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## CHANGE OF SUBJECT

OBSERVATIONS, REPORTS, TIPS, REFERRALS AND TIRADES  
BY ERIC ZORN

Monday, March 01, 2010

### `Swipe fees' -- why there's no such thing as free credit

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Updated and moved up in the blog Monday with more links added to the webliography.

In case you missed Linda Lisanti's article, [Report: Interchange Fees Impede Economic Growth, Job Creation](#) in yesterday's Convenience Store News, it touches on a subject that was top of mind for me when hearing about all the new changes in credit card law:

#### What does it cost the store every time I charge something?

Too much, the story says, citing "a new report by former U.S. Under Secretary of Commerce Robert J. Shapiro...` *The Costs of "Charging It" in America: Assessing the Economic Impact of Interchange Fees for Credit Card and Debit Card Transactions.*" ([here's](#) the link to a .pdf of the 21-page report)

These fees -- from 1 to 3 percent of the amount of the purchase, assessed every time you swipe your card -- totaled \$48 billion in 2008 alone, says the story, " up 300 percent in less than a decade."

Adding:

**Every dollar spent on the fees is a dollar not being spent on hiring employees or passing savings on to consumers.... More than half of the fee is passed on to consumers through higher prices... The report found the average American household, even if they never use a credit card themselves, pays \$230 a year in higher retail prices resulting from credit card fees not associated with the cost of processing transactions.**

Not associated with the costs? Yes. The report says only 20 percent of swipe fee goes to paying for processing. The rest goes to funding rewards programs and padding the credit card companies bottom lines.

**Also according to the report, if interchange fees were reduced to the actual cost of processing the transactions plus an average profit level, the resulting increase in economic activity would generate nearly 242,000 new jobs across the U.S. economy.**

I can't vouch for the math, but I do know that these fees create a bit of dilemma, particularly for those who patronize smaller businesses and reach for their credit cards to pay for small purchases.

Do I use the card because it offers rewards -- airline miles or like that -- and may save me an emergency trip to the ATM, scraping a bit of profit from the merchant?

Or do I pay in cash, when I have it, being a good guy but, in effect subsidizing those who will pay with credit cards?

There's more on this topic:

[The interchange-fee rip-off](#) by Felix Salmon of Reuters, Jan 5, 2010

**Both credit-card and debit card interchange fees are rising, with the fastest-growing segment of the market — debit PIN transactions — positively soaring.**

[How Merchants Deal with Rising Credit-Card Costs](#) by Diana Ransom, SmSmallBiz.com, January 25, 2010:

**(The) transfer fee set by issuers such as Visa and MasterCard ...rose from between 1.25% and 1.91% in 1991 to between 0.95% and 2.95% in 2009. MasterCard's rate also jumped from between 1.30% and 2.08% to between 0.90% and 3.25% last year, according to a recent Government Accountability Office report about credit cards. Processing fees have also been added to debit-card purchases, which in the past, were free for merchants to process.**

[Credit card biz shift: Penalties to perks](#), MarketPlace, American Public Media, February 22, 2010

**Interchange fees are what merchants pay card companies every time you use your card. They added up to nearly \$50 billion last year. To push that number higher, card companies are looking for ways to convince the credit savvy to swipe with abandon.**

[CREDIT CARDS Rising Interchange Fees Have Increased Costs for Merchants, but Options for Reducing Fees Pose Challenges](#) (.pdf) -- A 63 page, November, 2009 report from the United States Government General Accounting Office:

**Proposals for reducing interchange fees in the United States or other countries have included (1) setting or limiting interchange fees, (2) requiring their disclosure to consumers, (3) prohibiting card networks from imposing rules on merchants that limit their ability to steer customers away from higher-cost cards, and (4) granting antitrust waivers to allow merchants and issuers to voluntarily negotiate rates. If these measures were adopted here, merchants would benefit from lower interchange fees. Consumers would also benefit if merchants**

**reduced prices for goods and services, but identifying such savings would be difficult. Consumers also might face higher card use costs if issuers raised other fees or interest rates to compensate for lost interchange fee income. Each of these options also presents challenges for implementation, such as determining at which rate to set, providing more information to consumers, or addressing the interests of both large and small issuers and merchants in bargaining efforts.**

