A Report to the Nation from the Commission on Thrift

For a New Thrift
Confronting the Debt Culture

Institute for American Values
Institute for Advanced Studies in Culture
New America Foundation
Public Agenda
Demos
Consumer Federation of America
National Federation of Community Development Credit Unions

THIS REPORT COMES FROM THE COMMISSION ON THRIFT, a project of the Institute for American Values in partnership with the Institute for Advanced Studies in Culture, New America Foundation, Public Agenda, Demos, the Consumer Federation of America, and the National Federation of Community Development Credit Unions. The sponsoring organizations are grateful to the John Templeton Foundation for its generous support of this project. The contributions of other supporters are also greatly appreciated.

Being listed as a member of the Commission on Thrift designates only the signatory's overall endorsement of the report, *For a New Thrift*.

For more information on this initiative, visit www.NewThrift.org.

On the cover (clockwise): Rent-A-Center Truck, (Merrillville, IN); Jack's Pawn Shop (Gary, IN); Quick Sam Tax Refund (Gary, IN); Payday Loan Store at Night (Merrillville, IN). Photos by Tamara Reichberg, 2007.

ISBN: 978-1-931764-15-5

Institute for American Values
1841 Broadway, Suite 211
New York, New York 10023
Tel: (212) 246-3942
Fax: (212) 541-6665
Website: www.americanvalues.org
Email: info@americanvalues.org

For a New Thrift
Confronting the Debt Culture

Contents

Members of the Commission on Thrift

John Atlas, *National Housing Institute*

Peter Berkowitz, *Hoover Institution, Stanford University*

Lorraine C. Blackman, *Indiana University School of Social Work*

Jim Blaine, *State Employees' Credit Union, North Carolina*

David Blankenhorn, *Institute for American Values*

Ray Boshara, *New America Foundation*

David Bosworth, *University of Washington*

Gerard V. Bradley, *University of Notre Dame*

Sorcha Brophy-Warren, *Institute for American Values*

Don Browning, *Divinity School, University of Chicago, Emeritus*

Allan Carlson, *The Howard Center for Family, Religion and Society*

Frederic Clark, *Pacific Equity Management (La Jolla, California)*

Dalton Conley, *New York University*

William J. Doherty, *Family Social Science Department, University of Minnesota*

Tamara Draut, *Demos*

William C. Duncan, *Marriage Law Foundation*

Don Eberly, *The Civil Society Project*

Kenneth W. Eiden Jr., *Prospera Credit Union (Appleton, Wisconsin)*

Jean Bethke Elshtain, *University of Chicago*

Scott Fearon, *Crown Capital Management (Mill Valley, California)*

Lewis Finfer, *Massachusetts Communities Action Network*

Robert M. Frank, *Johnson Graduate School of Management, Cornell University*

Francis Fukuyama, *The Paul H. Nitze School of Advanced International Studies, Johns Hopkins University*

William A. Galston, *The Brookings Institution*

Sheldon Garon, *Princeton University*

Claire Gaudiani, *The George H. Heyman, Jr. Center for Philanthropy and Fundraising at New York University*

Neil Gilbert, *University of California, Berkeley*

Kenneth L. Gladish, *Austin Community Foundation*

Norval D. Glenn, *Department of Sociology, University of Texas at Austin*

Alan J. Hawkins, *Brigham Young University*

Rita Haynes, *Faith Community United Credit Union (Cleveland, Ohio)*

Randy Hicks, *Georgia Family Council*

James Davison Hunter, *Institute for Advanced Studies in Culture*

Robert L. Jackson, *Mississippi State Senate*

Byron Johnson, *Institute for Studies of Religion, Baylor University*

Tim Kasser, *Knox College*

Thomas C. Kohler, *Boston College Law School*

Phillip Longman, *New America Foundation*

Theadore Roosevelt Malloch, *The Roosevelt Group*

Sara Butler Nardo, *University of Chicago*

Leslie Parrish, *Center for Responsible Lending*

Robert A. Pedersen, *Goodwill Industries of North Central Wisconsin*

Christopher L. Peterson, *University of Utah, S.J. Quinney College of Law*

David Popenoe, *Rutgers University, Emeritus*

Stephen G. Post, *School of Medicine, Case Western Reserve University*

Kyle Pruett, *Yale Medical School*

Jan Roberts, *Earth Charter U.S.*

Alex Roberts, *Institute for American Values*

Clifford N. Rosenthal, *National Federation of Community Development Credit Unions*

