

The swipe and spend economy

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Abstract

Credit card uses and abuses have found a worldwide audience with the recent downturn of the economy. This paper will discuss the beginnings of credit card usage with the recent marketing by credit card companies to teenagers and will continue through to senior citizen's need for credit card usage to pay medical bills. Emphasis will be placed on the use of credit cards by college students whether the student is 20 years old or 40 years old. The recent credit card debate has focused on reforms in an effort to ease the credit card crunch of the average citizen. Congressional debate and the new laws affecting the credit card companies will also be discussed. The overall emphasis will be on the financial well being of the consumer and ultimately the financial well being of the worldwide economy due to the uses and abuses of credit cards.

Keywords: credit card abuses, dependence on plastic money, credit card meltdown, CARD act, scope of credit cards in developing countries.

Introduction

The recent downturn of the US and the world economies has led to an increased awareness of the usage of credit cards by the consumer whatever their age; teenager to senior citizen. According to *The Philadelphia Inquirer*, credit card use for buying gasoline has increased more than 25 percent, with an estimated 75 percent of all gasoline now being purchased with credit cards (Holcomb, May 21, 2008). This drastic over-usage of credit cards is due to the decline in the economy and the overwhelming availability of credit. According to Anton Dizon of *Business World*, the credit card was introduced in the United States in the 1920s (Nov. 2008). At first, credit cards were widely used for fuel purchases, but in time the cards grew in popularity to be used as an alternative payment tool when you experienced a cash shortage. Original credit cards were called charge cards and the balance was required to be paid by month end, but now the credit card has evolved into a total convenience tool. Beginning around 1958, American Express and Diners Club introduced the multipurpose charge card used mainly by travelers. According to Emily Starbuck and Ben Woolsey's web article on the History of Credit Cards, VISA became the first "general-purpose" credit card, established in 1966 by Bank of America. VISA's slogan: "Life takes VISA" is now being used literally, as the US and world economies slow and everyday living costs rise.

The use of credit cards has become so common place in today's society that the original purpose of a credit card is no longer in use. The increased usage of credit cards for routine, daily purchases has led to abuse of over usage by consumers and abuse by credit card companies through differing interest rates, reducing credit limits and other hidden fees. This over-usage has fueled the credit card companies' abuse of marketing to the various consumer age groups on the benefits of a credit card and not alerting the consumer to the pitfalls of a credit card. Teenagers to senior citizens world-wide are being caught in the credit trap, with the credit trap most prevalent in the college student consumer. Due to the marketing and hidden fee abuses by credit card companies in the United States, Congress has recently passed the Credit Card Accountability, Responsibility and Disclosure (CARD). This paper will explore the over usages of credit cards beginning with teenager usage and continuing through to senior citizen usage. The paper will examine how the credit card companies have been abusing this over usage by applying hidden fees, increasing interest rates, and cutting credit limits. Statistical data will show that the credit card companies are abusing the average families' usage of credit cards by raising interest rates, applying hidden ATM and cash back fees and marketing how easily one can obtain a card. The CARD Act passed in May 2009 will also be analyzed to determine whether the legislation will curb the abuses by credit card companies on the average American family. Recommendations will be offered on ways to improve the drastic decline in the global economy due to the usages and abuses of credit cards.

Literature Review

This paper is primarily a review of current newspaper and magazine articles. But several studies have been incorporated into the paper. First, Faig and Jerez (2007) explores the idea that "precautionary balances" or savings accounts no longer have to maintain high balances because the use of information technology has allowed for "uncertain expenditures" to be paid for by credit cards or internet banking. Their study concludes that due to the lower "precautionary

balances” the M1 circulation has dropped from circulation at a rate of 4.8 per year to a circulation of 1 percent or under.

Stauffer (2003) describes the effect of credit card usage on the money supply and the upward pressure on interest rates and the Federal Reserve monetary policies. The study emphasizes that consumers should consolidate their credit card balances and thereby reduces the demand for money. An analysis of how the credit supply affects the financial institutions ability to supply credit is the main point of the study.