Rewards Cardholders Face a Higher Price for Perks By Eric Dash, New York Times, February 19, 2010

**Retailers pay about 2.1 percent of the transaction value on a purchase made by a high-end rewards cardholder, compared to around 1.47 percent for an ordinary customer, according to Visa data. For a typical \$40 purchase with a rewards card, for example, a retailer would pay about 94 cents, compared with a 67- to 70-cent fee if an ordinary card is swiped. The retailers also may increasingly finance extra card benefits themselves, instead of splitting the cost with the banks.**

**But merchants warn that the shift to more rewards will raise the cost of goods as they pass along the fees. "It's like this huge, secret annual fee for credit," said Mallory Duncan, the chief lawyer for the National Retail Federation. "It's not good for us, and it is not good for our customers."**

How Visa, Using Card Fees, Dominates a Market By Andrew Marin, New York Times, January 4, 2010:

**"A dollar is no longer a dollar in this country," said Mallory Duncan, senior vice president of the National Retail Federation, a trade association. "It's a Visa dollar. It's only worth 99 cents because they take a piece of every one."**

**Visa officials say its critics are griping about debit products that have transformed the nation's payment system, adding convenience for consumers and higher sales for merchants, while cutting the hassle and expense of dealing with cash and checks.**

Credit Cards Under Fire For Interchange Fees Miami (CBS-Ch.4) – January 26, 2010

**Those cents add up for merchants who are struggling in the recession so they often pass the fee on to the customer. But now a class action lawsuit could trickle down to savings for consumers....The Justice Department is investigating anti-competitive concerns and several congressional bills are asking to give merchants a chance to negotiate the fees.**

The Damage Of Card Rewards New York Times, January 8, 2010

**For several years, I've wondered whether my aggressive pursuit of credit card rewards made me a selfish consumer....Stores build(interchange) fees into higher prices, so people who aren't earning any rewards can end up subsidizing those who do. Many of these people have no credit cards because they're financially troubled. So the risk is that we perpetuate a sort of reverse Robin Hood problem, as Prof. Steven Semeraro of Thomas Jefferson School of Law in San Diego puts it. It's possible that the poor pay subsidies to finance the rewards of the affluent.**

Small Business Owners Headed to D.C. to Fight Swipe Fees, February 1, 2010, Convenience Store News

**On May 22, 2009, President Barack Obama signed the "Credit Card Accountability, Responsibility and Disclosure Act of 2009," or "CARD Act," into law. The legislation included restrictions on interest rates, limits on fees and tough restrictions to protect young consumers, but the CARD Act did not address interchange fees. Main Street businesses are concerned the big banks and credit card companies will continue to exploit this loophole by raising credit card interchange fees. The CARD Act is slated to go into effect Feb. 22, but Consumers for Competitive Choice will tell Congress this week that it cannot consider its work on financial regulatory reform complete until excessive interchange fees have been addressed. Bob Johnson, president of Consumers for Competitive Choice, will lead the delegation**

Commentary: Reform Credit Card Swipe Fees, by Robert Shapiro (Forbes.com) 2/22/10:

**The credit card companies recruit banks to their networks by promising them higher fees paid by consumers and merchants, and the banks try to attract new, well-to-do subscribers by offering rewards that are then financed through these fees. All of these costs are hidden from consumers.**

**Most of these costs are then passed along to consumers in the form of higher prices. One to 3% of the price of every candy bar, airline ticket, restaurant meal or tank of gas that anyone buys goes toward these fees.**

The Electronic Payments Coalition: The Australia Case: How Interchange Regulation Hurt Consumers

**In Australia, where the government artificially regulated interchange, studies prove that merchants reaped the profits, leaving consumers with higher costs, fewer rewards, and no difference in cost at the register.**

Competitive Enterprise Institute: Payment Card Networks Under Assault, by John Berlau, Ryan Radia December 3, 2009:

**At a time when the U.S. economy is recovering from one of the worst recessions in decades, for government to intervene in this well-functioning market would have serious unintended negative consequences for consumer welfare.**

Credit Card Fees: 5 Things You Should Know -- The debate over interchange fees is heating up as merchants protest against them By Kimberly Palmer US News & World Report, September 29, 2009