Dean and Vicki Schooler for the *Schooler Family Foundation (Ohio)*

Ward R. Scull, III, *Virginians Against Payday Loans*

Michael Sherraden, *Center for Social Development, Washington University in St. Louis*

Ronald J. Sider, *Evangelicals for Social Action*

Peter Skerry, *Boston College*

Lee A. Unger, *The Piney Woods School*

Roland C. Warren, *National Fatherhood Initiative*

Amy L. Wax, *University of Pennsylvania Law School*

Barbara Dafoe Whitehead, *National Marriage Project, Rutgers University*

Robert Worsley, *NZ Legacy, LLC (Mesa, Arizona)*

Daniel Yankelovich, *Public Agenda*

Andrew Yarrow, *Public Agenda; American University*

Joshua Yates, *Institute for Advanced Studies in Culture*

Introduction

THE UNITED STATES IS EXPERIENCING a growing polarization in access to institutional opportunities to save and build wealth. For most of the twentieth century, nearly all Americans had access to grassroots institutions that helped them to save and to build a nest egg. These institutions included local retail banks, mutual savings banks, credit unions, savers' clubs, school savings bond programs, building and loan associations, savings and loans, and labor union-sponsored savings plans. Some institutions, such as credit unions, building and loans, and labor union plans, grew out of a cooperative, nonprofit banking tradition expressly created for the "small saver." But local retail banks also offered passbook savings accounts and children's savings programs for families of modest means. Together, these institutions constituted a broadly democratic "pro-thrift" sector of the financial service industry.

In addition to providing opportunities to save, pro-thrift institutions also limited the amount of debt that consumers could take on. Banks had strict rules for consumer lending. Americans who wanted to buy a house had to accumulate savings, apply to a local bank, document their credit-worthiness, undergo the scrutiny of the lending institution, and usually make a 20 percent down payment. Lending institutions were likewise constrained by government rules. Federal and state regulations set limits on the interest and fees lenders could impose. Finally, some forms of thriftlessness were outlawed entirely. Lotteries were illegal in all states; usury laws prohibited predatory interest rates; casino gambling was allowed in just a few venues, like Las Vegas and Atlantic City. To be sure, some Americans still borrowed from loan sharks, pawned their wedding rings, or gambled away the family farm. But these actions were widely viewed as disreputable, desperate, and beyond the pale of authoritative institutions.

Today, however, the institutional landscape looks much different. A pro-thrift sector still exists, but it is no longer broadly democratic in its reach. The institutions that encourage thrift have moved uptown. Major commercial banks and brokerages offer an ever-wider array of tax-advantaged opportunities to invest and build wealth. But in the wake of government deregulation and industry consolidation of the 1980s and 1990s, many leading financial institutions have abandoned the "small saver." Instead, they now focus on providing concierge services to Americans in the upper half of the income distribution. Changes in tax laws have also contributed to this upscale trend. Subsidies for savings now total more than $300 billion a year and go mainly to wealthier households that already have the means to take advantage of these tax incentives.

Meanwhile, new financial institutions have emerged to serve Americans whose wages or economic circumstances have locked them into the lower half of the income distribution. These institutions include a number of highly profitable businesses: subprime credit card issuers, payday lenders, rent-to-own merchants, auto title lenders, private student loan companies, some franchise tax preparers, check cashing outlets, and subprime mortgage brokers and lenders. Once a marginal presence on the financial landscape, these institutions now constitute a large and aggressively expanding sector. But this new sector is not pro-thrift. Quite the opposite. It is anti-thrift. And it is the growing influence of the anti-thrift sector that is dragging many American consumers into dissavings and overindebtedness.

