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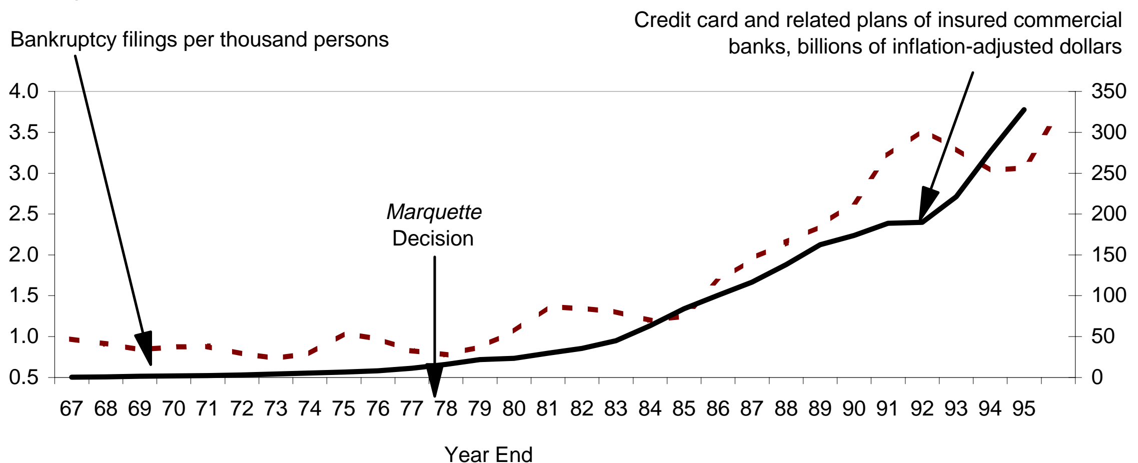
The Effect of Consumer Interest Rate Deregulation on Credit Card Volumes, Charge-Offs, and the Personal Bankruptcy Rate

The rising level of credit card debt is often cited as one of the factors in the rising U.S. personal bankruptcy rate. Numerous theories have been advanced to explain the increases, including aggressive marketing by credit card issuers and a lack of discipline on the part of consumers. These explanations do not address the underlying reason for these trends. This paper argues that a 1978 Supreme Court decision ("*Marquette*") fundamentally altered the market for credit card loans in a way that significantly expanded the availability of credit and increased the average risk profile of borrowers. *Marquette* ushered in deregulation of usury ceilings on consumer interest rates by allowing lenders in a state with liberal usury ceilings to export those rates to consumers residing in states with more restrictive usury ceilings. The result was a substantial expansion in credit card availability, a reduction in average credit quality, and a secular increase in personal bankruptcies. The Canadian experience with bankruptcies supports this argument. This paper contends that a tightly regulated world, marked by restricted access to consumer credit and a low level of personal bankruptcies, was exchanged for a deregulated world, marked by expanded access to consumer credit and a higher level of personal bankruptcies. This argument implies that a return to the bankruptcy rates and charge-off levels that prevailed in the early 1980s or before may be unlikely.

The Long-Term Rise in the Personal Bankruptcy Rate Started Shortly after Interest Rate Deregulation



Source: Bank call reports, Administrative Office of the U.S. Courts, and Census Bureau

The Effect of Consumer Interest Rate Deregulation on Credit Card Volumes, Charge-Offs, and the Personal Bankruptcy Rate

Introduction

The U.S. personal bankruptcy rate has risen to a historically high level, from less than one per thousand population annually in the early 1970s to almost five per thousand population for the year ending September 30, 1997. An increase in outstanding consumer debt, particularly credit card debt, has been cited as a significant contributor to the increased rate of filing. One financial planner was recently quoted as saying, "I've never seen anyone come in with a financial problem that wasn't related to credit cards."[1]

Aggressive marketing by credit card lenders or a lack of discipline on the part of consumers often are blamed for the increase in credit card debt outstanding. These explanations in essence argue that behavior has changed: that lenders have become more aggressive or borrowers less prudent. Whatever the merit of these explanations, they leave unanswered questions as to when and why behavior changed.

Some industry experts have attributed the increases in credit card debt outstanding and personal bankruptcies to changes in marketplace rules rather than changes in lender or borrower behavior. One type of change to the marketplace rules occurred in both 1978 and 1994 when federal bankruptcy law was modified, in part, to increase the level of assets that could be protected in a bankruptcy filing.[2]