**Interchange fees tend to be lower in other countries. A report recently released by merchants and retailers reports that fees in the United States are among the highest in the world—higher than the fees in Canada, Europe, and Britain. But Trish Wexler, spokeswoman for the Electronics Payment Coalition, which represents credit unions, banks, and card networks, says that comparison is misleading because while the interchange fee might be lower, the overall fee that merchants pay—known as the merchant discount fee—is average.**

More Lies by the Merchants Payments Coalition (.pdf) . Electronic Payments Coalition:

**The Merchants Payments Coalition continues to make outlandish and unsubstantiated claims about interchange fees and the electronic payments system – statements that are misleading, opportunistic, and/or outright false....False Claim: "Credit card swipe fees are skyrocketing." ....False Claim: "Interchange fees are 'secret.'" ....False Claim: "Swipe fees are higher in US than in any other country." ...False Claim: "Consumers would benefit if Congress forced down interchange fees." ....False Claim: "Merchants can't offer a cash discount."**

Specter 'Seriously' Considers Bill on Card-Swipe Fees Business Week/Bloomberg February 26, 2010

**U.S. Senator Arlen Specter may introduce a bill that seeks to limit interchange fees charged to merchants with each swipe of a credit card ...**

**Specter, 80, a Pennsylvania Democrat who faces a primary challenge in his quest for a sixth term, is "seriously considering" introducing legislation..... Representative Barney Frank, chairman of the House Financial Services Committee and a Massachusetts Democrat, said yesterday at a conference in Washington that interchange "is not on our agenda this year."**

Posted at 12:29:00 PM in Webliographies

Selected for you by a sponsor:

**Traveler's Aide: Customer gets lost looking for GPS refund** (*USATODAY.com in Travel*)

**Heidi Montag Funny or Die Plastic Surgery** (*iVillage*)

**You might also like:**

**MasterCard spent \$960,000 in 4Q to lobby Congress on credit cards, security, Internet issues** (*Chicago Tribune*)

**Check for best fit as credit card issuers squeeze rewards programs** (*Chicago Tribune*)

**The crazy imaginings of the Texas Board of Education** (*Chicago Tribune*)

**Obama polling starting to become suspect ---numbers may be flawed, but need to attack misconceptions is real** (*Change of Subject*)

## Comments



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I spent about eight years of my career working in finance and Treasury on two of the largest credit card portfolios in the country so I know something about the subject if anyone is interested. If not, that's fine, too.

ZORN REPLY-- Well, I'm obviously interested.

Posted by: MCN | Tuesday, February 23, 2010 at 04:37 PM

MCN, what do you recommend consumers do? I already refuse to carry rewards cards, since I really don't want to give myself that excuse to make unnecessary purchases. I'd like to support local businesses, but I'm not keen on carrying a bunch of cash around, in case I have my wallet stolen. It's actually easier for me to spend cash than it is to put purchases on the credit cards, too, since I think long and hard before using a card, but with cash, it's easier for me think, "Easy come, easy go," for some reason.

Posted by: Heron | Tuesday, February 23, 2010 at 04:47 PM

There are a lot of complexities to this issue, many of them discussed here. I ain't going to defend the credit card companies--their virtual monopoly on the processing system gives them the upper hand. But they are businesses trying to make money, and it's not a cinch. The credit card "consumer protections" just enacted have only slammed people like me who pay their bills and manage their accounts--with new fees and higher rates. I've had all kinds of rate and price increases imposed. But we should also acknowledge some of the efficiencies. Until recently, most state and local revenue collectors would charge you a stiff fee to pay with a card, because their accounting procedures were too primitive to account for the transfer fees--even when they did accept plastic. Yet the CTA and others used to spend huge amounts of money to move bags of coins and dollar bills from their stations--expenses they no longer have. Metra just recently finally figured out how to handle credit cards, so they will reduce expenses related to cash handling, the theft that goes with it, and the expense of bounced checks. I notice that the sharpest national merchants, like McDonald's and 7-11, happily push credit card use for small purchases--convenience equals more sales. However, especially during gas price spikes, I feel sorry for the station owners: they make the same piddly margin on a gallon of gas, but pay a higher cut to the credit companies because it is a percentage of the sale--meaning their profit is squeezed. So there is good and bad, and in some ways in the bad from fees comes from the benefit we get from convenience, the stupid airline miles we delight in (even if they are becoming close to worthless), and rebates.