Some anti-thrift institutions, such as the payday lenders, have become the new "people's banks." They provide face-to-face relationships, convenient service, and easy access that many small savers of modest means once found at the local bank and neighborhood savings and loan. Unlike the neighborhood pro-thrift institutions, however, the neighborhood anti-thrifts don't offer opportunities to save through interest-bearing checking or savings accounts, CDs, or IRAs. Their business is limited to providing "fast cash" and "no hassle" loans at triple-digit interest rates.

Anti-thrifts exist in the public sector as well. State governments have created their own anti-thrift institution: the state owned and operated lottery. Like the private anti-thrifts, these public anti-thrifts have emerged in recent decades. For seven decades, from 1894 until 1964, not a single legal government-sponsored lottery existed in the United States. Today, forty-two states plus the District of Columbia run lotteries.

The state lottery does not make predatory loans, but it exerts a powerful anti-thrift effect on the low and moderate-income players who are its most loyal customers. Through state-financed advertising, promotions, and new product campaigns, lotteries work relentlessly to habituate players to spend their spare cash on gambling and to regard small dollar investments in the lottery as the way to instant wealth—or, as is more often the case, to a fantasy of instant wealth.

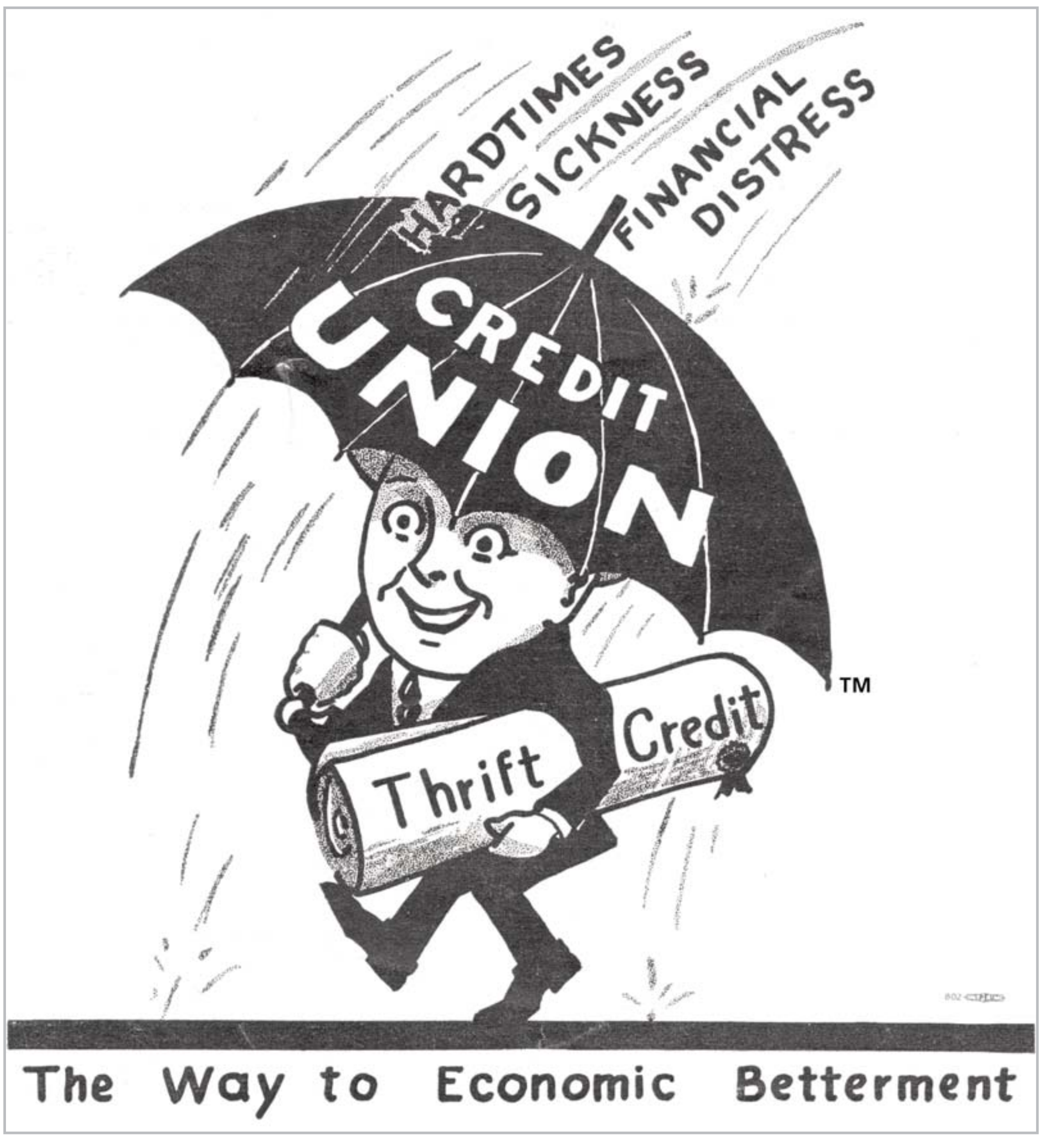
With the swift growth and spread of the anti-thrifts, a two-tier institutional system is emerging: The top tier consists of pro-thrift institutions that provide myriad ways and means for higher earning Americans to invest and build wealth. The bottom tier consists of anti-thrift institutions that provide multiple ways and means for lower earning Americans to forego savings, borrow at predatory interest rates, and fall into a debt trap.