Soman and Cheema (2002) analyzes the consumer in an attempt to understand how the consumer utilizes lines of credit. The study analyzes how a consumer views the larger line of credit available as a signal that their future incomes will also grow. The study analyzes the marketing behavior of the consumer and tested the theories in five areas of study. Soman and Cheema analyzed the Modigliani and Brumberg 1954 life-cycle hypothesis that “consumers attempt to maintain their lifestyle and consumption basket over their lifetime even though their income and wealth may fluctuate over time”.

Von Hagen and Ho (2007) find that a “slowdown of real GDP, lower real interest rates, extremely high inflation, large fiscal deficits, and over-valued exchange rates tend to precede banking crises”. The world economy is bracing itself for America’s credit card meltdown. The world’s consumers use credit cards for the smallest of purchases today. The interaction of the marketing of credit cards and the technological change in the timing of monetary transactions has changed rapidly in the last decade fueling the fear of a credit card meltdown.

Weistart (1972) reviews the beginnings of the credit card as an oil credit card through the 1950’s Diners Card and American Express card to present day bank issued credit cards. Mr. Weistart’s study concerns the legislative attention of credit cards which resulted in the federal Truth-in-Lending Act in 1970. Parts of this Act have been revamped with the 2010 CARD Act. The study also analyzes the loss ratios of banks due to fraud and credit loss.

Claus (2007) refers to the bank lending channel and the balance sheet channel when describing the economic impact of credit market conditions on monetary policy. All of these studies emphasis the roller coaster ride of credit card usages by the world’s population and the impact on the world’s economy of these over usages. The credit card companies have been quick to capitalize on the over usage by applying additional fees and thereby profiting on the world’s over use of credit cards.

The Swipe and Spend Economy

According to an April 24, 2009 *Newsday* article, which interviewed Long Islanders, many were reluctant to discuss their credit-card debt. Buying into the latest fashion or electronic gadget trends caused some to rack up debt, but others had to put everyday purchases such as food or utility-bill payments on their cards (Portlock, April, 2009). An April 13, 2008, *Washington Post* article discusses why, as the economy worsens, consumers are so eager to accept the easy availability of credit. The article continues to explain that credit card debt is a behavior that begins at an early age. Decades ago, one had to have a spouse, a career, or even a child before credit cards typically entered the picture. Now once people turn 18, they are bombarded with credit card offers, without regard to the economy. (Trejos, April 2008)

The *Business Week*, October 20, 2008 article says “The next horror for beaten-down financial firms is the \$950 billion worth of outstanding credit-card debt—much of it toxic” The article sites that thirty percent of outstanding credit card debt is due to risky borrowers with low

credit scores, compared with eleven percent of mortgage debt, the subprime threat will be greater in credit-card land (Silver-Greenberg, October 2008). In today's economic downturn credit card firms like American Express, known to cater to wealthier borrowers, has upped its provision for credit-card losses from \$810 million to \$1.5 billion in the latest quarter. This is a sign that even upscale consumers are having trouble. "We have enhanced our credit models and continue to prudently manage our risk by scaling back some card acquisition efforts and reducing credit lines where appropriate," says an AmEx spokeswoman. (Silver-Greenberg, October 2008)

The *Business Week* article also comments on emerging markets such as Eastern Europe, Latin America, and South America, are filling their wallets with credit cards. In the past three years, statistically, the number of cardholders in Brazil and Mexico has more than doubled. This world-wide rapid rising of credit card debt is causing destruction on emerging economies. The article uses South Korean consumers, as an example, the easy availability of credit in 2002-2003 caused a large percentage to default on these loans and seriously crimped the country's growth. (Silver-Greenberg, October 2008)

Credit card companies take advantage of this economic downturn and according to Andrew Martin (June 2009) of the *New York Times*, American's Mom & Pop companies are being squeezed with a crackdown on credit limits. According to the National Small Business Association, as of April 2009, approximately fifty-nine percent of America's small business firms financed their day-to-day operations with credit cards. This percentage is up fifteen percent over 2008 statistics. The article continues on by stating that within the last six months, three quarters of the small businesses has seen large cuts to their credit limits. This cut in small firms credit limits has only worsened the stagnant US economy. Yet, credit card companies have not only reduced US companies' credit limits; they have focused on the world economy and cut credit limits in other countries as well.

