Three Million Americans Are Debt Poor
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Three Million Americans Are Debt Poor

BY STEVEN PRESSMAN AND ROBERT SCOTT

Signs of the debt crisis facing a growing number of U.S. households are not hard to find. The subprime lending debacle, with its mushrooming rates of mortgage default and foreclosure, has been front-page news for months—perhaps because it has made victims of Wall Street firms as well as Main Street homeowners. Although less of a focus in the media, consumer debt—that is, household debt excluding mortgages and home-equity loans—is rising as well. Consumer indebtedness has reached record levels in the United States, currently averaging more than $21,000 per household, according to Federal Reserve data.

Rising consumer indebtedness can put families from across the income spectrum into precarious financial straits. However, it is poor and low- to middle-income families for whom the combination of stagnating incomes and rising debt creates the greatest risks. Yet the standard approach to calculating a poverty level of income and estimating the number of Americans who are poor fails to account for rising debt and the interest payments on that debt. If it did, about three million more Americans, including over half a million children, would be recognized as living below the poverty line.

Weighing Debt, Measuring Poverty

Consumer debt comes in many shapes and sizes (see sidebar). To measure the burden of household debt, economists generally look at the consumer debt-to-income ratio. Households with high incomes generally have lower debt-to-income ratios (see "Household Debt-to-Income Ratios"). Poor and near-poor households, on the other hand, are heavily in debt. The average amount of consumer debt per poor household is over $7,300, with debt-to-income ratios exceeding 60%.

Such high levels of consumer debt are new. For the median U.S. household, consumer debt has increased nearly tenfold in real terms (i.e., adjusted for inflation) since the early 1960s and is now growing at over 5% a year. Debt levels and debt-to-income ratios for low-income households have risen even faster than for more prosperous households. And predictably, interest payments (relative to income) have now reached their highest level ever. In 2005, the average household spent over 4% of its income servicing consumer debt, compared to just 0.8% in 1959 (see "Servicing Consumer Debt").

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Rising debt and interest payments distort much economic data; most noteworthy is how they affect estimates of poverty. In 2005 (the most recent year for which data are available), 12.6% of Americans were poor according to the official U.S. Census Bureau tabulation. The poverty rate stood at 11.7% in 2001, when the Bush administration took office; it rose each year, hitting 12.6% in 2004 and again in 2005. But even these disheartening figures are too optimistic. Policymakers assume that when income (adjusted for inflation) goes up, households' living standards rise as well. But this assumption ignores the problem of rising debt. When more income must go to pay down debt or even just to cover interest charges, households have less money to meet day-to-day expenses and their living standards stagnate or fall.

The U.S. government's official definition of poverty was developed in the early 1960s by economist Mollie Orshansky of the Social Security Administration. In Orshansky's model, still used by the federal government today, the poverty-level income is equal to a basic food budget for a family of a given size multiplied by three. The model assumes, in other words, that food represents about one-third of a family's budget. Every year, the poverty threshold is adjusted based on the annual rise in consumer prices.

For a single person under age 65, the poverty threshold was $10,488 in 2006; for a single mother with two children, it was $16,242. For a family of four, the 2006 figure was $20,444—equal in real dollars, i.e., in purchasing power, to the 1962 poverty line of $3,100 for a family of four.

The current poverty thresholds are widely seen as unrealistic at best. So how to measure poverty has become a contentious issue, and Orshansky's methodology has for some time been criticized on a number of grounds by academics and policymakers. Some have pointed out that the food budgets Orshansky used were meant for emergency purposes only and could not sustain people for an extended period of time. Indeed, the food budgets she used were set at 80% of a permanent nutritionally adequate diet. Others have complained that her estimates fail to account for taxes paid by the poor and the near-poor, who may pay little or no income tax but are still subject to payroll taxes. Still others criticize the model for overlooking government benefits that low-income families receive, such as Food Stamps, Medicaid, and housing vouchers, arguing that the value of these benefits should be added to household income.

In all these debates, Americans' rising indebtedness has gone unnoticed. Many Americans have incomes above the pov-

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erty line, but because they must use a portion of their income to service their debt, they cannot buy the goods and services needed to escape poverty. These people are debt poor, and they should be recognized as poor by the government.