THE TWO-TIER INSTITUTIONAL SYSTEM is contributing to a cleavage between an "investor class" and a "lottery class." The higher earning members of the investor class are not necessarily smarter or more disciplined about building wealth. But they do have greater access to institutions and expertise that foster wealth-building discipline. They are beneficiaries of tax incentives and advantages linked to their savings and investment plans. They are courted and served by a bevy of insurance agents, tax lawyers, stockbrokers, tax accountants, deferred compensation experts and investment bankers who will help them with their financial planning. They are likely to work in organizations with 401(k)s, profit-sharing plans, Keogh plans, deferred income compensation plans, and retirement savings programs. With pro-thrift opportunities and disciplines so seamlessly integrated into their work culture, members of the investor class have an automatic pathway to building a nest egg. As one bank brags, its investors can "make money while they sleep."

The lottery class, on the other hand, lacks such ready access to pro-thrift institutional disciplines. Many members of the lottery class are not working in jobs that offer benefits such as 401(k)s, profit sharing, or retirement plans. (In 2004, 70 million of America's 153 million wage earners worked for employers without a retirement plan.[1]) Nor are people in the lower half of the income distribution pursued by investment firms, tax accountants, or major banks. Instead, they are targets of payday lenders, subprime mortgage brokers, credit card issuers, tax refund lenders, and their friendly state lotteries. Their extra dollars do not find a convenient or automatic pathway into a savings account. Instead, they are drained off into high interest payments on predatory loans or used to support a daily lottery habit. Nor do they get tax-avoidance advice or tax advantages in return for their investments. More likely, they give up some of their tax refund dollars to franchise tax preparers in exchange for fast cash. And the leading public anti-thrift, the state lottery, imposes what amounts to an excise tax on them as well. In this way, millions of working Americans who might, under more favorable institutional circumstances, join the class of savers and investors, are now being recruited into a burgeoning population of debtors and bettors.

This is not the first time that anti-thrift institutions have stolen the dollars and dreams of so many working Americans. A century ago something similar was happening. Chattel lenders and salary lenders, more popularly known as loan sharks, were racking up huge profits by making usurious loans to a growing population of urban wage earners. In New York City alone, more than three out of ten workers owed money to the salary lenders.[2]

But back then, these predatory institutions did not go unchallenged. They faced fierce opposition from a small but determined band of Progressive reformers. These leaders spearheaded a campaign to drive the salary lenders out of business. They wrote social science reports and muckraking articles to expose the deceptive practices of the lenders, passed model legislation to encourage banks to compete against the loan sharks for the consumer loan market, and established a new pro-thrift institution—the credit union—to provide cooperative saving and low-cost lending as an alternative to the predatory lenders.[3]



At left: "Little Man Under the Umbrella," the main early symbol of the U.S. credit union movement.