According to a June 7, 2009, *Washington Post* article about India's new credit card consumers, "A report by the National Institute of Advanced Studies in Bangalore, the information technology hub in the south, showed that 18-to 24-year olds in the outsourcing industry had grown accustomed to using credit cards to buy the latest cellphones, motorcycles, plasma TVs and home-theater systems". The article further states that India is one of the fastest growing credit card markets in the world with more than 25 million card users especially among the 35 or younger group which makes up more than two-thirds of the country's 1.1 billion people. Yet recently, credit card companies have slashed the credit limits of India's Young Consumers. The article quotes Geetajali Bahl as saying: "Now, suddenly I feel, 'Oh, God, I can't spend freely. I feel poor...', I don't have the power to swipe and spend anymore". The article explains that Bahl belongs to the first generation of credit card users in India, a country where spending power soared in the booming economy of the last decade and where the usage of plastic money encouraged the young middle-class to defy the Hindi adage "Don't stretch your feet beyond your sheet" which is another way of saying, "Live within your means". The institute research report does show that a large segment of the middle class continues to spend conservatively and that credit card addiction is nowhere near US levels.

Along with this addiction and with the recession picking up steam, credit cards have become a lifeline. Many now use cards to pay for groceries, utilities, even mortgage or rent payments. Demos, a public policy research group, showed that more than one-third of low- and middle-income households used credit cards to cover basic living expenses in five of the past twelve months. (*St. Petersburg Times*, August 2009) According to, *South China Morning Post* (October 2008) "We're looking at a generation that's been told that immediate gratification, the

‘just do it’ consumption culture, is the real new school.” Remember: “earn now, pay later” is better for your future than “buy now, pay later”.

In the past 10 years, credit card debt is up seventy-five percent as Americans’ real wages and savings rate remain flat. That means Americans have been spending beyond their means and fueling economic growth based on borrowed money. (Goldfarb, Washington Post) Yet, credit card companies continue to market easy credit. Referring back to the Visa slogan, “Life Takes Visa”, in a USA Today article titled “Marketing play: Game of Life really does take Visa”, Visa and Hasbro released the Game of Life with “plastic” credit cards replacing the cash. According to Susan Linn, co-founder of Campaign for a Commercial-Free Childhood, credit card companies have set their marketing sites on younger consumers, since the teen market has already been saturated. (Horovitz, USA Today) Companies world-wide see the tween and teenager consumer market as having real potential, not only for growth, but for brand loyalty as well.

The Swipe and Spend World-Wide Population

Teenagers are the newest consumer target market. What does a teenager really need a credit card for? Financial responsibility is a skill and should be taught like driving a car is taught. Parents have resources available like the Department of Transportation for advice on how to train the teenager to drive. The same should be done by credit card companies to teach a child financial responsibility. It is not often that a parent will just let the teenager take the car out for a spin, but does the parent just whip out the credit card when a teenager wants a new pair of jeans? As with driving a car the teenager thinks they know everything there is to know about how to do it right, but there are pitfalls. Accidents, mistakes and dents along the road, same as with credit cards, but financial responsibility seems harder for the parents to teach, especially if the parent are not financially responsible themselves. Therefore, parents must decide whether or not to give this financial responsibility to their teenager by allowing the teenager a credit card. The Washington Post article mentioned above has one Indian saying maybe our parents were right in teaching us to spend modestly. Americans have not been taught this skill. Most Americans have the buy now, pay later frame of mind, especially with credit cards. Where does that frame of mind leave a parent of teenagers in deciding whether to let the child have a credit card?

