The Sun: Monday, February 26, 2001: Page 9A

American households swimming in red ink

By Robert D. Manning

Houston – Like an athlete who uses steroids to temporarily exaggerate muscle mass and to boost physical strength, the U.S. economy has been perilously inflated through the enormous increase of debt over the last two decades.

And, like the myriad of medical maladies that eventually afflict steroid abusers, the negative long-term impact of societal debt has been neglected during this period of unprecedented U.S. economic growth.

Today, the three principal legs of the U.S. debt triangle have reached staggering proportions: About $6.7 trillion in household (including home mortgages), nearly $5.7 trillion in federal (cumulative deficits) and more than $4.4 trillion in corporate debt. The key issue concerns the future consequences of enhancing national economic performance through the enormous infusion of borrowed money.

The most striking feature of the triangle is the explosion of household debt in the 1990s. This is because the post-industrial economy is fueled by the growth of consumer-related goods and services, accounting for about two-thirds of U.S. economic activity, known as Gross Domestic Product.

As long as American consumers demand increases, stagnant real wages (mid-1970s to late 1990s), declining labor benefits (health pension) and the expansion of temporary workers (from 417,000 in 1982 to 2.65 million in 1997) were obscured by the unprecedented use of consumer credit.

But, like steroid abuse, the dramatic decline in the U.S. personal savings rate (from nearly 8.5 percent in the early 1980s to less than zero today) and the sharp rise in consumer debt could have deleterious effects on the U.S. economy.

Since the end of the last recession (1989-1991), the Federal Reserve reports that total installment consumer debt rose from $731 billion in 1992 to about $1.5 trillion today. This includes a huge increase in unsecured credit card debt: from $292 billion in 1992 to $654 billion at the end of 2000. It’s a remarkable trend since credit card debt was only $50 billion in 1980.

Together with the bull market of the 1990s (“wealth effect”) and the corporate promotion of immediate gratification (“just do it” consumption) which inflated consumer expectations, Americans have tended to purchase more than they could possibly afford on their household income. This was facilitated by the aggressive marketing of bank and retail credit cards to traditionally neglected groups such as college students, senior citizens and the working poor.

The massive growth of household debt is only part of the problem. Since the onset of banking deregulation in 1980, the “real” cost of consumer credit cards has nearly doubled – not including penalty fees (one-third of total credit card revenues) – whereas the corporate “prime” rate has increased only slightly.

As a result, even the robust wage increases of the last three years have riot compensated for the rising cost of personal debt; only home mortgage-related finance charges are tax deductible. For instance, three out of five U.S. households are credit card "revolvers," with an average balance of more than $11,000. Last year, a 4 percent increase in U.S. family household income ($50,000 median) merely equaled the cost of their average credit card debt.

For the most heavily indebted, the cost of consumer credit is soaring.

The rapid expansion of "second-tier" banks includes check-cashing outlets, pawnshops, car-title lenders and rent-to-own stores with interest rates that make old loan sharks blush – typically from 120 percent to more than 400 percent per year (annual percentage rate). Not surprisingly, these enormous interest rates have attracted the attention of "first-tier" banks. In 1997, Wells Fargo formed a joint venture with Cash America (largest corporate pawnshop) to introduce an automated system of "payday" loan kiosks.

Today, a major concern is that financial services conglomerates such as J.P. Morgan Chase and Citigroup may overreact to the slowdown of the U.S. economy by curtailing loans to small businesses and heavily indebted families that previously were considered acceptable credit risks.

This would limit short-term employment grow and household consumption as well as force tens of thousands of economically distressed households (due to job loss, medical bills and divorce) into bankruptcy.

With bankruptcy reform a legislative priority of the Republication leadership, bankers could contribute to a potential consumer-led recession by requiring financially insolvent households to continue paying off a portion of their consumer debt for several years.

The realities of the "new" economy may complicate the Federal Reserve's ability to stimulate economic growth through its traditional policy of reducing interest rates.

This is because America's growing dependence on foreign investment is generating pressures against low rates at the same time that moderate rate reductions may not offer sufficient incentive for banks to loan additional money to heavily indebted families and small businesses.

It is this pendulum swing in the availability of easy credit that constitute a major challenge to the Fed's current policy of guiding the nation's consumer driven economy into a euphemistically labeled "soft" landing.

Robert D. Manning is a professor at the Institute for Higher Education Law and Governance at the University of Houston Law Center. Hi is author of "Credit Card Nation: The Consequences of America's Addiction to Credit" (Basic Books, 2000).