Posted by: quotidian | Tuesday, February 23, 2010 at 05:39 PM

OK, here are some thoughts. First, it strikes me that the interchange fees have drastically risen in the past four or five years, and shockingly so. Obviously, the issuers are trying to make up for their increased losses via passing the costs on to the merchants, and the merchants on to the consumer.

Briefly, the issuer's P&L consists of net interest revenue (finance charges less interest expense), fee income (fees are also way too high), interchange, marketing and operating expense, and losses (the issuer also has to consider opportunity cost of the equity, but that isn't an accounting cost). Losses are way way up and the consumer pays for that, too, through increased finance rates and fees. Issuers aren't too profitable right now from a return on asset perspective.

There are two types of cards: private label (your Sears or Home Depot card) and general purpose (your BofA Visa card). Private label merchant cut very competitive deals with the issuers. Merchants don't have any leverage on the general purpose side, and there's the rub.

As I said, the increased interchange is (I believe) making up for part of the increased issuer losses (and marketing expenses--it is very costly to acquire a new account now, probably well over \$200 an account).

The merchants, though, are caught between a rock and a hard spot. There is simply no question that consumers are willing to spend more on a credit card than with cash (we call it incremental sales). Also, consumers need the cards as a borrowing device because they don't have cash (this is not the same as the previous point). This is especially true for big ticket purchases.

Also, it costs about 0.50% to the issuer to handle cash and checks.

So the merchant has to sign with Visa and MasterCard or the business goes elsewhere. The merchant will push the price increase onto the consumers (depending on the elasticity of demand).

From the consumer perspective, IF you can pay off your bill monthly, OR if you pay the "Balance Transfer Game" (get a zero per cent card, put your purchases on it, get a different card when the 0% period is over), cards are a great deal. You get free financing for the month, you don't have to carry cash, and you don't have to pay a fee if you're smart. You can get 0% financing on big ticket items, too, using a private label card.

The best deals out there are the give back cards, where you get x% back on your purchases (usually 1%, but can be 3% or higher on specialty cards like gas). The reward is free. This is way better than using cash. EVERYBODY should be using these, if you have good credit.

Not so great a deal are the airline miles, which are fee cards (so you need to spend a lot to make up for your fee). Also, airlines are constantly either increasing the miles per flight or increasing the black out days, or decreasing the life of the miles, all of which are increased costs to the consumer.

There is no point to using cash, as it is inconvenient and you don't get the rewards, EXCEPT that using cash is the best way to discipline yourself into restricting your spending. You spending cash helps the merchant but from a macro perspective has absolutely no affect at all on merchant pricing.

Posted by: MCN | Tuesday, February 23, 2010 at 05:39 PM  
Quotidian, excellent points.

Posted by: MCN | Tuesday, February 23, 2010 at 05:42 PM  
@quotidian:

I do know that in the cases of the fast food joints, they not only pay a much lower fee, but the card companies have guaranteed them the money even if the card is stolen or a fake. That's how desperate the card companies were to get that business!

But I'm one of those that will demand a cash discount for larger purchases, almost all stores will do that, Abt definitely does, as do most appliance stores. I once walked out of Best Buy years ago when they wouldn't do that when they were running free financing on everything that week.

What's needed is Congress to require a discount equal to the fee at all stores that takes cards. That will cause a lot more cash purchases & also cut the fees charged to the stores.

Posted by: Garry | Tuesday, February 23, 2010 at 06:03 PM

Garry, what you may not understand is that Best Buy's card is issued by a credit card company, not Best Buy. Best Buy may or may not pick up some/all of the cost of the 0% financing, but there is almost no incentive for BB to give you a discount for cash, because that comes directly out of its pocket, while most/all of the cost of the 0% promotion is being paid by the issuer.

I think that card contracts currently prohibit stores giving discounts for cash. If you go with that, you're really going to cut the availability of credit to the consumer, which is not good.

Posted by: MCN | Tuesday, February 23, 2010 at 06:16 PM

Mike, thanks for the explanation.