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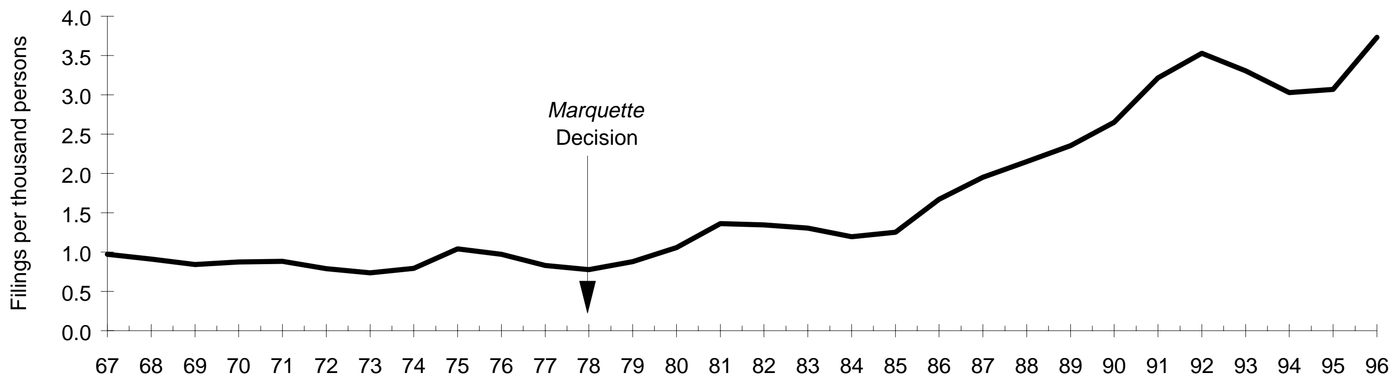
These legal changes, which made bankruptcy a more attractive option for debtors, sometimes are cited as reasons for the rising level of personal bankruptcies. Despite the intuitive appeal of this argument, there is some evidence that changes in bankruptcy laws may not be a primary driver of increases in personal bankruptcy rates. For example, Ellis (1998) provides evidence on the lack of correlation between state homestead exemption rates and state personal bankruptcy rates. Zandi (1997) points out that a similar increase in personal bankruptcies has occurred in Canada without any significant recent changes in the bankruptcy law.

Another significant change to the marketplace rules occurred in the late 1970s with deregulation of consumer interest rates. Both Ausubel (1997) and Rougeau (1996) focus on interest rate deregulation as the event that set the United States on a course of rising credit card volumes. Chart 1 illustrates that the dramatic rise in personal bankruptcies did indeed begin shortly after the Supreme Court's *Marquette* decision, which initiated interest rate deregulation. This chart suggests a relationship between interest rate deregulation and the increase in personal bankruptcies. The evidence alone is not sufficient to establish a causal relationship; this paper argues that such a relationship exists.

The argument advanced in this paper for the importance of interest rate deregulation as a driver of expanded credit availability and higher personal bankruptcy rates differs from those offered by Ausubel and Rougeau. Ausubel (1997) maintains that borrowers underestimate their use of credit cards and, therefore, the importance of credit card interest rates, which enables lenders to earn an extranormal profit on every good customer. He argues that the extraordinary profits made by credit card lenders have

Chart 1

The Long-Term Rise in Personal Bankruptcy Filings Started Shortly after Interest Rate Deregulation



Source: Administrative Office of the U.S. Courts, Census Bureau

caused them to relax their standards and make credit available to poorer credit risks. Rougeau (1996) suggests that the absence of interest rate regulation allows credit card lenders to pursue unlimited profits by taking advantage of borrowers' weakness and desire to consume, which often reaches an irrational level.

This paper does not take a position on the merits of Ausubel's and Rougeau's arguments. Instead, it offers another explanation of the impact of interest rate deregulation that is based on the pricing and underwriting decisions of lenders and the rational borrowing decisions of consumers. The argument suggests that an increase in both credit availability and bankruptcies was a perhaps inevitable result of interest rate deregulation.

Usury Laws Have a Very Long History

Usury laws perhaps have a more ancient lineage than any other form of economic regulation. Modern scholars appear to agree that limitations on lending rates at least in Western law derive from biblical prohibitions on usury.[3] During biblical times, and throughout much of recorded history, usury was defined as lending at *any* amount of interest. The prohibition of usury was based partially on the principle that charging interest is taking advantage of the debtor (Moser 1997, 3–4).

The Greek philosopher Plato also condemned charging interest because he felt that it produced an inequality of wealth and destroyed the harmony between citizens of the state (Moser 1997, 5–6). Plato's writings suggest that some members of society need to be protected from lenders, an argument that still finds its way into the modern-day debate over consumer credit.[4]

As commerce expanded and money lending became increasingly important, opinions about usury changed. The Romans were more tolerant of usury and were one of the first societies to recognize interest and set maximum legal rates for various types of loans (Mandell 1990, 13). Throughout much of recorded history, societies around the world have felt that it was important to limit the interest rate that a lender can charge in order to restrain lenders from taking advantage of borrowers.

American Usury Laws Have Been in Place since the Colonial Era

The American colonies built upon well-established English law regarding usury and after the Revolution retained this body of law (Ackerman 1981, 85). By 1886, every state had some general usury limit in place.[5] However, when states felt that the general usury limit was unduly restricting the amount of credit, they passed legislation to create exceptions. For example, almost every state has some provision permitting businesses to borrow at higher rates than the general usury limit (Ackerman 1981, 108). As the number of exceptions grew, state usury laws became a complex and disorganized array of rules.

The Development of the Credit Card Industry and the Role of Usury Laws

Charge cards came into use around 1914 when Western Union and various department stores, hotels, and oil companies began using them.[6] These early cards could be used to purchase the issuer's goods and services only, and balances had to be paid in full each month. In 1950, Diners' Club introduced the first "general-purpose" charge card that could be used at a variety of establishments; American Express issued a similar card in 1958. Credit cards evolved from charge cards when banks entered the industry as issuers in the late 1950s. Banks issued general-purpose credit cards that allowed balances to be carried over from month to month.

