, and here's how much you'll pay in interest over that period of time." In other words, I believe in contracts, I believe in the freedom of both sides to come in and enter these contracts; but I think the consumer has a right to know what the terms of the contract are going to be, and I think the consumer has a right to have some minimal protection in the kind of contract that can be written. That's all.

## **Assuming what you say [is correct], that they are this billion-dollar industry that contributes more money to both sides of the aisle than anybody else, and they get what they want in Congress whenever they want it, what's going to happen if we continue down this road?**

Only so many million middle-class, hardworking families can go bankrupt, only so many million middle-class, hardworking families can lose their homes, see their cars repossessed, have to give up their wedding rings and other things that they've built up over a lifetime, before they say, "I've had enough," before they start to say, "I want to know how my senator is voting on consumer protection in financial services."

This is a real pocketbook issue for American families, and when there are only a few thousand families in trouble, you get one level of response from Congress, maybe when there are only a few million. But we're talking about a system now where, if we go in the path where we are headed, between this year and the year 2010, one in every seven families with children in America will have declared bankruptcy. At some point, we're going to see the tip on the other side, and the senators and the representatives are going

to be lining up to support legislation that supports families, because after all, let's remember, the financial services industry may have all the money, but families have all the votes.

### **Aren't these regulators doing something?**

So if they have so much regulation, why is it that not one single credit card in America today has the little line on it that says if you make the minimum monthly payment, it will take you this many years and this many months to pay off your credit card bill, and you'll spend this much in interest? If they're so deeply regulated, why isn't someone telling them to have a fair contract between two sides, [that] you at least have to give them that much information? Why isn't that happening?

**But they say in response that you've got a skewed view here. When you take out a 20-year mortgage, and it has set payments, or a car loan with set payments ... that's why you have that statement. But when you're dealing with a credit card, you, the consumer, have the freedom to borrow or pay back as much as you want every month. They will take the minimum payment, but they'll take anything above that, so it'd be misleading to give you a number that may not be relevant at all.**

It would be misleading to give you the basic information to make the decision on whether to make the minimum monthly payment or to make a higher monthly payment? It's misleading to learn that there are a whole lot of credit cards out there in the U.S. today that are negatively advertised, which means that they answer to the question, how long will it take you to pay off this bill if you make minimum monthly payments? And the answer is, you'll never pay it off if you make minimum monthly payments. ... They say that this would somehow be misleading? ... Lowell, what it would be is not profit-maximizing. Because there are many people who, if they understood that minimum monthly payments means never paying it off, or minimum monthly payments means paying it off in 34 years, well, a lot of people [would] ... put a little more wood on the fire, [would] try a little harder to pay down, but that wouldn't maximize the profits of the credit card companies. They just don't want people to know, and that's all one can describe about why they don't tell. They don't tell because they don't want

the customer to know, because an informed customer is not as profitable a customer.

**And to what extent is the behavior of the credit card industry driven by this phenomenon of securitizing these loans, of selling off these loans to third parties as investments?**

Well, securitization, as this is called, has had two real effects. The first is, it's just pumped billions of more dollars into the industry. In other words, investors who don't know one industry from another and frankly don't care, but are looking for maximum return to their dollars, look around and say, "Well, I could do oil, I could do pharmaceuticals, ... whoa, or I could do credit cards, because that's where profits are high." And so it means more money keeps flowing into the consumer credit industry, more money than into marketing, trying to get people to take out more credit cards, and more money into that phalanx of lawyers to write the credit agreements in ways that maximize profits for the credit card companies and trick as many of the customers as they can.

The second way securitization matters is it takes credit card companies out of the business of working with people. Once upon a time, your lender kept the debt, and that meant if you borrowed money from the first national bank at your local town, they carried that on their books, and ... they cared whether or not you paid back. They watched, and if you had a special problem, they could look at you individually and say: "We know you; we understand the limits of the problem. We'll take a little now, counting on a big payment when the crops come in, when you're able to sell your business, when ... something turns around in your life."

