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SHOPWORN

The Last Temptation of Plastic

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By ERIC DASH
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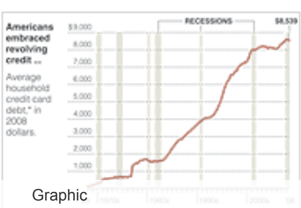
Was that a layaway sign I saw?

Multimedia



Graphic
How Credit Cards Came to Rule American Lives

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For the last two decades, layaway has been a relic, a vestige of a time when banks promoted Christmas savings clubs and a Depression ethos of thrift reigned. Instead of swiping a credit card and walking off with the goods, shoppers would put their objects of desire on hold until they paid for them.

Almost sounds like a novel idea: “Pay first. Buy later.”

Today, with the financial crisis worsening, the layaway sign has crept back into consumption culture. Discount retailers like Kmart and Sears are aggressively promoting layaway as a smart and exciting way to buy. No less a tastemaker than Oprah Winfrey has suggested that a new frugality might herald the return of the installment plan. “Remember layaway?” she prodded on her talk show this fall. “That is where we are heading.”

Perhaps. But never underestimate the cravings of the American consumer and the convenience of the credit card. Fifty years ago, the financial industry was transformed by a thin piece of plastic. It was an innovation that lifted the American economy — and the world’s, too. By making it easier to obtain credit — sometimes recklessly easy — the credit card empowered people to buy their dreams.

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European Pressphoto Agency/Justin Lane

Still, the economic upheaval now under way raises the question: will the current crisis leave a lasting impression on the credit card? Consumers, having watched their home values, their retirement plans and in many cases even their jobs evaporate, are plucking more slowly from their wallets. Banks, already crippled by billions of dollars in mortgage-related losses and fearful that bad credit card debt will balloon, are tightening standards and raising interest rates. And the federal government is considering tough new regulations that the industry says will end up restricting credit further.

"We are in the throes of a global credit crisis that has implications on consumers at all income levels," said Carl Pascarella, a former chief executive of Visa USA. "People are going to have to live within their means."

If they do, the impact on the American economy could be profound. Debt-fueled consumer spending accounts for as much as 70 percent of gross domestic product.

"We are probably going to be in a period of slower growth for the next two to five years," said Bernard Baumohl, chief global economist at the Economic Outlook Group.

Ever since BankAmerica blanketed Fresno, Calif., with a mass mailing of credit cards in 1958, flexing plastic has been part of daily life. With a flick of the wrist, we could buy groceries or a refrigerator, pay for a vacation or a hospital stay, furnish a home or finance a business. It might not have been life, liberty or the pursuit of happiness, but easy access to credit was surely an inalienable right.

For the last half-century, that basic precept has held true. Credit card debt has grown to roughly $822 billion today, increasing almost every year, even when the economy slumped.

Amid the recession of the early 1980s, lenders put more cards in the hands of senior citizens, students and other low-income customers. By charging high interest and pesky fees, banks were making money as borrowers defaulted.

During the recession of the early 1990s, lenders continued to extend credit to a broad range of borrowers, including those who already had two or three cards. Subprime lenders aggressively marketed their cards to unemployed workers for "bridge loans" until they found another job.

And after the technology bubble burst in 2001, credit card issuers confidently loosened lending standards and even went after indebted borrowers with zero-interest teaser rates. Lenders reasoned that cardholders who lost their jobs could still refinance debts by extracting the equity from the rising value of their homes.

Still, this recession is different. Many consumers today have maxed out on their credit and have little or no home equity. And credit card lending is no longer as profitable for banks since their own borrowing costs have risen.

"This is the first crisis of the modern credit card industry," said Robert D. Manning, the author of "Credit Card Nation" and a critic of credit practices.

And the crisis is widening.

Credit card lenders are on pace to write off at least $45 billion on bad debt this year. As the unemployment rate soars — the loss of 533,000 jobs in November was the largest one-month drop in 34 years — the industry could lose an additional $60 billion or so in 2009. Many analysts and bankers believe that loss rate could easily eclipse the record 7.9 percent level of outstanding credit card debt reached in early 2002.

