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The credit card crisis and the false promise of the Obama administration

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A crisis in credit card debt is likely to be one of the next major shocks to the US banking system. Many large institutions, such as Bank of America and Citigroup, already effectively insolvent but for billions of dollars of bailout money from the federal government, will now see their financial positions deteriorate even further.

Personal debt, primarily in the form of home equity loans and credit cards, has been one of the principal mechanisms whereby working class families have attempted to counteract the decline in real income since the 1970s. Indeed, much of the consumer spending that has buoyed the US economy over the last few decades was facilitated by credit cards and other forms of personal debt. At the same time, the provision of "credit" has become one of the most substantial sources of income for banks in the face of an increasingly frenzied drive to raise profitability. However, this situation is now undergoing rapid change.

As banks have suffered major losses in mortgages and other "toxic assets," they have continued to make money on credit card debt by increasing interest rates and fees and through a range of deceptive practices that are being imposed on card holders abruptly and with little or no justification. The growing anger over these practices, which affect working class and also more well off middle class people, has been receiving increasing attention in the media; so much so that bills have been introduced in both the House and Senate to address the issue.

And, last week President Obama held a meeting with prominent credit card industry executives during which he gave them some friendly advice that they should moderate their most egregious practices so as to deflect additional damage to their public image among the mass of the population. The executives listened politely, but gave no indication that they intended to follow Obama's advice.

The banks remain determined to continue to exploit this, one of their few remaining sources of profits. Fitch Ratings reports that US credit card delinquencies and charge-offs exceeded record levels last month as a result of the economic crisis. Nevertheless, yields to the card issuers increased, indicating that terms are being manipulated to squeeze borrowers even more tightly.

There is a substantial contradiction in the banks' credit card practices. On the one hand, middle and working class people are suffering ever more from the effects of the economic crisis. Unemployment, loss of medical insurance, home foreclosures, and the like are making it increasingly difficult to keep up with credit card payments. Indeed, credit cards are often a desperate last resort when all other sources of support have been lost.

This is leading to the increase in delinquencies cited by Fitch Ratings. At the same time, however, the credit card issuers are doing their utmost to extract even more money from credit card holders by whatever means they can devise. Interest rates of 10 percent to 15 percent are now becoming the norm, and rates of more than 20 percent are appearing with increasing frequency; this at a time when the rate paid by banks to borrow money from the Federal Reserve is virtually zero.

The “scissors effect” between payment defaults on the one hand and rising interest rates and fees on the other is becoming ever more pronounced. The Washington Post reports, “Already some credit card issuers are seeing close to double-digit charge-offs. For example, Capital One Financial said its charge-off rate spiked to 8.4 percent in the first quarter, up from 5.85 percent in 2008 and 3.72 percent in the first quarter of 2007. The company said it expects further increases in its US credit card charge-off rate through 2009 as the economy continues to weaken.” Charge offs are losses that the companies remove from their balance sheets because they have no hope of collecting what is due. The amounts of money involved are substantial. According to Time, analysts predict credit-card defaults could total more than $75 billion this year.

In part, the banks’ usurious practices are intended to compensate for the rising defaults on credit card payments, but also, and more importantly, the banks are trying to bolster their overall cash flow in the face of massive losses in other investments. Never mind that by squeezing ever more tightly people who are already in economic difficulty the banks are guaranteeing that even more defaults will occur, thus creating an ever-increasing downward spiral. Such is the perverse logic of the capitalist system.

The perversity of the drive for profit apparently knows no bounds. Card issuers actually like to give high-fee credit to people in or just out of bankruptcy because a debtor can only seek personal bankruptcy protection once every 8 years, according to Forbes. College and even high school students are being actively marketed by credit card companies. It’s being reported that as education costs are rising students are forced to make increasing use of credit cards. Coming on top of education loans, this desperate measure is placing them in even greater debt, before they even fully enter their working lives.

Credit cards are a form of “predatory lending” as was the whole range of risky mortgages and mortgage-related “instruments” that have already blown up into a major financial crisis. Credit card debt has been “bundled” and sold off by the banks in a manner similar to what was done with subprime mortgages. For years, both of these investment categories were virtually unregulated mechanisms for banks and similar institutions to realize large profits by selling and reselling the same assets at increasingly inflated prices and with less and less relation to real value.

The Federal Reserve has announced some rule changes that would put some minimal curbs on the most extreme of the banks’ abusive practices. However, these changes would not take effect until July of 2010. A bill with similar provisions recently passed by the House Financial Services Committee, the “Credit Card Holders Bill of Rights,” has effectively the same time line. Therefore, even this “relief’ will not come until a tremendous amount of additional pain has been inflicted on working people. These time frames give the credit card issuers another year or more of totally unfettered license to rake in super-profits and, at the same time, give the government the ability to claim that it is helping ordinary people against the rapaciousness of the banks.

At best, the proposed rules, either those of the Fed or of the Congress, would only retard slightly the banks' ability to increase interest rates and raise fees. So, the charging of usurious rates of interest and all the other changes that are placing so much additional stress on working people could continue, just a little more slowly.

In supporting these moves, President Obama has indicated that his aim is to provide more "information" to people using credit cards. Obama takes issue with "deceptive practices," framing the issue as one of "fairness."

Giving debtors forewarning of an impending increase in already onerous interest rates or fees, or the enactment of new fees does nothing for people who are already or soon will be in financial difficulty. Those facing layoffs, mounting medical bills or other effects of the economic crisis have no ability to pay off the outstanding balance or to switch to another credit provider since their credit rating is likely already low.

Even these virtually worthless proposed changes are receiving strong opposition from the credit card industry and their political allies. Furthermore, banks are frantically raising rates in anticipation of possible restrictions in the future. Some Democrats in the House and Senate have proposed an immediate freeze on credit card interest rate increases. The chances for passage of such a measure in the Senate are seen as slim, at best, even by its supporters.

The credit card industry is raising the claim that government regulations, especially via legislation rather than the more easily reversed moves by the Fed, would simply result in greater restrictions on the availability of credit to "good" borrowers, making them pay for the mistakes of "bad" borrowers. The hypocrisy of such statements is colossal given that the banks are already engaged in a major triage of credit holders after having practiced outright usury on a massive and uncontrolled scale.

Tied to this is the myth of "good" verses "bad" debtors—the former being those who pay their bills on time, maintain balances below the maximum and don't behave in ways that the banks consider "risky." Good debtors deserve the government's help, but bad debtors don't. This mythology is intended to justify the ruthless behavior of the banks by demonizing people who are being hit by the economic crisis. As a consequence, cosmetic changes can be heralded as restoring "fairness" for the good debtors, while the banks are pretty much left to do what they like. Of course, as the crisis deepens, more and more people will be driven into the bad debtor category.