Once it's securitized, it's not in your individual lender's hands anymore. It's made it out into a big anonymous pool, and the anonymous pool is managed by a set of rules. And the set of rules is not a set of rules that says: "Let me look at you; let me understand your individual circumstances; let me see how I can work with you ... so we both can get out of this clean. You pay me back in full what I'm owed, but I have a little flex in the schedule." ... Nope. Once it's securitized, you're just one more number in a computer program. Try calling a credit card company to say, "I need to talk to you about this problem I have," and most credit card companies ... oh, they may hire minimum-wage people, they'll listen on the other end of the line, but

most of them have no authority to work out, no authority to make distinctions between the people who aren't trying hard, the people who have problems that will never be fixed, and the people who have just hit a rough patch and need a little flexibility in the schedule.

**So it's taken out the ability even of the credit card issuer to renegotiate the loan ... to make it more possible for the customer to pay?**

That's right. In fact, another way to think of this is it's not really a credit card issuer so much as just one more middleman now. So here are the customers on the one side, and there are these big computer-driven securitization pools, and ... Bank of America, whatever, ... Citibank is just moving the paper back and forth between the two. But there's not really a lender there who has put its own money up and is waiting for you to pay to get its own money back.

**Isn't it really simplistic to say that credit cards, ... if you will, ... [are] pushing the bankruptcy rate higher and higher? Isn't it America's lifestyle? Isn't it in the ... consumer culture that we want all these things?**

I wish it were. I went into this research with my finger out and sharpened, ready to say to American families, "Bankruptcies are up because you're spending too much on stuff." ... The problem is, when you look at the data, you really actually look at the numbers ... what were a mom, dad and two kids in the early 1970s spending on clothing compared with what a mom, dad and two kids are spending on clothing today? You know what I found? Adjusted for inflation, today's family is spending 22 percent less than the family a generation ago.

How about food, eating out? Surely families are spending much more today than they did a generation ago. No. What the numbers actually show is that they're spending about 21 percent less than they spent a generation ago. Appliances -- today they're buying microwave ovens and espresso machines. ... Turns out, families today are spending 44 percent less on appliances than they spent a generation ago. We could go through the whole list -- furniture, ... floor coverings, tobacco. ... We spend a little more on alcohol, but all those other things are down, down, down. ...

In other words, families aren't going broke because of ordinary consumption. It's just not what the numbers show. Where are families going broke? The mortgage, that's up about 70 times faster than a man's wages over the last 30 years. Health insurance, also up about 70 times faster. A second car, because now Mom and Dad are both in the workforce, and they're more likely to live in a more distant suburb. Child care ... and after-school care, college tuitions. ... Today's family has put two people into the workforce, but for the medium-earning family, they've got 75 percent more money than their parents had a generation ago. But by the time they make those four basic purchases -- the mortgage, their health insurance, their cars and their child care -- they have less money to spend on everything else than their parents had a generation ago. American families are under the gun financially, but they're under the gun because of big purchases, mortgages, health insurance ... two cars, child care. ... They're not under the gun because they spent too much when they went to the mall. Families are just trying to make it in the heart of the middle class, and expenses have just shot out of the reach of the medium-earning family.

### **What is usury, and what's the history of it in this country?**

Well, the history of usury starts at the Bible. There are multiple references going back to Deuteronomy about the evils of usury, about those who have money lending it at excessive rates to those who don't. It really just means a cap on what lenders can charge. It's sort of like consumer product safety [regulation]. Creditors and debtors ... can make their decisions within a range, but they can't go crazy; they can't go over the top. We've had usury laws in the United States since colonial times, but in the early 1990s, we just very quietly got rid of them.

### **And they're key to the financial health and development of the credit card industry?**

Absolutely. The consumer credit has been available in the United States for decades in many ways, for centuries, while we had usury laws. Sears, Roebuck was famous in the early 20th century for selling to people on credit to be able to boost its sales.

**Mm-hmm.**

But in those days, it was capped by state laws. States had consumer regulations that said they could charge, they could make their decisions, but there would be a cap on how much they could charge customers. And because there was a cap, there was no reason to put in the contract, and we can change the rate whenever we want to, or we will pile on \$50 charges and \$75 charges, or we won't tell you what the rate is. ... Because it was capped, there was just a limit on what they could do, so most customers understood their credit card contracts.

So we had consumer credit ... governed by usury laws, and consumer credit continued to grow throughout the 20th century. But it took off when they figured out that the best profits were not to be made from lending money to good customers; the best profits could be made from lending money to bad customers. And as soon as they figured that out, consumer credit goes through the roof, and so do profits. That's the effect of a deregulated industry.

