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Extra Credit

Lagging Behind the Wealthy, Many Use Debt to Catch Up

U.S. Borrowing Hits Record; Soul-Searching in Utah As Bankruptcies Surge

'Monster' or Sign of Progress?

By BOB DAVIS
Staff Reporter of THE WALL STREET JOURNAL
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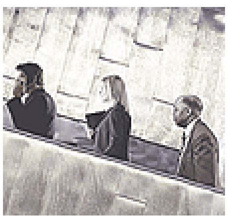
SALT LAKE CITY -- In 1757, Benjamin Franklin wrote, "Better to go to bed supperless, than wake up in debt."

One of his modern-day namesakes hasn't heeded the admonition. Benjamin Franklin Baggett of Salt Lake City got his first credit card on his honeymoon in 1990 and promptly maxed out his $300 credit line. Mr. Baggett had grown up on tales of Franklin -- his father gave him a Franklin memorial coin and bought copies of Franklin's works. But 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.

The charges were the first of many for Mr. Baggett, now 38 years old. In 1995 he moved into a house in the Harvard-Yale section of Salt Lake, a tree-lined 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.

SECOND IN A SERIES



MOVING UP
Challenges to The American Dream

Part One: As Wealth Gap Widens, Class Mobility Stalls[1]
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"I felt insecure; I was an hourly-paid worker in this fancy neighborhood," says Mr. Baggett. He says he was making $13 an hour for a time doing back-office work at a local bank while supporting two children.

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. "I looked at $1,000 on my credit

WALL STREET JOURNAL VIDEO

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WSJ's Bob Davis discusses[3] growing U.S. household debt and whether the debt burden is a risk to the economy.

card as disposable income." He now works at a foreign-exchange broker, and has sold his house and divorced.

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, seduced by TV shows like "The O.C." and "Desperate Housewives," which take upper-class life for granted, and bombarded with advertisements for expensive automobiles and big-screen TVs. Financial firms have turned credit for the masses into a huge business, aided by better technology for analyzing credit risks. For Americans who aren't getting a big boost from workplace raises, easy credit offers a way to get ahead, at least for the moment.

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 the borrowing binge 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. How could the typical family afford to spend so much? Median household debt outstanding leaped by 80%.

Utah vividly illustrates the changes credit has wrought in the U.S. Last year, 28 of every 1,000 Utah households filed for bankruptcy, twice the national average and nearly triple Utah's rate a decade earlier, according to Economy.com, a West Chester, Pa., consulting firm. Utahns often get married early and have the largest families in the nation on average. That makes for a lot of young parents with modest incomes looking for big homes and cars. The median monthly mortgage payment in Utah equaled 45.3% of a worker's average monthly income in 2002, the fourth-highest level in the nation, according to the Utah Foundation, a Salt Lake City think tank.

Benjamin Franklin Baggett

In a conservative, largely Mormon state that favored George Bush over John Kerry, 72% to 26%, the surge in bankruptcies has led to soul-searching. At a conference of Mormon officials in April, Thomas Monson, the church's second-ranking leader, said he was "appalled" at advertising for home-equity loans that is "designed to tempt us to borrow more in order to have more." He repeated the words a Mormon elder spoke during the Depression: "Interest never sleeps nor sickens nor dies.... Once in debt, interest is your companion every minute of the day and night."

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, says CardWeb.com Inc., which tracks the industry.

Melanie Taylor, a 26-year-old French teacher in Kenosha, Wis., wanted to match the affluent lifestyle she had known as a young girl. Her father, a nuclear engineer, took his family of five out to eat several times a week, she says, and helped pay for her to study abroad in France. But she and her husband, also a Kenosha teacher, had to borrow heavily to afford similar extras. They ran up as much as $40,000 in credit-card and other debt to help pay for their wedding and outfit their home. Her husband flew to Toronto occasionally with his buddies to see Maple Leafs hockey games. "It was hard to put money away," she says.

After Ms. Taylor's husband developed a serious spinal illness, the couple decided recently to sell the lakefront home they had bought in 2003 to help pay off their debts.

Economists Fabrizio Perri of New York University and Dirk Krueger of Goethe University in Frankfurt, 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. Cornell University economist Robert Frank sees house sizes, which have grown 30% since 1980, as an indication that middle-income Americans are battling to keep pace with the wealthy homeowners who build king-size McMansions.

