

Life-in-Debt Situation

More Americans Use Credit to Enjoy the Things They Can't Really Afford

BY BOB DAVIS

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Benjamin Baggett got his first credit card on his honeymoon in 1990 and promptly maxed out his \$300 credit line. He wanted to buy himself and his wife some new clothing, and he hadn't saved enough to buy it outright on his \$11-an-hour concierge job at a Doubletree Hotel near Salt Lake City.

The charges were the first of many for Mr. Baggett, now 38 years old. In 1995 he moved into an upscale neighborhood near the University of Utah that is home to many doctors, lawyers and professors. Mr. Baggett used credit cards to furnish the home with the kind of carpets and furniture his neighbors and relatives could afford. "I felt insecure; I was an hourly-paid worker in this fancy neighborhood," he says.

Twice he used a home-equity loan to pay off his credit-card debts, and twice he ran up steep credit-card bills again. When his debts reached \$30,000 and he ran out of home equity, he filed for bankruptcy in 2003. "We came to rely on credit as part of our income, even though it wasn't part of our income," says Mr. Baggett.

A Way to Get Ahead?

More and more Americans are turning to debt to pay for lifestyles their current incomes can't support. They are determined to live better than their parents, and easy credit offers them a way to get ahead, at least temporarily.

To some, the expansion of credit is a milestone of democracy, giving middle- and lower-income people financial flexibility that only the rich used to enjoy. Others see borrowing as a way for average households to make up for sluggish growth in income over the past several decades. Since 1990, income for the median American household has risen only 11% after adjusting for inflation, while median household spending has jumped at 30%, according to an analysis by Economy.com. Median household debt outstanding, meanwhile, leaped by 80%.

Americans spent half the money from refinancing their homes in 2001 and early 2002 to pay for home improvements, cars, vacations and other consumer expenses, the Federal Reserve reports. Many other consumers relied on credit cards. U.S. households with at least one credit card owed \$9,205 in 2003, a 23% increase from five years earlier after adjusting for inflation.

Economists Fabrizio Perri of New York University and Dirk Krueger of Goethe University in Germany trace the credit surge to the widening income gap between the rich

and the rest of U.S. society. The gap between the incomes of those at the top and the bottom widened substantially between 1970 and 2000, but the gap in consumption widened much less, as moderate-income Americans turned increasingly to debt.

But many economists—led by Federal Reserve Chairman Alan Greenspan—see the expansion of credit to lower-income families as a sign of progress. In a recent speech, Mr. Greenspan noted that in colonial times through the late 19th century, only the affluent had access to credit, and rates were high. In the early 20th century, gasoline companies and retail stores started issuing credit cards, but cards didn't spread widely until the late 1960s when banks piled into the business. Now, Mr. Greenspan says, "innovation and deregulation have vastly expanded credit availability to virtually all income classes."

Those who celebrate credit's new reach, such as University of Chicago economist Erik Hurst, talk about income "smoothing"—the idea that debt enables people to borrow from their future earnings. In an earlier era, many people had no choice but to save first and spend later. Now, with credit, they can spend right away. For many young people, it's realistic to expect their earnings to rise.

In Miami, April Danese, a 30-year-old grade-school teacher, used a mortgage that required her to make only interest payments for the first five years to buy her first home, a \$140,000 condominium. The interest-only feature reduced her payments by about \$400 a month, she calculates. By the time she has to start paying principal as well, she hopes to have finished a master's degree and be in line for a substantial raise. Failing that, she figures she could sell the condo for a profit if the mortgage payments get out of hand.

Yet many people fear credit has spread so widely that many Americans are overextending themselves, leaving a growing number anxiously in debt and, increasingly, bankrupt. Outstanding household debt doubled to more than \$10 trillion between 1992 and 2004, after accounting for inflation.

Because of low interest rates, consumers' monthly debt burden didn't increase nearly as rapidly over this period. But it's not clear whether this relatively benign situation can continue. Interest rates are rising—although long-term rates remain low—and wage growth is sluggish.

'I Have to Have It'

Indeed, using debt to try to move ahead has as many pitfalls as promise. Growing up in a small house with a large family, Winford Wayman, a 30-year-old construction worker in Utah, longed for privacy and open spaces. But

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he and his wife, Kristin, a 26-year-old bookkeeper, fell behind as they borrowed to buy pickup trucks. Mr. Wayman has purchased or leased four since 1999.

"I like trucks," says Mr. Wayman. "They make them so damn good-looking. I see a good-looking truck and I have to have it."

Recently, the Waymans got interested in a \$125,000 home in Tooele, a suburb in the Salt Lake flatlands. They applied for an interest-only loan, but just as the loan was being finalized, Kristin Wayman got cold feet. She feared the couple couldn't afford the payments. They ended up going through with the deal, fearing a lawsuit if they tried to back out.

Now the Waymans are trying to figure out how to finish the basement, an expense that may require additional borrowing. "I don't think I'm too glad that I have all these ways of borrowing," says Mr. Wayman.

*Is the expansion of consumer borrowing
a sign of economic danger or progress?
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