Even after banks entered the credit card industry, the growth of the industry was slow for more than a decade because most merchants accepted only cards issued by local banks. The modern-day credit card industry emerged in 1966 when Bank of America began licensing its BankAmericard credit card logo to other banks, and a national system to process credit card transactions began to develop. These participating banks later formed the entity known today as VISA. Another group of banks formed the MasterCard association in 1966.

State Usury Laws Restricted the Credit Card Industry

The VISA and MasterCard associations developed the infrastructure for a nationwide credit card payment system and convinced merchants nationwide to accept their cards. However, state usury laws prevented credit card lenders from reaping all the benefits of a nationwide system. First, the differences in state laws imposed a costly legal burden on credit card issuers, who were required to monitor and adhere to at least 50 different state laws. Also, lenders did not always find it profitable to lend in states where usury ceilings were low.

Lenders were bound to the individual state limits because of the way the federal banking law was interpreted at that time. Federal law subjects national banks to the rate ceilings imposed by the states.[7] This law originally was interpreted as requiring the lender to charge no more than the limit prescribed by the state where the borrower resided. State laws varied as to the maximum rates that could be charged on credit card loans as well as on whether other charges, such as membership fees and late fees, were permissible.

Usury Laws Limited the Volume of Credit Card Lending

The development of the VISA and MasterCard associations resulted in significant growth in credit card debt outstanding; however, not all consumers were granted access to credit cards. If the rate ceiling in effect was too low to enable lenders to generate sufficient income to cover the losses incurred when lending to high-risk borrowers, lenders would deny that group access to credit. Therefore, in a regime of restrictive usury ceilings, where the lenders' income potential was limited, lenders extended credit only to higher-quality borrowers, and poorer quality borrowers were shut out of the market. This situation resulted in less credit availability and lower charge-offs.

Studies by Canner and Fergus (1987) and Villegas (1989) confirm that restrictive usury ceilings reduce the overall supply of credit and that high-risk borrowers are the hardest hit by the cutback.[8] The example of Sears provides a good illustration of a lender's reaction to restrictive usury ceilings.[9] In 1974, rising interest rates caused usury limits in some states to become binding, and Sears began to cut back promotion of its retail card in those states. For example, in Arkansas, Minnesota, South Dakota, Iowa, and Washington, where interest rate limitations ranged from 9 to 12 percent, residents were allowed to receive service, but accounts were opened only on request. Delinquent customers in these states often found that their accounts were closed permanently.

The Dismantling of Consumer Usury Laws

Economic Forces in the 1970s Made Credit Card Lending Unprofitable

High inflation and high interest rates in the late 1970s made state usury limits more restrictive. As a result, credit card issuers experienced declining earnings and even suffered losses. A General Accounting Office (1994) report on the credit card industry shows that the average pretax earnings of VISA and MasterCard issuers was over 4 percent of outstanding balances in

1977 but fell for four consecutive years to less than negative 1 percent in 1980 and 1981. The interest rate ceilings set by many states simply were too low to make credit card lending profitable in the high-interest-rate environment.

Usury ceilings varied widely throughout the United States, but at the end of the 1970s, 37 states had some kind of interest rate ceiling on credit cards.[10] Only three states had no limit, and two states had limits that were above 18 percent. Three states allowed rates of above 18 percent for a portion of the balance, while the remainder of the states set rates lower. Minnesota had the lowest interest ceiling in the country, at 8 percent.

The Supreme Court Deregulated Consumer Interest Rates

In the economic environment of the late 1970s, the general opinion on usury limits appeared to change.[11] Part of this relaxation can be attributed to the high nominal interest rates of the time, which restricted credit availability and made the disadvantages of usury limits more apparent.

In 1978, the Supreme Court profoundly changed the interpretation of usury laws with a ruling in the case of *Marquette National Bank of Minneapolis v. First Omaha Service Corp.* ("*Marquette*"). The solicitor general of Minnesota was attempting to prevent First Omaha from soliciting credit card customers in Minnesota at the higher Nebraska interest rates by contending that the exportation of Nebraska's interest rate would make it difficult for states to enact effective usury laws.[12] The Supreme Court agreed that such might be the case, but it decided that the usury issue was a legislative problem to be handled by Congress.[13] The Court held in *Marquette* that section 85 of the National Bank Act allowed a lender to charge the highest interest rate allowed in the lender's home state, regardless of a lower rate limitation in the customer's state of residence.[14]

The Effects of the *Marquette* Decision on Credit Card Lending

The *Marquette* decision applied to all types of consumer loans, but it had the greatest consequences for the credit card industry. Because of its use of technology in the solicitation and underwriting process, credit card lending can be accomplished entirely by mail, without the borrower and lender ever meeting. Consequently, credit card lenders head-quartered in states with liberal usury ceilings can easily export their rates to borrowers residing in states with restrictive usury ceilings.

State Usury Ceilings Were Dismantled

After the *Marquette* decision, liberalization of state usury ceilings occurred. Some states quickly seized the opportunity to deregulate interest and other banking functions to attract banks and other consumer lenders. Two such states were South Dakota and Delaware. Citicorp was one of the first lenders to take advantage of deregulation at the state level. It established a new national bank and credit card processing center in Sioux Falls, South Dakota, in 1981 (Janklow 1985, 32).