Courtesy of the Credit Union National Association, Inc.

Debt and Its Discontents

THE ABILITY TO BORROW IS A GOOD THING. Or ought to be. Credit helps consumers to buy houses, get educations, start businesses, and acquire other valuable goods that may boost their job prospects and future income. As economists like to point out, consumer credit helps to smooth out spending over a lifetime—allowing people to borrow in their lower-earning years in order to build assets and investments for the future.

But easy access to consumer credit is always double-edged: It can open the door to greater opportunity and freedom, but, if promoted deceptively and used recklessly, it can close that door. As the subprime failure so painfully revealed, the binge in easy mortgage credit slammed shut a lot of doors. Foreclosures, which soared to over a million in 2007, are predicted to affect upwards of 2.5 million households in 2008. Consumer bankruptcy filings rose to 819,000 last year, and the stage is set for more than a million in 2008. In the wake of the mortgage meltdown, auto loan and credit card delinquencies are also sharply up.[4]

Even before the subprime debacle, however, many Americans were struggling with a growing debt burden. In 2004, according to the Federal Reserve's measure of burdensome debt, the typical family spent more than 18 percent of its income on debt payments, the largest share since the institution started collecting these data.[5] Moreover, the proportion of families with debt-service payments exceeding 40 percent of their income rose to 12.2 percent in 2004.[6] Consumer loan delinquencies also rose during this period.

Some of this debt is to be expected. Many middle-income and young families—who now make up the largest share of households in the heavy debt-service category—are at the stage in life where they are rearing children and buying big-ticket items, like houses, cars, and computers. But families have also been hit hard by stagnating wages and the rising costs of health care, food, and energy. In a recent 2008 survey, fully 58 percent of the public say that their incomes are falling behind the rising cost of living.[7] This has led many American families to rely on credit, not as a way of building assets, but as a way of simply making ends meet.

Some aren't making it. Late fees and missed payments on credit cards have risen, costing consumers $17.1 billion in fees in 2006. About one in every seven families report that at some point in their lives they experienced debt problems serious enough to have caused them to file for bankruptcy or to use a credit consolidator. More than one out of three Americans say that they have felt their financial situation was out of control at some point in their lives.[8] Even those who are able to manage high household debt are increasingly operating at the razor's edge of solvency—with little cushion to cover an unexpected expense, such as a car repair or medical emergency. In 2006, about a third of adults said that they had experienced an unexpected expense in the past year that "seriously set them back financially."[9]

DEBT IS BURDENING YOUNG AMERICANS AS WELL. Historically, young people are often poor, but they haven't always been buried in debt. Today, however, many are. Long before they finish school and become full-time earners, teenagers and young adults are amassing a staggering amount of debt. Most college students today enter school with credit cards and acquire more cards as they go along. Forty-four percent carry forward a balance each billing period, with an average outstanding balance of more than $2,000. Almost a quarter of undergraduates in 2004 carried balances in excess of $3,000.[10]

In addition, more students are borrowing to cover the costs of their education. In 2004, two-thirds (66.4 percent) of students at four-year colleges and universities had student loan debts, compared to less than half of four-year graduates in 1993.[11]

Borrowing for college is generally considered a "good" debt, because college graduates earn substantially more than those with only a high school diploma. Research suggests that good debt for education, however, may be reaching a tipping point where it is turning into bad debt. Compared to the early 1990s, the level of student debt has become crushingly high. Graduating seniors in the Class of 2006 left college with an average debt estimated at $21,000 in educational loan obligations, an 8 percent increase over average student loan debt in just the previous year.[12] In addition, some college students borrow to go to school but then fail to graduate, leaving them with few of the benefits and all of the debt obligations for the years they spent in college. Further, college graduates may find that their early earnings are not as high as they had hoped or that they can't find regular employment after graduation. Some students borrow heavily for college with the optimistic assumption that they will be able to repay college loans as soon as they find work. But life does not always obey optimistic assumptions. Recent college graduates who start out in low-wage jobs or face unexpected financial setbacks, such as job loss, health problems, or divorce, can struggle for years to pay off heavy student debt.[13]

