

# The crisis that credit created

Home ownership is the heart of the American economy and the most valuable asset for most Americans. Today, record numbers of households are facing foreclosure, and they will likely surge in the remainder of 2009. The real estate bubble and the sub-prime mortgage crisis that precipitated the collapse of the financial industry have pounded the United States and global economies. How did we get here?

The "American Dream" is about 19th-century immigrants who came here with very little and through hard work and perseverance rose above the financial barriers of their homelands. They strove to create a better quality of life through their celebrated work ethic, self-sufficiency, practicality, and ability to save for a rainy day.

The post WWII baby boomers copied the work ethic of their parents but, given the prosperity and optimism of the mid-20th century, relaxed the saving habit. We traded our parents' and grandparents' sacrifice and habit for saving in favor of immediate gratification. This was a major shift in our core financial values.

The 21st century version of the American Dream is unrecognizable. The boomers' children and grandchildren are raised on car loans, student loans, and credit cards. Many borrow from themselves using the equity in their homes! Paying our dues and working our way up the ladder is considered old-fashioned. Financial accountability is a relic.

The shift in core financial values has had help. Wall Street created flimsy investment products for their financial institutions to push, like the securitization of bundled mortgages, derivatives, hedge funds and other inane financial products. The repeal of regulations that resulted in the consolidation of banks, investment firms and insurance companies ensured the fire walls that protected consumers

## The Civic Beat

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were abolished. Wall Street went wild.

Up the block on Madison Avenue, the MadMen were busy selling materialism as an accomplishment and equating spending with happiness. There is no reason to wait for anything. Enter the credit card: a way to spend money we don't have on stuff we don't need.

Charging is chic. There is respectability in reaching the level of a "Gold", "Platinum", or "Black" card.

A 2006 promotion for a credit line from now-defunct Washington Mutual asked, "Just Can't Wait To Have It?" But charged an extra 25% interest to have it now. The result? There is more than \$1.5 trillion of yearly con-

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Common sense says that credit should be extended to those who can repay it. But the average family has as many as 13 credit cards and most of these cards were issued without proof of financial worth. We do not need a job to get a credit card. We can be 18 years old. Why? Credit card companies do not want us to pay our balances in full or on time. The industry's most profitable consumers are "revolvers," those people who carry a monthly balance and who pay late and incur late fees and higher interest rates (78% of us do not pay off our credit cards every month).

Modern credit scoring enables companies to divide us into groups based

on the likelihood that we will pay our bills on time. Those less likely to pay are more of a risk and, therefore, the companies charge a higher interest rate. Creditors wanting access to the more than 1 billion annual consumer credit reports must submit information about their own customers, payment history and current unpaid balances to the Fair Issac Corporation (FICO).

FICO uses this information in a formula that predicts the creditworthiness of borrowers and awards scores from 300 to 850. Scores above 770 get the lowest interest rates. Scores below 600 are subprime and those borrowers pay higher interest rates.

The credit score is increasingly important as more companies use it to make decisions about insurance rates, cell phone fees, rental car costs and rental apartment lease approvals. Some reporting agencies deliberately include incorrect information in credit scoring so their competitors do not pursue us as customers. Use [www.annualcreditreport.com](http://www.annualcreditreport.com) and [www.FICO.com](http://www.FICO.com) to review your credit report.

The government makes meek attempts to tame credit card companies. But credit card companies find ways to continue the confusing fine print of the lending agreement and use misleading advertising. The government has failed to address the usurious interest rates, fees and penalties charged by credit card companies. Why? Because credit keeps money flowing into the economy (buying all that stuff we don't need) even when we cannot pay it back.

We have gone from the "American Dream" quality of life to a full blown "more is better" consumption of stuff. So now that our core financial values rely on the daily use of credit instead of saving and the debt has come due, what's next? Faster your seat belts — it's going to be a bump ride. But the buck stops with us — the consumers. Go green and use cash.

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