The practical effect of the *Marquette* decision was to force states to deregulate or face a loss of the credit card segment of the banking business (Langevoort 1987, 686). Major banks pressured state legislatures to relax limits on lending by threatening to move their businesses to states with more liberal ceilings. The four largest banks in Maryland did move their credit card operations to Delaware when the Maryland state legislature refused to relax the state's usury laws.[15]

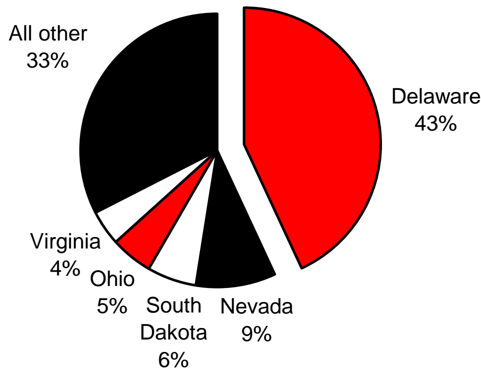
According to Ausubel (1991), most leading banking states had relaxed or repealed their interest rate ceilings by 1982, and the bank credit card market was effectively deregulated.

A Redistribution of Credit Card Lending Occurred among States

After leading banking states had deregulated their interest ceilings, a redistribution of credit card activity to those states occurred. Delaware has been the primary magnet for credit card lenders.[16] In the two years after Delaware deregulated, at least ten banks had a new, major credit card presence in Delaware. Today, six of the top ten banks with the highest volume of credit card lending are located in that state, and lenders in Delaware hold 43 percent of total credit card loans made by insured depository institutions (see Chart 2). Chart 3 illustrates the dramatic growth in credit card volumes that occurred after deregulation in Delaware.

Chart 2

Delaware Has the Largest Credit Card Volume* of any State in the United States, June 1997



Source: Bank and thrift call reports *Includes securitizations

Credit Card Lending Has Accelerated

In addition to a redistribution of lending to certain states, growth in credit card lending has accelerated throughout the United States. Since the *Marquette* decision, total credit card loans have grown at a rapid pace compared with the previous decade (see Chart 3). According to the Federal Reserve *Survey of Consumer Finances*, the percentage of households with at least one credit card account grew from 38 percent in 1977 to 43 percent in 1983 to 54 percent in 1989 (GAO 1994, 13). Credit cards have revolutionized consumer debt and have become firmly entrenched as means of financing household purchases.

The Benefits of Holding Credit Cards Have Increased

As credit cards have become more widely held, collateral benefits of holding credit cards have arisen (Baxter 1995, 1022). More merchants have started accepting credit cards, which has made paying for goods and services more convenient for consumers. Also, entire industries, such as the catalog/phone order industry, have emerged as a result of the widespread acceptance of credit cards.

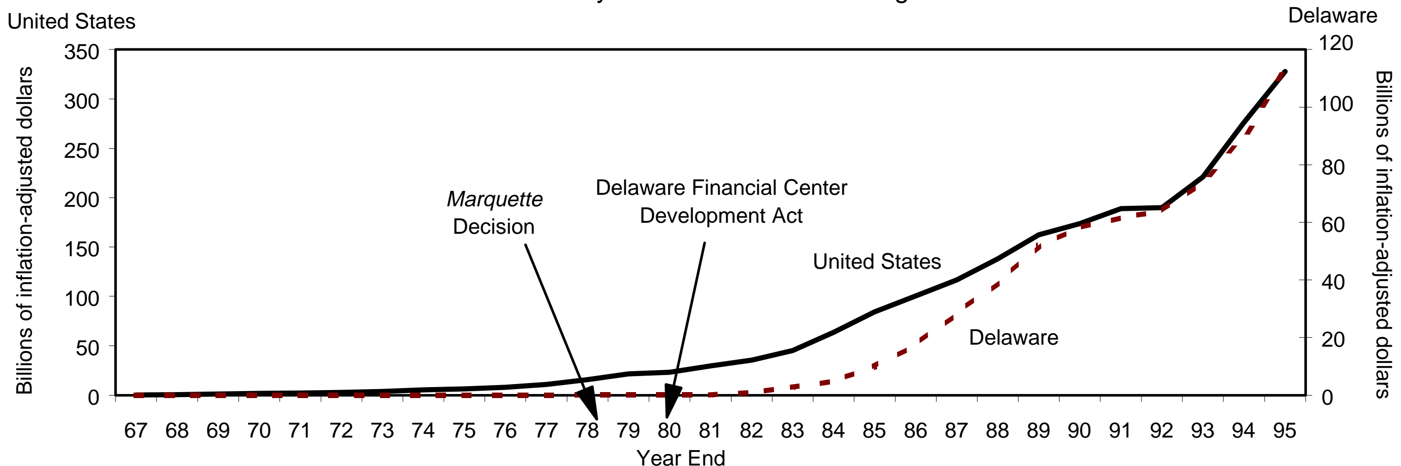
The expansion of the credit card industry and increased competition also have resulted in financial innovations (Baxter 1995, 1022), such as balance transfer offers that have reduced the cost of switching to a new credit card that offers better terms. Furthermore, in addition to competing on price, credit card lenders have developed a wide array of price-service options. Credit cards that offer frequent flyer miles, cash rebates, or credit toward future purchases of goods such as gasoline, groceries, and cars have become the standard.