In another troubling trend, more students are turning to private lenders who charge variable interest rates as high as 20 percent APR (annual percentage rate) compared to the fixed rate maximum interest of 6.8 percent on federal student loans.[14] Private lenders typically prohibit student borrowers from paying off the loan ahead of time or paying more than the required amount on each installment—thus ensuring the lender maximum interest over the repayment period.[15]

Low-income students who enroll in a proprietary school are even more vulnerable to the risks of incurring debt but ending up with nothing to show for it—except perhaps a garnished paycheck. Proprietary schools enroll more than a million students, most of whom are poor, have experienced past educational failure, and must take out federal student loans in order to attend. The schools promise training for the local job market, but their placement services are often limited or nonexistent.[16] And if low-income students graduate but fail to find work, they are less likely than more affluent students to have family resources to fall back on.

Many young adults remain strapped by debt well into their thirties. Indeed, the twenty-five to thirty-four-year-old age cohort devotes 24 percent of its income to paying off debt, most of which is for credit cards, student loans, and car loans.[17] High debt can influence career paths. More than four out of ten college graduates cite student loan debt as the reason for not pursuing graduate school.[18] Overindebtedness affects love as well as work. Young single adults and young unwed parents with high debt or bad credit ratings are less attractive as prospective marriage partners.[19] Given these realities, it is fair to ask this question: How good is debt when it hangs on for a decade or more and creates obstacles to career development and family formation, the two main tasks of early adult life?

The Institutional Sources of the Debt Problem

Why is it that so many Americans are struggling with high levels of consumer debt? Some blame individual greed and recklessness. Clearly, human frailty is part of the story. Some people get over their heads in debt because of their own profligacy and irresponsible choices. Others point to a rampant culture of consumerism. To be sure, the ceaseless temptation to overspend is also part of the story. But soaring levels of household debt are also tied to another, often overlooked, source: recent changes in the institutional landscape.

In money matters, as in most things that matter, authoritative institutions play a role in guiding individual choices and in setting cultural norms. Individual choice is fallible; it is hard for an individual to take into account the full range of forces affecting the present and future and to assess personal outcomes as well as outcomes for others. Nor does every individual invest the time, effort, and practice in acquiring the knowledge and self-discipline that would make for highly informed decision making. That is where authoritative institutions come in. They establish the norms, conventions, and values that vest individual decision making with broader social knowledge. Additionally, institutions function as commitment keepers. They help individuals to form regular habits and steadiness of purpose in a cacophonous world of competing messages and appeals. And finally, authoritative institutions command trust. They reduce the costly need for constant monitoring and surveillance. They are, as economists say, efficient.

But this is not to suggest that authoritative institutions are themselves infallible or that they consistently guide individuals into wise choices. Some authoritative institutions inculcate norms and values that foster unwise choices or contribute to unjust outcomes. Such is the case in today's debt culture. Newly powerful and aggressive institutions are promoting behaviors and attitudes that undermine the habits of thrift, the ability to save, and the opportunity to achieve important life goals.

America's Anti-Thrift Institutions

IN MID-TWENTIETH CENTURY AMERICA, a strapped wage earner who needed extra cash to pay an overdue utility bill, repair the family car, or make the rent had limited ways to get the necessary funds. Family and friends were often the first source of a short-term, possibly interest-free, loan. Failing that, pawn shops would take a wedding ring, musical instrument, fur coat, or some other piece of personal property as security for a small, high-interest loan. As a last resort, the local loan shark could provide the cash at predatory interest rates.

*At left:
Jack's Pawn Shop on Broadway (Gary, IN), 2007.*