Suggestion that financial advisors help client’s young-adult children with the realities of credit card debt by arming the young adult with the financial information, and the financial knowledge to counter the barrage of credit card marketing aimed at them. (Pavia, Investment News) Bill Hardekopf, chief executive of LowCards.com, says in Nancy Trejos, *Washington Post* article that parents should be honest with their children about credit cards and explain the monthly credit card bill to them. Rather than hide credit card problems from the child, parents should explain the interest rate, minimum payments, grace period and finance charges. A parent could use their own problems with late fee, interest rate hikes and the problems with minimum payments as a teaching example (Trejos, October 2008).

Emily Peters, a personal finance expert for Credit.com, explains that a 2007 Charles Schwab survey acknowledged that only forty-five percent of teens know how to properly use a credit card and pay for purchases immediately, while only twenty-six percent of teens understood the expense behind credit card interest and fees. Founder of CardRatings.com, Curtis Arnold says there are prepaid cards targeted specifically at teens, where a parent can log in and monitor

the child's spending habits online. The *Washington Post* article continues by explaining that Mr. Arnold allowed his own son a debit card before he turned 18, in an attempt to monitor his son's spending. Mr. Arnold states that he will definitely encourage his son to obtain a credit card before enrolling in college if his son has no spending issues with the debit card (Trejos, October 2008). Credit cards for the teen while at home encourage early learning of financial responsibility. It also allows for gradual financial independence by the teenager.

But according to a October 18, 2008, *New York Times* editorial entitled "The College Credit Card Trap", the author suggests that in addition to the country's financial woes, credit card companies have begun aggressively targeting college students. Many college students are naïve about money matters and vulnerable to the predatory marketing of credit cards on college campuses that has begun to overburden students with debt (New York Times). According to the *Investment News* article by Jim Pavia (2008, p.8), "On average, a college freshman is offered eight credit cards in his or her first semester. Eight terms later, the average graduating senior has an astonishing six credit cards in his or her name. That translates into about 25% of college students leaving school with more than \$5,000 in credit card debt, according to a recent national poll. What's more, about 10% of those polled admitted that they owed more than \$10,000 on their credit cards upon graduation".

Pavia goes on to say that college students usually have no idea their credit card history will follow them after college, thus affecting their life far greater than their grade point averages. Mr. Pavia continues by suggesting that therein lays the paradox of credit cards; without one and with no credit history, a student finds it difficult to jump into the real world. A student without a credit history finds it difficult to do anything even renting an apartment becomes difficult. It is suggested that a middle ground exist where the student is allowed only one credit card, closely monitor by a parent, to assure the student's credit history will not be blackened and the card is not abused. Also, it is suggested by financial advisor's that the parent always be available to discuss credit issues and how to manage credit responsibly. (Pavia, September 1, 2008) But, herein again lies the irony; many baby boomers do not know how to manage credit.

According to the program director, Ed Mierzwinski, of a federation of state Public Interest Research Groups (U.S. PIRG), the majority of adults already have an abundance of credit cards. (Trejos, April 13, 2008) So college students are becoming an attractive market for credit card companies to exploit. *The Washington Post* article continues with statistics from a U.S. PIRG survey of fifteen hundred college students in fourteen states at forty colleges which showed that almost two thirds of the students had at least one credit card and fifty-five percent used their card for day-to-day purchases. The survey also found that fifty-five percent used the credit card for books and nearly one fourth paid their tuition with a credit card. In addition, freshman not receiving help from parents, on average, had balances of \$1,301 and seniors \$2,623. *The Washington Post* article also sites credit card companies as arguing that college students are now adults and therefore have a right to credit. The industry views anyone 18 or older as a responsible adult and should be allowed the right to a credit card (Trejos, April, 2008).