How Could Interest Rate Deregulation Trigger an Increase in the Number of Personal Bankruptcies?

The remainder of this paper analyzes how interest rate deregulation altered the consumer credit market and how lenders and borrowers reacted to this change. The paper develops a "change in credit markets" hypothesis that deregulation altered the consumer credit markets and triggered a substantial

Chart 3

Credit Card Volumes* Have Increased Dramatically after Interest Rate Deregulation



Source: Bank call reports (credit card and related plans of insured commercial banks). *Does not include off-balance-sheet securitizations.

increase in consumer credit availability, charge-off rates, and personal bankruptcies.

Lenders Will Expand Credit Availability in a Deregulated Environment

One of the most important results of the shift to a deregulated environment was that lenders found it profitable to grant credit to individuals who had been shut out of the market in a regulated environment. Lenders were no longer discouraged by restrictive usury ceilings from lending in certain states. Consequently, lenders extended the geographic breadth of their activity, and major credit card lenders with a nationwide presence emerged.

After the dismantling of usury laws, lenders also extended the depth of the credit card market in order to increase their market share and profitability. For example, low-income borrowers received unprecedented access to credit. Empirical tests of credit card lending prior to the *Marquette* decision confirm that restrictive usury ceilings resulted in limited credit availability for low-income individuals. Two such studies, a Credit Research Center study and a New York State study, found that pre-*Marquette* rate ceilings affected the probability that a low-income or lower-middle-income family would hold a credit card but did not affect the probability of cardholding of higher income families (Baxter 1995, 1023). The wider access to credit that occurred after interest rate deregulation is sometimes referred to as the "democratization of credit."

High-risk Borrowers Will Receive More Credit in a Deregulated Environment

Another group that benefited from the expansion of credit was high-risk borrowers, or individuals with poor credit ratings regardless of their income level. The ability to generate more income allowed lenders to lend to individuals who were further down the spectrum of credit quality because lenders could be compensated for a higher rate of credit losses. Lenders were able to increase their profitability by expanding their lending volume while taking on a greater degree of credit risk. As discussed earlier, a restrictive usury regime resulted in significant credit rationing, with high-risk borrowers being shut out of the market. When interest rates were deregulated, less credit rationing occurred, and higher risk borrowers were allowed into the market.

Lenders Will Set Price According to the Credit Quality of the Borrower

Among the factors that lenders consider when pricing credit, the credit quality of the borrower is an important one. High-risk borrowers, as a group, usually are charged higher interest rates to compensate for their higher default rates. In setting price, lenders assume that the average credit quality of borrowers in a portfolio will decline as the portfolio interest rate rises. This outcome occurs because higher quality borrowers tend to decline to borrow at high interest rates because they usually have other sources of credit. Borrowers with poorer credit qualities usually have fewer borrowing options and, consequently, will remain willing to borrow at higher interest rates.

In short, borrowers have different price sensitivities. Therefore, a lender can maximize revenues by segmenting borrowers into different credit groups and charging them different rates. Charging a higher price to credit groups that are less price sensitive and charging a lower price to credit groups that are more price sensitive will increase a lender's profitability over charging a single price for every credit group.

Average Credit Card Interest Rates Will Rise in a Deregulated Environment

Because lenders tend to set prices according to the credit quality of the borrower, another result of the shift to a deregulated environment is an increase in the average credit card interest rate. The new customers allowed into the credit markets tend to be charged higher interest rates because of their poorer credit ratings. Consequently, average borrowing costs across the spectrum of borrowers are likely to be higher in a deregulated environment.

Consumers Will Borrow More in a Deregulated Environment

One consumer response to interest rate deregulation was to take advantage of the increased supply of credit to borrow more. Individuals who could already obtain credit card loans in a highly regulated environment did not necessarily benefit from the

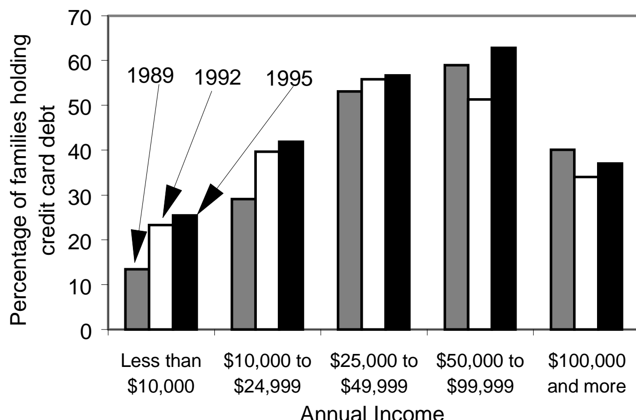
increased access to credit, but they were able to increase their holdings of credit cards and take advantage of the cards' increased acceptance by merchants. This development gave rise to the "convenience users," who use credit cards for their convenience over cash or checks but pay the outstanding balance in full each month to avoid interest charges. Higher quality borrowers who wanted to borrow occasionally were able to take advantage of financial innovations such as balance transfer options, which allow consumers to shop for interest rates and easily transfer existing balances to the most competitive lender.