I have two credit cards, one for on-line purchases, the other for emergencies. I keep my balances low, about \$600 or less for both.

I don't use cash very often. I have a bank/atm card I use to make most of my purchases, which takes money directly from my checking account at time of purchase. I also have direct deposit, so I handle very little cash. I like it better this way, I don't have to worry about someone stealing my money and the reward programs get me free gift cards for various local businesses.

I think, eventually, currency will become a thing of the past. All transactions will take place using some kind of card, if our government can learn how to stay one step ahead of the credit card companies and their desire to fee us, and local businesses, to death.

Posted by: Wendy C | Tuesday, February 23, 2010 at 06:27 PM

Wendy, if I were you, I would apply for a couple of no fee general purpose cards, and make a purchase every couple of months on them (to keep them active), just to have additional open lines of credit in case something in your life goes south.

Cash has costs and its use will continue to diminish.

Posted by: MCN | Tuesday, February 23, 2010 at 06:58 PM

I'm wondering just how many card issuers are going to start charging annual fees and fees for not using their cards, and curtailing their cash back programs in an effort to make up for the revenue lost to the new credit card law. They've already made many of their customers angry by hiking everyone's interest rates.

The fact that I have to pay a foreign exchange fee for ordering a book from alibris.com (a Canadian company) is absurd, too. One of the authors of the Bucks blog on nytimes.com recommended switching to Capital One to avoid paying that kind of fee, but their customer service practices are even more abysmal than most, so it's not worth it.

Posted by: Heron | Tuesday, February 23, 2010 at 07:28 PM

Make that, "not using their cards often enough."

Posted by: Heron | Tuesday, February 23, 2010 at 07:29 PM

EZ,

But the good news is that the GOP Health Care Reform proposals include granting the Health Insurance Industry the same freedom to "sell across borders" that is currently enjoyed by credit card companies.

Just as credit card companies rushed to Sioux Falls when South Dakota removed its consumer protection and usury laws, health insurance companies all would be able to move their businesses to the state willing to scrap consumer protections in exchange for insurance industry jobs.

Americans could then enjoy the benefits of an deregulated health insurance market in the same way that we currently enjoy the deregulated credit card industry.

And here you thought the GOP didn't have any ideas...

-- MrJM

Posted by: MrJM | Tuesday, February 23, 2010 at 07:38 PM

@Garry. I see your point, but any time government imposes pricing, bad things happen--namely, more government employees and regulations to make it happen, and a big pain in the ass for retailers. And there will go your discount. Not every good idea involves a federal mandate. I would rather see the market work by having sharp consumers like you to negotiate to their benefit. The government can't do everything for us! If we wish it to, it will be so cumbersome that it is not worth it.

An example: A big part of the stimulus package involved the dream of putting everyone to work right away. Almost no weatherization has happened because Davis-Bacon requires every county in the United States to determine the "prevailing wage." This was a union/Democratic requirement. A whole year has been spent doing that, and almost no houses have been weatherized. I am not a government hater, but this has got to be exhibit A of why government cannot achieve all of our grand dreams. If we had just put out the money, people would have been employed at fairly decent wages actually weatherizing thousands of houses.

Posted by: quotidian | Tuesday, February 23, 2010 at 07:38 PM

For me, I use my Amex as much as possible because almost everything I use it on can be claimed as an expense on my year-end tax returns. I'm too lazy, if truth be told, to keep organized receipts and without the convenience of online bank records (downloaded into Quicken periodically) doing the legwork for me, I'd lose out on a lot of deductions. I get rewards for using this card, but I have not ever thought of that being relevant (hence I have lots of reward points that will never get used).

Had not thought much about screwing small businesses, that's an interesting point, especially since, historically at least, Amex charges more per transaction than Visa/MC.

Posted by: Seth Anderson | Tuesday, February 23, 2010 at 09:09 PM

@Quotidian - Davis-Bacon wage Determinations can be located quickly and easily here: <http://www.gpo.gov/davisbacon/allstates.html>

For that reason, I find it highly unlikely that determining the prevailing wages available at the above site is responsible for delays in housing weatherization.

Posted by: MrJM | Tuesday, February 23, 2010 at 09:44 PM

--- Possible, but unlikely.

-- MrJM

[For some reason the last line of my comment was clipped.]