Using the Federal Reserve's *Survey of Consumer Finances*, we calculated that indebtedness of households with incomes up to 50% above the poverty line increased from $150 (the equivalent of around $1,000 today) in the early 1960s to over $4,000 in 2005. At the going interest rate, a typical low-income household in 2005 spent more than $400 servicing its past debt, compared to interest payments of just $10 to $20 (around $100 today) in the early 1960s. In the late 1950s, when poverty was first measured, both consumer debt and interest were negligible for poor households—mostly because the poor had limited access to formal credit markets.

Taking account of higher interest payments by American households, we calculate that the poverty rate for 2005 should have been around 13.6%, nearly 8% higher than the official rate. Put into concrete terms, this means that three million additional Americans should be counted as poor due to their high consumer debt and interest payments.

The effect of consumer debt on child poverty rates is particularly worrisome. Ayana Douglas-Hall and Heather Koball of the National Center for Children in Poverty already refer to children as the United States' "new poor" because 18% of children (13.4 million, in 2005) live in households with incomes below the poverty level. This marks an increase of 12% over the past five years. But again, this figure is too low. When interest on consumer debt is factored in, child poverty rises to 19%. Over half a million children in the United States are debt poor today, none of whom are included in official government poverty estimates.

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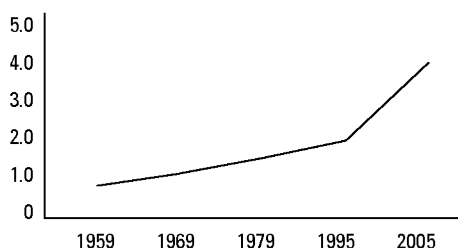
HOUSEHOLD DEBT-TO-INCOME RATIOS, BY INCOME (2004)

Income Range	$35,000 to $40,000	$40,000 to $45,000	$45,000 to $50,000	$50,000 to $55,000	$55,000 and more
D-I Ratio	61%	44%	48%	39%	29%

Source : Federal Reserve Board, Survey of Consumer Finances, 2004.

SERVICING CONSUMER DEBT

Share of income required to service consumer debt for the average U.S. household



Source: Authors' calculations based on data from Federal Reserve Board, Release G.19; and U.S. Department of Commerce, Bureau of Economic Analysis.

TYPES OF CONSUMER DEBT

Families take on consumer debt for many reasons and in many ways. Here are the most significant forms of consumer debt:

- **Installment debt**—The largest category of consumer debt for the average household, amounting to more than $8,000 per household (2004). These loans are used for large purchases (computers, televisions, furniture, home appliances) and typically have long repayment periods and low interest rates.
- **Vehicle debt**— Averaging more than $5,000 per household, the second largest category of consumer debt. With increasing sprawl, people rely on their cars more and more to get to work and school; U.S. households now have on average 1.9 vehicles—for 1.8 drivers. But vehicles are expensive; few people can afford to buy one (let alone two or three) outright. Those with strong credit histories may qualify for optimal terms on car loans, including very low interest rates, but others can borrow only in the subprime market, at far higher rates.
- **Education debt**— A relatively new phenomenon, but one that has been rising rapidly. College tuitions have risen far faster than inflation over the past two decades, in part because the government has reduced aid to colleges and universities. At the same time, financial aid for students has increasingly come in the form of loans rather than grants. These factors, in combination, account for the fact four-year college students today graduate with a median debt of about $16,000.
- **Revolving credit card debt**— Different from installment debt in that monthly payments and interest rates can both vary over time. Unless a credit card bill is paid in full each month, interest charges are applied to the remaining balance. Interest rates on credit card debt range from 0% to over 30%, with a national average of 14%; the average U.S. household owes about $3,000 in credit card debt.

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exposing themselves to dangerous levels of debt. As Mark Weisbrot, economist and co-director of the Washington, D.C.-based Center for Economic and Policy Research, has written, the bank is still active primarily in places where it can do the most harm.

To be fair, the bank will also still be tapped if important but fragile economies like Turkey find themselves in the midst of a panic. The bank also remains, as attorney and global justice activist Terra Lawson-Remer has noted, a crucial—if not at all adequate—source of funding for things like malaria eradication, subsistence agriculture, and education for young girls. Another possible role for the bank has been mentioned by former U.S. Treasury Secretary Lawrence Summers: as a kind of clearinghouse for climate-change reduction subsidies for the developing world.

So given the complex mixture of trends currently shaping the World Bank's role, how should progressives view the bank today?