After deregulation, there also was an increase in the number of consumers with outstanding credit card balances, even at high rates of interest. As discussed in the introduction, one interpretation of this trend is that borrowers exhibit irrational behavior. Another explanation is that some households would be expected to have a need to finance current consumption that outweighs the cost of borrowing. Such households include those with limited financial means. Indeed, as illustrated by Chart 4, in recent years the growth in the percentage of families holding credit card debt has been fastest in the lowest income bracket.

Low-income households are not the only ones with a high propensity to borrow. Young households, which have yet to reach their prime earning years, and households with volatile incomes that are experiencing an off year are more likely to take on debt, even at high interest rates. They may be willing to borrow at high rates of interest on occasion with the expectation that future income will enable them to repay their debts.[17]

Chart 4

The Fastest Growth in the Credit Card Market Has Been at the Lowest Income Brackets



Source: Federal Reserve Board Survey of Consumer Finances

Interest rate deregulation resulted in greater access to credit for individuals with a high propensity to borrow. This access to credit created a new class of risky borrowers.

More Borrowers Will Experience Credit Problems in a Deregulated Environment

One of the consequences of more consumer borrowing can be an increase in credit problems. Credit problems are not unique to low-income households; any household that takes on debt increases its risk of credit problems. Deregulation expanded opportunities for households, particularly those with a high propensity to borrow, to take on debt. One of the implications of some households' higher propensity to borrow is that they will tend to experience higher financial leverage at the margin. Higher financial leverage increases a household's exposure to financial shocks, such as job loss, illness, and divorce, which are events often cited as reasons for personal bankruptcies.

The fact that access to credit has come largely in the form of credit card loans, rather than some other form of consumer loan, is an important factor in rising credit problems. Credit card loans are unsecured, general-purpose loans that can be granted in small denominations. Even for the best borrowers, they usually carry a much higher interest rate than other forms of consumer loans. Consequently, borrowers may turn to credit card lenders as a kind of "lender of last resort" when other less expensive means have been exhausted. Moreover, consumers who are heavy users of credit card loans probably have limited financial resources elsewhere and are the most at risk for credit problems. Finally, the fact that these borrowers are likely paying high interest rates compounds their risk for credit problems.

Lenders Will Experience More Credit Losses in a Deregulated Environment

One of the implications of borrowers having more credit problems is that lenders will experience higher charge-off rates. Chart 5 shows the close relationship between the rising U.S. personal bankruptcy rate and

the consumer charge-off rate for commercial banks, which is being driven by charge-offs on credit card loans.

Despite rising charge-off rates, credit card lenders on average have been able to maintain profitability. The willingness of some individuals to borrow at high interest rates and their ability to repay is critical to offset banks' losses on those who default.

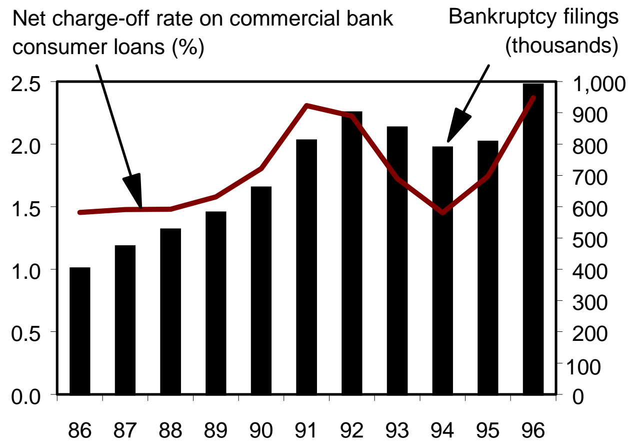
The Canadian Experience

This paper has argued that interest rate deregulation altered the credit markets and led to a substantial expansion in credit card availability and an increase in the level of personal bankruptcies. This argument can be tested by analyzing the experience in Canada, because the modern history of credit cards in Canada is very similar to the U.S. history. In 1968, two years after the development of the VISA and MasterCard associations in the United States, VISA entered Canada, resulting in a dramatic growth in credit card loans (*Canadian Banker* 1994).

However, there were significant differences at that time between U.S. and Canadian laws regarding interest rate regulation. Interest rates in Canada have been deregulated since at least 1886, when the Interest Act of Canada was passed (*Financial Post* 1994). This act permits a lender to charge any rate of interest that is agreed upon (Hutchison 1986). Therefore, although the modern-day credit card industry got its start at the same time in the two countries, there were no legal limits that restricted

