Banks sharply increased fees as US households fell deeper into debt

By Andre Damon
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As millions of Americans fell ever deeper into debt, lenders drastically increased penalty fees and interest rates. These are among the findings of an investigative report published in Sunday's *New York Times* by journalist Gretchen Morgenson.

The report notes, "The lucrative lending practices of America's merchants of debt have led millions of Americans—young and old, native and immigrant, affluent and poor—to the brink. More and more, Americans can identify with miners of old: in debt to the company store with little chance of paying up."

Morgenson observes that since many lenders no longer hold the debt they issue—they sell it off in tranches to the highest bidder—they have more and more relied on penalty fees on late payments, huge penalty interest rates, and other miscellaneous "junk fees" to generate profits.

The report cites Julie L. Williams, chief counsel of the Comptroller of the Currency, part of the US Treasury Department, who said in a 2005 speech, "Today the focus for lenders is not so much on consumer loans being repaid, but on the loan as a perpetual earning asset." In other words, people are kept in perpetual bondage never able to completely pay off their massive loans.

While inter-bank lending rates have remained below 6 percent since 2000, credit card companies have increased their interest rates—the average rate increased from 17.7 percent to 19.1 percent from 2005 to 2007. Average late fees have nearly tripled since 1994, and overdraw fees more than doubled during that time. Mortgage fees have seen similar increases.

Moreover, banks have sought to boost their profits through refinancing services needed by borrowers struggling to consolidate their debts. "Done to reduce borrowers' monthly payments, serial refinancings allowed lenders to charge thousands of dollars in loan processing fees, including appraisals, credit checks, title searches and document preparation fees," the *Times* report notes.

Such predatory practices have accompanied the massive increase in consumer indebtedness over the previous two decades. Between 1979 and 2004, household debt rose from 71 percent of disposable household income to 126 percent, according to a report by the Woodstock Institute. Adjusted for inflation, US credit card debt doubled between 1989 and 2004, while total mortgage debt in the US rose from $4.8 trillion in 2000 to $10.5 trillion in 2007.

Total household debt now exceeds total GDP, while it equaled just half of GDP in 1980. Consumer debt increased by 22 percent since 2000 alone. The ratio of mortgage and consumer debt payments to income has increased from less than 11 percent to more than 14 percent since 1994 (see chart).

This staggering accumulation of debt broke open in mid-2006 with the home foreclosure crisis. Individuals and families that had relied on rising home prices (along with second or third mortgages) to finance daily spending suddenly found that the assets that underlay this debt had suddenly decreased dramatically in value. Some 1.5 million American households lost their homes last year, to be followed by an estimated 2.5 million this year, according to the Treasury Department. All other forms of debt—from credit cards to auto loans—have seen their default rates increase in the past year.

While recent increases in debt defaults are at least partially due to the outbreak of economic turbulence—rising unemployment, falling home values, and skyrocketing gas prices—the ultimate cause of the growth in consumer indebtedness is to be found in

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falling real wages.

According to the US Census Bureau, the median US Household income fell by $1,043 from 1999 through 2006, the last year for which figures are available. Labor Department statistics suggests that real wages have fallen a further 2.4 percent in the past year alone.

At the same time, household discretionary income—i.e., income not taken up by mortgage, food, insurance, healthcare and car payments—has been falling for decades. The average two-income family now has less discretionary income than the average one-income family in the 1970s, according to a report by the Century Foundation.

As wages have stagnated, workers turned to debt accumulation as a means of preserving their standard of living, perhaps with the assumption that, like previous generations, their incomes would grow over time. But after seven years of wage stagnation, followed by the outbreak of the credit crisis and the downturn of the housing market, millions of people have found themselves faced with the prospect of being in debt for the rest of their lives.

The instability of this debt accumulation was obvious even before the outbreak of the current crisis. Like the mortgage originators responsible for much of the sub-prime meltdown, credit card companies had developed methods of "securitizing" loans—bundling them up into tranches and selling them to the highest bidder. Loan originators thus rid themselves of much of the risk inherent in lending to people with poor credit histories, giving them the incentive to make otherwise untenable loans.

Credit card companies bombarded borrowers with tempting low-interest credit offers, knowing that, since most people's incomes are falling, a significant portion of applicants would be unable to meet the terms of their original offer and would be charged penalty interest rates—sometimes exceeding 30 percent per year. Morgenson writes of one woman whose interest payments totaled more than 40 percent of her total income, and who moreover had to pay thousands of dollars in fees every year to refinance and maintain her loans.

The vast majority of Americans have had to respond to this crisis by lowering their standard of living year after year. Even those who live within their ever-shrinking means must live with the constant fear that if something happens—if they lose their job, fall ill, or get a divorce—they could well find themselves with tens of thousands of dollars in debt that they might never fully pay off.

Though unemployment has risen for seven consecutive months, the US economy has avoided contracting in the first two quarters of this year. But even the beginning of what will likely be a protracted downturn is pushing masses of people into foreclosure and bankruptcy, with nine out of ten people reporting that they have had to cut back their discretionary spending. Analysts predict that, given conditions in the housing and credit markets, the US economy will fall into recession during the second half of this year. This will only intensify the trends seen thus far.

Official commentary on Morgenson's article has been limited to calls for working people to tighten their belts. David Brooks of the *New York Times* wrote an op-ed column along these lines Tuesday, saying, " The important shifts will be private, as people and communities learn and adopt different social standards.... As the saying goes: People don't change when they see the light. They change when they feel the heat."

In essence, Brooks is saying that ordinary Americans have no business expecting that tomorrow will be better than today, and that they should simply learn to be poor. This begs the question: What do workers have to gain from a social order that guarantees them nothing but that they will be worse off in 10 years than they are today? This is not, as Brooks implies, a personal question, but rather a class question. Not content with merely lowering workers' wages and salaries, the very rich have taken to robbing those who can't pay their debts with quasi-medieval lending practices.

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