Lenders have been rushing to slow the spread. Every major credit card issuer — from Bank of America, Chase and Citigroup to the finance arms of General Electric and Target Corporation — is approving fewer new applicants, pulling in credit limits and canceling unused accounts.

And sweeping regulatory changes could reduce the amount of credit available to consumers even more. Having missed the implications of the housing bubble, the Federal Reserve and Congress are considering rules to crack down on unfair lending practices.

"Lenders will ultimately choose to provide fewer credit lines to fewer customers," Meredith A. Whitney, a banking analyst, said recently. By her projections, consumers could lose access to $2 trillion in credit in the next 18 months.

This would force many Americans to radically change their behavior — saving for what they can afford rather than financing what they covet.

Already, there are some signs of such a shift. Visa said that spending on its credit cards in the United States dropped in the first three weeks in October after barely increasing in the third quarter. Spending volume has fallen only twice before — immediately after the 9/11 attacks, and in late 1980, when the country slipped into recession.

Cardholders are also changing how they spend their money. Bank executives say more customers are using their credit cards for groceries, gasoline and other necessities and are deferring purchases of big-ticket items like furniture and flat-screen televisions. Retailers are bracing for the worst holiday shopping season in decades.

New government statistics, meanwhile, suggest that Americans are socking away more money. The savings rate has been climbing since it flattened out in April at a record low of zero.

Thrift is hot on Madison Avenue and Hollywood, too. Wal-Mart's new slogan is "Save money. Live better." Bank of America has been advertising its "Keep the Change" debit card savings program and risk-free certificates of deposit. And in what was either prescient or a lucky bit of timing, "Confessions of a Shopaholic," a morality tale for the "Sex and the City" set, is coming to theaters in February. Its protagonist is head over her high heels in credit card debt until she becomes Successful Savings magazine's advice columnist, finds true love with her handsome editor and ultimately pays off her loans and learns to live within her means.

Whether there will be a lasting cultural change in the way consumers use their credit cards is likely to depend on the depth and duration of the current recession. History suggests that we are quick to forget. Often when the American economy contracts, some new innovation in credit seems to follow, paving the way for an even bolder era of consumption.

After the Great Depression, commercial banks began moving into the consumer lending business, which blossomed into the Golden Era of Consumption of the 1950s. The downturn of the late 1970s ushered in the electronic payment revolution. Credit cards became even more convenient to use. The 1980s are remembered for "Generation Me."

This time, Americans may think twice about using credit cards and start flexing debit cards more frequently — just as they do in Europe and Asia, where credit cards are less a part of daily life.

In 2007, Americans used a debit card in roughly 21 percent of all transactions; credit cards accounted for about 19 percent, according to The Nilson Report, an industry newsletter. By 2012, debit card use is expected to rise to about 29 percent of all transactions, while credit card use would stay about the same.

Gary L. Perlin, Capital One's chief financial officer, said he has seen a "mild shift" to debit card use in the past three months as his customers hunker down. Other industry experts suggest that the downturn could accelerate this trend.

Indeed, some banks have begun offering an overdraft line of credit on debit cards. Others are testing a rewards point program, as they have done with credit cards for years.

The layaway and other installment plans that are making a return this holiday season may also be here to stay. Burlington Coat Factory, Marshalls, and TJ Maxx are filling up their layaway racks. Business is also bustling at E-Layaway.com, an online service bringing the old-fashioned installment plan into the new economy.

It's probably premature to suggest that consumers will wean themselves from their costly addiction to credit cards, though. "I have always been struck by how many people want to see this as the end of an era of consumer excess and the beginning of a new age of thrift," said Lendol Calder, a history professor at Augustana College who has studied the role of consumer credit in American culture. "I don't see that happening."

"We will see people pulling in their belts for one or two years," Mr. Calder added, "and then it will be back to where we left off."

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