Chart 5

There Is a Close Link Between Bankruptcies and Charge-Offs



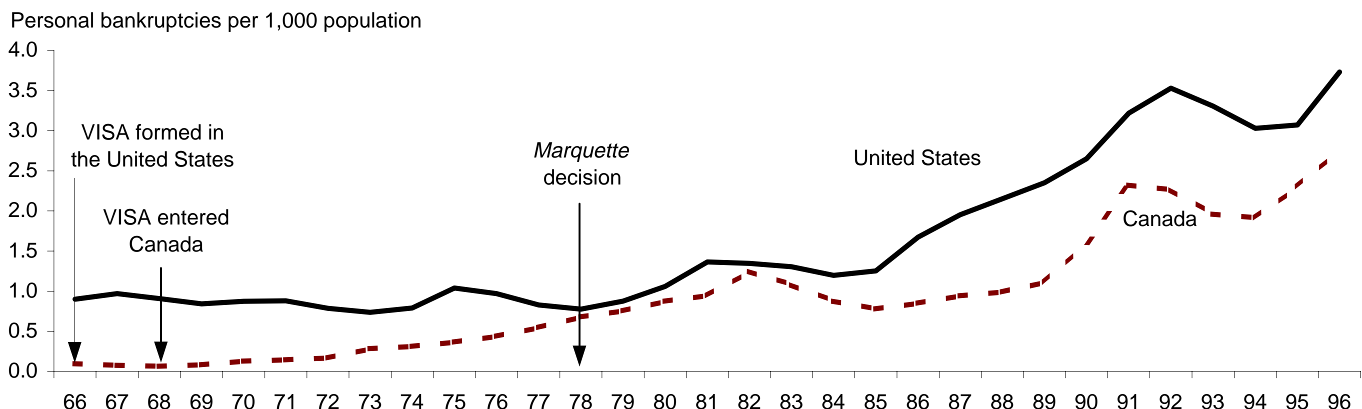
Source: Administrative Office of the U.S. Courts, Bureau of Census, Federal Reserve Board

credit availability in Canada, as there were in the United States.

Credit card outstandings have grown dramatically in Canada in the past two decades, as they have in the United States. Personal bankruptcies have grown in Canada as well. Chart 6 shows that personal bankruptcies grew sharply and immediately after the VISA association entered Canada. From 1966 to 1976, the personal bankruptcy rate in Canada grew 340 percent. Over that same period, the personal bankruptcy rate in the United States grew by only 8 percent. One explanation for this difference in rates may be that usury laws were limiting credit availability in the United States over that period, while the absence of

Chart 6

Personal Bankruptcies Started Rising Sooner in Canada than in the United States



Source: Superintendent of Bankruptcy (Canada), Statistical Abstracts of the United States, Administrative Office of the U.S. Courts, and Census Bureau

usury ceilings in Canada was permitting the expansion of credit card debt to more high-risk borrowers.

Chart 6 also shows that after interest rate deregulation in the United States, the personal bankruptcy rates in both countries follow a remarkably similar pattern. Over the next decade, 1976–1986, the Canadian bankruptcy rate grew by approximately 93 percent, and the U.S. bankruptcy rate grew by 72 percent. In the decade 1986–1996, as the credit card industry underwent rapid innovation and expansion, personal bankruptcy rates in both countries grew dramatically. In Canada, the personal bankruptcy rate grew 225 percent; in the United States, it grew 123 percent.

The Canadian experience also suggests that changes in U.S. federal bankruptcy law have not been a significant factor in the rise in U.S. personal bankruptcies. Some industry experts have pointed to federal bankruptcy law reform, which occurred at roughly the same time as interest rate deregulation, as an explanation for the rise in personal bankruptcies. However, Chart 6 shows that Canada's personal bankruptcy rate has taken a very similar path to the U.S. personal bankruptcy rate since 1978, although there have been no significant recent changes to Canada's bankruptcy law (Zandi 1997).

Conclusion

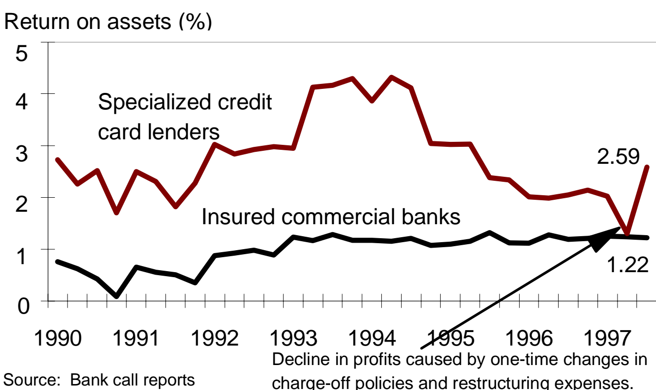
This paper argues that the deregulation of consumer interest rates in the late 1970s triggered a dramatic increase in consumer credit availability, charge-off rates, and personal bankruptcies. Deregulation has created a different consumer credit environment than existed before the late 1970s. A tightly regulated world, marked by unrestricted access to credit and a low level of personal bankruptcies, has been exchanged for a deregulated world, marked by expanded access to consumer credit and a higher level of personal bankruptcies. This argument suggests that the personal bankruptcy rate may be rising toward a new "norm" and is unlikely to reverse itself to the levels experienced in the 1970s.

Despite the costs associated with a higher level of personal bankruptcies, the results of deregulation have not been all negative. Deregulation has resulted in more choice for consumers, particularly those with poorer credit ratings.

For lenders, deregulation has expanded market options and increased profit opportunities. The opportunity to earn high profits has attracted intense competition, which appears to be eroding some of the high profits earned in the early 1990s (see Chart 7). Chart 8 shows that the volume of credit card solicitations remains at high levels, despite high rates of personal bankruptcies and credit card charge-offs, suggesting that the expansion of credit is ongoing. This ongoing expansion suggests that the process of expansion of credit to new market segments described in this paper is continuing.