A Nellie Mae, 2004 survey showed on average, undergraduates owed \$2,169 on credit cards. 2006 data from Nellie Mae showed the average graduate student with credit card debt of \$8,612 (Chu, March, 2008). In Nancy Trejos' *Washington Post* article consumer advocates contend that with the current economy and an unstable job market, college students cannot afford to graduate loaded down with credit card debt. Most of the graduating seniors will already have student loan debt and credit card debt just intensifies the debt burden. (Trejos, April, 2008)

Statistics quoted in a September 8, 2009, *USA Today* article by Sandra Block from a Sallie Mae survey show that credit card companies have succeeded in the marketing of credit cards to college students. More than 80% of college students had credit cards in 2008. A table comparing 2000, 2002, 2004, and 2008 data shows that students having credit cards in 2000 was 78%, 2002 was 83%, 2004 was 76% and 2008 was 84%. The survey also showed the percentage of college students with four or more credit cards was 32% in 2000, 47% in 2002, 43% in 2004 and 50% in 2008; and the average credit card debt of students in 2000 was \$2,748, in 2002 it was \$2,327, in 2004 it was \$2,169 and in 2008 up to \$3,173. The marketing of credit cards to college students and the above mentioned statistics is one reason for the new legislation, but the provisions in the law do not take effect until February 2010 and credit card companies in the meantime continue marketing on college campuses. The *USA Today* article explains that according to an attorney at Consumers Union, Gail Hillebrand, May 2009 to February 2010 is the last open season on credit for college students. Consumers Union wants to warn students not to be misled by what it calls “low teaser rates” which some card companies use when offering a low introductory rate. These low rates do not apply when the college student carries a balance; the low rate is only to entice the student to sign-up for the card. (Block, September 8, 2009)

Credit card companies have not only marketed to United States college students, but also marketing to college students throughout the world. According to a *New Straits Times (Malaysia)* article, running up credit card debt begins innocently enough. Many students are given supplementary cards by their parents and the students continue to swipe and buy. The article begins with the quote, “Do I know how to use a credit card? You just hand it to the cashier whenever you want to buy something and sign the receipt.” The article goes on to explain that students think that once they have graduated, their diploma comes with an implied promise of a high paying job and that along with the job they can settle their credit card debt as quickly as it was acquired. (New Straits Times (Malaysia), June 15, 2008) In today’s economy, the reality is that debt is rising quicker than income levels.

With the downturn in the US economy, universities have experienced an upturn in enrollment by the “older college students” who wish to reinvent their careers. Enrollment by the older college student comes at a time when the economic downturn has affected universities budgets causing a college education to become costlier when paid for by a credit card. According to a *USA Today* article, in a survey by the National Association of College and University Business Officers, college institutions are paying on average two percent to process a credit card transaction. The article notes that in the past colleges bore the processing fee, but with an increased enrollment come increased costs, and the market crash has also affected universities’ endowments causing budget shortfalls. (Chu and Marklein, July, 2009)

A *New York Times*, October 23, 2008 article shows statistics from the National Center for Education Statistics that between 2001 and 2005, graduate students older than 50 grew by thirty-eight percent. Older students view college as a journey, not a destination. Yet in today’s economy many of the older students need the college degree to compete. Larson states in her *New York Times* article “Older, and Wiser, Students” that an Oklahoma master’s degree was approximately \$8,600 for residents and \$22,100 for nonresidents, while Stanford’s master’s degree could be anywhere from \$26,000 to \$35,000. This is an extremely costly additional expense to seniors that could be facing medical bills in their future (Larson, October 23, 2008).

In a July 28, 2009, *USA Today* article “Credit card debt rises faster for seniors; Those 65 and up are more likely to have medical bills”, a study by Demos, a liberal public policy group, shows that older Americans are racking up credit card debt faster than other consumers due to

their retirement portfolios values dwindling and rising medical costs. The study also shows that the older cash strapped consumer of low and middle income is now carrying on average \$10,235 in credit card debt, up twenty-six percent from 2005, while other lower aged consumers with the same income level is only up three percent. The cost of living, especially rising medical costs, is what is driving the average family into debt.