**OK. And ... as a responsible corporate citizen, Citibank, for instance, recently announced that they're going to spend \$200 million educating credit card customers, educating people about how to use this instrument that they've put out there in the marketplace.**

You know, I'd like to save them \$200 million. What I'd ask them to do is just reprogram their computers to put two little lines on every credit card statement, one that says if you make the minimum monthly payment, this is how long it will take you to pay off, and if you make the minimum monthly payment, this is how much interest you'll pay over time. They could go a long way towards educating a lot of consumers that way, and they could save their \$200 million.

**And you think that would really make a difference?**

I do think it would make a difference. It wouldn't make a difference to everybody, but it would make a difference to some people.

## **To the people who are caught in a jam because there's a family crisis, there's no place else to turn?**

The only way you help those people is you put a cap. You say to Citibank: "From the first day, you can't charge more than" -- pick your number -- "18 percent interest, 20 percent interest. ... You can't go into the stratosphere on your interest rates, and you can't keep loading people up with charges. Fifty dollars, \$75, \$99 -- that's what's killing families.

**I'm thinking of ... various economists who would say that you just don't believe in the future; you don't believe in increased productivity; you don't believe in the ... model, for instance, of the U.S. economy which, in spite all the naysayers, continues to expand, and consumer credit in particular has been key to that expansion over the last 20 years.**

Families cannot expand their earnings fast enough to make up for the 29 percent interest rates. They just can't do it. It's not possible. ... Our economy may grow fast, it may hit another boom, and we may grow ourselves out of all kinds of debt problems, but the individual family can't count on increasing its income next year by 29 percent.

Look at where American wages have been for the last 30 years. A fully employed male today earns 1 percent more than a fully employed male earned 30 years ago. Inflation adjusted, there's been 1 percent growth in wages in 30 years. When people take out credit card loans at 29 percent interest, they're spending tomorrow's wages, and there's no way that those wages are going to go up fast enough that they're going to have the money to pay it back other than by cutting their future purchasing.

## **Or going bankrupt.**

The alternative is always massive default. But let's think about what that means. ... We're sending more and more consumers out to the financial edge, spend[ing] tomorrow's paycheck and the next month's paycheck and the next month's paycheck, and there they hang. Only two things can happen: Either they have a lot of time in which they earn ... and don't spend, and the economy sags back down over a long period, or they massively fall off the edge and into bankruptcy.

## **I'm putting myself in the position of a bank. Why do I want to drive people into bankruptcy where they can discharge their debt?**

You've got the problem that there are multiple lenders. If someone only had one bank or one loan shark, which is how it usually works, that bank or that loan shark would be interested in keeping you alive. But the problem we have is that multiple banks are all feeding off of the same American families, and so ... each bank maximizes its profits by eating the most from every single consumer today. And if that means, as a group, that consumers are in trouble next month, next year ... not my problem. No one of them can solve the problem. If bank one doesn't eat everything it can from the consumers, then bank two will eat everything it can from the consumers. ... That's why the only real answer here is some kind of regulation on the most outrageous of the practices. You've got to rein all of the creditors in at the same time. Otherwise, they're competing with each other, both for customers and for profits.

**When we talk to the bankers, they say ... there's the [Office of the Comptroller of the Currency; they have a complaint section. There's the Federal Trade Commission; they regulate fraudulent practices. There's the FDIC [Federal Deposit Insurance Corporation], which ... insures the banks. They're all looking, as well as state regulators. So there are places to go for help..**

Oh, the federal regulators have been very active recently. But the way they've been active is, they have been suing the state regulators to tell them to keep their hands off the credit card companies. In other words, our regulators are there, many of them. ... [But] most of them are political appointees, and most of them see their principal job as protecting the safety and soundness of the banks, and that means seeing that the banks are profitable. Their customer is not the American family; their customer is the profitable bank that issues credit cards. That's who they are designed to protect, and that's who they are protecting.

**But they don't see an economic threat to the banks from these massive**

## bankruptcies?

Right now, they think that everyone can keep feeding and that there are still plenty of families to gobble up before they all head over the cliff, financially. But I have to tell you, the numbers are worrisome.

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posted nov. 23, 2004

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