Chart 7

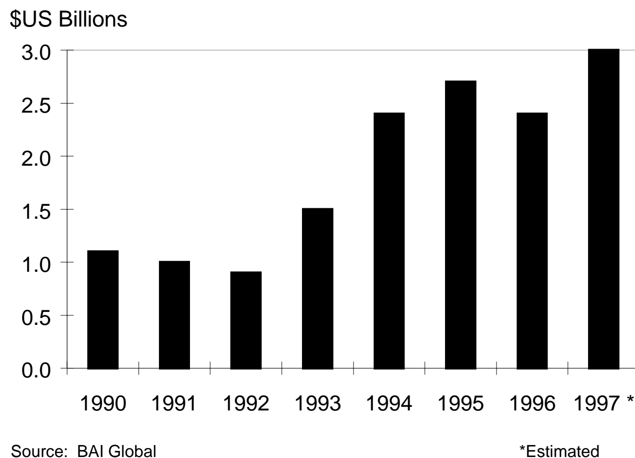
Credit Card Lending Is a Very Profitable Line of Business, Despite Recent Declines in Returns



Source: Bank call reports

Chart 8

Credit Card Solicitations Continue to Rise



Source: BAI Global

*Estimated

Endnotes

[1] The quote is from Elissa Buie of the Financial Planning Group Inc. in Falls Church, Virginia, in the January 11, 1998, *Washington Post*.

[2] The Bankruptcy Reform Act of 1978 established the current federal bankruptcy code. Under the 1978 act, discharge or dismissal of a debtor's financial obligations was made readily available with a number of excepted debts, and federal asset exemption levels were established that were higher than many of the state levels. The Bankruptcy Reform Act of 1994 expanded eligibility for Chapter 13 filings and doubled all dollar amounts for exempt property in Chapter 7 under the federal plan.

[3] Deuteronomy 23: 19–20 states, "Thou shalt not lend upon usury to thy brother; usury of money, usury of victuals, usury of anything that is lent upon usury: Unto a stranger thou mayest lend upon usury; but unto thy brother thou shalt not lend upon usury; …"

[4] Plato writes that those men who owe money and those who have lost their property are "eager for revolution," while:

> on the other hand, the men of business, stopping as they walk, and pretending not even to see those whom they have already ruined, insert their sting–that is, their money–into someone else who is not on his guard against them, and recover the parent sum many times over multiplied into a family of children: and so they make drone and pauper to abound in the State. (Moser 1997, 6.)

[5] See Ackerman 1981, 85.

[6] For a more detailed explanation of the development of the credit card industry, see GAO, 1994, 10–11.

[7] Section 85 of the National Bank Act states in relevant part:

> Any association may take, receive, reserve, and charge on any loan or discount made, or upon any notes, bills of exchange, or other evidence of debt, interest at the rate allowed by the laws of the State, Territory, or District where the bank is located, or at a rate of 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal reserve bank in the Federal reserve district where the bank is located, whichever may be the greater, and no more, except that where the laws of any State a different rate is limited for banks organized under state laws, the rate so limited shall be allowed for associations organized or existing in any such State under this chapter [title 62 of the Revised Statutes]. (Rougeau 1996, 9, note 28.)

[8] The study by Canner and Fergus (1987) includes a survey of individuals in Illinois, Louisiana, Wisconsin, and Arkansas that found that higher usury ceilings on credit card lending restrict credit availability. Arkansas had a significantly lower usury rate (10 percent) than did the other states (18 percent, 21.6 percent, and 18 percent, respectively). The survey data show that families residing in Arkansas were significantly less likely to hold bank credit cards than were families living in one of the other three states.

Villegas (1989) analyzed data in the 1983 Survey of Consumer Finances and found that restrictive usury ceilings reduce the overall supply of credit and that high-risk borrowers are the hardest hit by this cutback.

[9] For a more detailed discussion of the actions taken by Sears, see Mandell 1990, 100.

[10] Reference for remainder of paragraph is Mandell 1990, 71–72. Mandell credits survey of state usury rates prepared by Professor Robert W. Johnson of Purdue University's Credit Research Center.

[11] For a more detailed discussion of the changing attitudes regarding usury, see Rougeau 1996.

[12] Ibid.

[13] Ibid, 9–10.

[14] Ibid., 9.

[15] Maryland Bank, N.A., the state's largest bank at the time, moved its credit card operations to Delaware early in 1982 and was followed shortly thereafter by First National Bank of Maryland, Equitable Trust Co., and Suburban Bank. All together, these banks had incurred losses of almost $19 million on their credit card operations the year before but showed profits on other operations. (Muscatine 1982, B1, and American Banker 1982, 2.)

[16] Delaware's 1981 Financial Center Development Act abolished rate limitations on all classes of loans, liberalized Delaware's consumer lending law, and established a favorable tax structure for banks. (Eckman 1984, 1264–1265.)

[17] This proposition is based on the permanent income hypothesis developed by Milton Friedman (1957). Friedman posited that consumers tend to base their choice of present consumption largely on their expected lifetime income and will tend to borrow or lend at prevailing interest rates if their choice of current consumption is different from current income. This hypothesis gives credence to the idea that households may differ a great deal in terms of their willingness to take on debt.

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