According to the Employee Benefit Research Institute, a non-partisan group that studies economic security, from 1992 through 2007, older Americans' credit card debt grew faster than the overall population. The *USA Today* article quotes statistics show that the average credit card debt by age group to be for 18-34 year olds, \$9,111, up one percent since 2005; for 35-49 year olds, \$10,514, up seven percent; for 50-64 year olds, \$9,342, up seven percent; and 65 and older, \$10,235, up twenty-six percent (Chu, July, 2009). Older consumers are the ones in need of protection from the credit card industry.

The CARD Act

The landmark credit card legislation should begin to provide relief from soaring interest rates and fees, while at the same time making it tougher for the credit card companies to market to young people. But the new law will not help those overextended, like the older consumer (Furman, May 2009). In a May 10, 2009, *Daily News* article, Obama is quoted as saying, "Instead of abuse that goes unpunished, we need to strengthen monitoring, enforcement and penalties for credit card companies that take advantage of ordinary American... We need a durable and successful flow of credit in our economy, but we can't tolerate profits that depend upon misleading working families... The abuses in the credit card industry have only multiplied in the midst of this recession, when Americans can least afford to bear an extra burden" (McShane, May 2009).

Iris Claus article titled "The Effects of Bank Lending in an Open Economy" refers to the bank lending channel and the balance sheet channel when describing the economic impact of credit market conditions on monetary policy. The article acknowledges that households receive income from three sources, the job (labor), the interest on savings, and the dividends on investments. Claus explains that the monetary policies and interaction of household incomes affect the overall economy with the supply of money for firms to borrow from. Claus explains that the "shocks" to the credit markets have affected other areas of the economy.

Banks are bracing for a large credit card write off. A result of the bank stress test results in May of 2009 suggests that the nineteen biggest banks could expect nearly \$82.4 billion in credit card losses by the end of 2010 (Dash, Martin, May 2009). Statistics do not show how much of this debt is actually from consumer spending or if the debt is due to the gimmicks credit card companies and banks have been applying to the average consumer. Banks and credit card companies have been double-cycling billing and retroactively raising interest rates on current balances. One estimate shows the credit card industry could lose fifteen billion in US dollars when the new law takes effect. The economics of credit card debt has changed from formerly being short term consumer loans to now becoming long term consumer loans. Yet still this debt needs to be repaid. This debt is also affecting the world economy. Changes need to be made to the way consumers spend in order for changes to take place in the world economy.

The CARD Act will help potentially new credit card holders and will eliminate some of the current abuses of credit card companies, but the CARD Act does not help the overextended consumer. The shocks to the economy will continue to happen if Americans do not learn to live

within their means. The American Dream is affecting other world economies. Other changes and recommendations need to take place in the spending habits of Americans in order to help the overall world economy.

Recommendations

As there is no world-wide autobahn, there is no world-wide financial autobahn either, but there is conformity about driving, so there should be conformity about financial responsibility. Churches teach a “Financial University” for married couples, yet financial responsibility should begin before marriage. Just as driving is a skill, so is financial responsibility a skill. Parents need to have the skill in order to teach their children the skill.

Swipe and spend has become an addiction. Teenagers to senior citizens world-wide need to understand that today the economies of all nations are intertwined into a global economy. American spending habits affect other national economies. Americans addictions to swiping and spending influence other populations when they try to live the American Dream.

The world population is also aging and with aging comes other financial responsibilities for the nations to maintain a certain standard of living for their loved ones. Medical expenses are bankrupting elder Americans and severally straining government budgets. The CARD Act does help to alleviate some of the debt burden by causing the credit card companies to stop the constant interest rate changes and the credit limit changes, but other changes need to be made to the attitude of the American and world consumers.

College campuses are trying to help educate their students to the pitfalls of credit card debt. Financial responsibility is being taught to incoming freshman as a course on financial literacy. These same skills need to be taught to the younger generations since the younger generations are becoming the newest consumers worldwide. Along with the help on financial responsibility, the addiction to just swiping and spending needs to be addressed. Once the financial responsibility skill is taught and understood by consumers, the world's economies can begin to recover and stabilize.

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