First of all, we should be extremely cautious about the anticorruption push. For one thing, the campaign reeks of double standards. As I write, news has emerged from the UK that the attorney general there not only halted an anti-corruption investigation into payments of more than one *billion* pounds (about $1.97 billion) to Saudi Arabia's Prince Bandar for his role in setting up Britain's largest-ever arms deal, but misled the Organization for Economic Cooperation and Development's anticorruption watchdog as well. When corruption in some countries is treated as no big deal, other countries can be forgiven for questioning the motivations behind the bank's high-profile focus on *their* corruption.

Here's one step that might begin to reassure the developing world. The United States should relinquish the right to appoint the head of the bank—especially as U.S. contributions to the bank's coffers have lagged behind its agreed-upon obligations. The demand for broader participation in the selection of the bank's head looks all the more salient given that Bush's choice for a successor to Wolfowitz, former U.S. Trade Representative Robert Zoellick, has shown himself to be an economic nationalist of the first order, cajoling desperate economies like Nicaragua into lopsided bilateral trade agreements worse (for them) than even the draft regional or WTO agreements would have been. Even economist Jagdish Bhagwati, an outspoken advocate of free trade and corporate globalization, has characterized Zoellick's appointment as nothing less than "a dagger drawn at the developing countries."

It's ironic: The World Bank and IMF were created to allow countries experiencing difficulties balancing their international books the opportunity to retain access to credit in a manner compatible with steady economic development—and so avoid the downward spiral of capital flight, monetary gyrations, and protectionism that led to the Depression and World War II. Instead, they have ended up prompting their clients to liberate themselves by building up humungous reserves, at some cost to development and with no small distorting effects on the global economy. Far from being aided by the multilateral banks, middle- and even low-income developing economies now go out of their way to amass reserves while skimping on crucial expenditures in such arenas as education and health care for their own people. This is a huge price to pay to keep the World Bank and the IMF at bay, but it's one that many developing countries (or their elites, anyway) consider worth paying. ▦

Larry Peterson is a member of the Dollars & Sense *collective and the Union for Radical Political Economics.*

SOURCES Naomi Klein, "The World Bank Has the Perfect Standard Bearer," *Guardian*, 4/27/07; Tessa Lawson-Remer, "Neocons in the Wings," TomPaine.com, 5/23/07; David Leigh & Rob Evans, "Attorney General Knew of BAE and the One Billion Pounds. Then Concealed It," *Guardian*, 6/8/07; Bradford Plumer, "Is Bob Zoellick the Next Paul Wolfowitz?" *New Republic*, 6/8/07; Lawrence Summers, "Practical Steps to Climate Control," *Financial Times*, 5/28/07; Mark Weisbrot, "Wolfowitz and the Bank," *The Nation*, 6/11/07; James Crotty & Gary Dymski, "Can the Global Neoliberal Regime Survive Victory in Asia? The Political Economy of the Asian Crisis," *Int'l Papers in Political Economy* 5(2), 1998.

DEBT POOR AMERICANS

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Lifting the Burden

There are several reasons for the growing phenomenon of debt poverty. The federal minimum wage has been set at $5.15 an hour since 1997 and, until the increase Congress enacted this year takes effect, is at its lowest level in real terms (i.e., in purchasing power) in the past 50 years. At the same time, globalization, the skill requirements of a global economy, and an administration hostile to U.S. workers have all been forces restraining real income gains for low- and middle-income households.

A number of policy changes would help to remedy the problem. In addition to the minimum-wage increase, Congress should raise the child care tax credit and enact limits on credit-card interest rates. We also need to educate low- and middle-income people about the potential dangers of consumer credit. Finally, the government must provide more money to colleges and universities, especially those that cater to middle- and low-income students, so that they can keep their tuition and fee increases under the rate of inflation. Doing so would both reduce families' debt and increase college attendance and future earnings.

Unless the problem of fast-rising consumer indebtedness is recognized and addressed in short order with steps such as these, George W. Bush is likely to become one of the very few presidents since the Great Depression to preside over rising poverty rates. And if we take rising consumer debt into account, he is likely to preside over the largest increase in poverty since the government began to measure it. ▦

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SOURCES Jeffrey J. Williams, "Debt Education: Bad for America, Bad for the Young," *Dissent*, Summer 2006; Leslie Miller, "Cars, Trucks Now Outnumber People," *Salon*, Aug. 29, 2003; Federal Reserve Board, *Survey of Consumer Finances*, 2004.

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