Despite the dicta of old sages, many economists -- led by Federal Reserve Chairman Alan Greenspan -- see the expansion of credit to lower-income families as a sign of progress. Some speak of the "democratization" of credit. In an April speech, Mr. Greenspan said 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. Their spending isn't just on baubles -- they may buy a house in a neighborhood with good schools, helping their children get ahead over the long term.

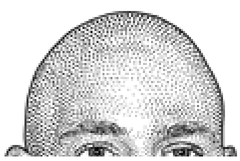
In Miami, April Danese, a 30-year-old grade-school teacher, used a mortgage that required her to make only interest payments for the first five years to buy her first home, a $140,000 condominium. The interest-only feature reduced her payments by about $400 a month, she calculates. By the time she has 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 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.

Economists disagree whether this relatively benign situation can continue. Interest rates are rising -- although long-term rates remain low -- and wage growth is sluggish. One danger: Housing prices could stall or decline, upending calculations such as Ms. Danese's in Miami.

Concern about out-of-control credit is especially prevalent in Utah. Last month, Jay Evensen, the editor of the editorial page at Salt Lake City's Deseret Morning News, wrote a column blasting "people who wield their Visa cards like swords as they cut through the jungles of greed on a shopping crusade."

By the time Jason Wadsworth graduated from the University of Utah in 1994, he was married with two children and he and his wife, Amy, had run up $60,000 in student loans. He ditched his dreams of becoming a music teacher and took a steadier job at the post office, where his father



worked. To keep afloat financially and treat his growing family to occasional extras that many of his wealthier friends took for granted -- a video camera, DVDs, a stereo -- he eventually piled up an additional $15,000 in debt spread over a dozen credit cards.

The Wadsworths had two more children, and their debts became so onerous that they moved into the basement of Mrs. Wadsworth's parents' house for five years. Today they live in a tiny brick home with a carport a few miles from her parents, and are slowly paying down their debts, which include $45,000 in student loans and $7,000 in credit-card debt.

"Interest compounds and it becomes like a monster around the corner," says Mrs. Wadsworth. To bolster her husband's $60,000 annual income, including overtime, Mrs. Wadsworth started writing novels with a Mormon theme and now collects about $5,000 a year in royalties.

Robert Head, a Utah mortgage broker, reflects the state's ambivalence toward debt. He specializes in interest-only loans, which sometimes can leave people in over their heads. But at the same time he complains that too many Utahns suffer from what he calls "the Nephite syndrome," referring to a clan described in the Book of Mormon that was reduced to poverty through greed. Mr. Head says he also helps solve debt problems by restructuring high-interest loans.

One couple he counseled was Quinn and Miriam Stewart. Seeking a better life for their kids, the Stewarts have figured out how to use credit to their advantage. Mr. Stewart, 29, remembers how he and four brothers and sisters grew up jammed into a two-bedroom house outfitted with bunk beds and a single television set. With his wife, Mr. Stewart ran up more than $5,000 in credit-card loans to furnish their home in a run-down section of west Salt Lake. But they had their eye on a home in the suburb of South Jordan, near Mr. Stewart's childhood home, where every driveway seems to have a basketball hoop and the schools are considered top-notch.


Kristin Wayman

Mr. Stewart, who has been moving up steadily at his job at Amsco Windows from a $10-an-hour production worker to a $16-an-hour computer programmer, wasn't able to find a buyer for his home. So he decided to refinance his mortgage, pay down his credit-card debt and rent the place. To pay for a three-bedroom $167,000 house in South Jordan, he found a mortgage that didn't require a down payment. Attending seminars on mortgages, Mr. Stewart says, "I was shocked at how many things you could do to get into a house." Once he refinishes the basement, he'll have enough space for his three boys to have their own rooms.

For others, using debt to try to move ahead has as many pitfalls as promise. Growing up in a small house crammed with as many as 11 kids, Winford Wayman, a 30-year-old construction worker, longed for privacy and open spaces. But 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. They make them so damn good-looking. I see a good-looking truck and I have to have it," says the slender, goateed Mr. Wayman.

He keeps his green Ford F-150 SuperCrew in pristine shape, which he acknowledges is his way of trying to keep up with his wealthier younger brother, who favors diesel-powered trucks and owns the construction company where Mr. Wayman works.

Recently, the Waymans got interested in a $125,000 vinyl-side home in Tooele, a suburb in the Salt Lake flatlands abutting the snow-capped Oquirrh Mountains. 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 mortgage payments. "We freaked. We didn't know what to do," says Ms. Wayman. They ended up going through with the house 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.

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