Posted by: MrJM | Tuesday, February 23, 2010 at 09:46 PM

@MrJM

"But the good news is that the GOP Health Care Reform proposals include granting the Health Insurance Industry the same freedom to "sell across borders" that is currently enjoyed by credit card companies."

I thought EZ was telling us this provision already existed in Obama's plan. Wasn't that one of the quiz answers?

Posted by: Jimmy G | Tuesday, February 23, 2010 at 10:12 PM

@MCN,

Very interesting points and I may consider a card that offers cash back. However, my no-fee United card has served me well and I haven't had a problem with blackouts. I know that's just anecdotal evidence and I'll defer to your judgment about where the better deals are overall.

@Wendy C,

Be careful what you wish for when it comes to your desire to have government stay one step ahead of the credit card companies. They will always find a way to make their money and the costs of regulations will always be passed to consumers and businesses. Regulate customer fees and they will raise rates. Regulate fees on businesses and rates on consumers and they will reduce customer service and start charging annual fees for the right to use their card. We will all pay for any hit these companies take to their bottom line as a result of regulation. It's similar to my clients' reactions whenever they are hit with additional taxes - they pay me to figure out how to minimize them and pass any remaining costs on to their customers. Their bottom line usually doesn't suffer a bit.

Posted by: Greg J. | Tuesday, February 23, 2010 at 11:17 PM

@quotidian:

There's just one problem to your argument.

The Davis Bacon Act was passed into law in 1931 & is named after its two REPUBLICAN sponsors! Hoover signed it, you do remember him? Most Republicans don't want to!

In fact, it's considered to be a racist law, designed to stop the hiring of blacks on federal projects,

So there's yet another law that Republicans wanted, but now blame Democrats for!

Posted by: Garry | Wednesday, February 24, 2010 at 12:00 AM

@MrJM The New York Times and others have reported that confusion over "prevailing wage" (an inaccurate term, since it is always higher than the true prevailing wage) for weatherization has stalled this boondoggle.

<http://www.msnbc.msn.com/id/32392585/>

@Garry: I really don't care who passed it; I want it repealed. Are the Democrats going to run against Hoover forever? Young voters don't even know who he is. Lots of things trade unions, especially the skilled trades, do are considered racially discriminatory; doesn't stop the Democrats from allying with them. Davis Bacon stifles employment. I once sat on the village board of a small Wisconsin town. We were doing a million-dollar street project with mostly federal and state money--90 percent. We were paying the workers way more than the true prevailing wage because of Davis Bacon, but of course it didn't cost us anything. Point is, if government construction paid actual prevailing wage, there could be more projects--still at decent wages--and more jobs.

Posted by: quotidian | Wednesday, February 24, 2010 at 08:22 AM

This is OT, of course, but Davis BAcon is a joke, or worse: a truly bad piece of legislation. And who cares who passed it--if it was such a bad Republican idea, why hasn't the Obama Congress repealed it? Answer: It benefits the labor unions.

Posted by: MCN | Wednesday, February 24, 2010 at 09:12 AM

@Garry,

I have said it before and I will say it again. I don't understand how you can be a liberal. You are against racial quotas and now you say you are against the Davis Bacon Act. Some day you will wake up as I did and say, "Gee, maybe I don't belong in the Democratic Party anymore."

Posted by: Jimmy G | Wednesday, February 24, 2010 at 10:00 AM

GregJ - If the government ends up having to bail out the banks because they issue credit irresponsibly, and raise fees indiscriminately, the government should be able to regulate credit cards and the agencies that issue them. We consumers will end up paying more, anyway. I just don't want my rates to go up because credit is being issued to people who end up overcharging and defaulting on their accounts.

Posted by: Wendy C | Wednesday, February 24, 2010 at 10:18 AM

Wendy, in general, your rates shouldn't go up because other people are defaulting; you should be charged based upon your credit score and behavior. The credit card business is EXTREMELY competitive. Moreover, as I said above, you should be able to shop around and play the Balance Transfer Game for free.

GregJ is right when he says how card companies will respond to additional regulation. They will do their best to either pass on costs to the consumer OR deny credit to people who would have gotten it before. Neither is a good result.

To repeat, if you are a credit card user and pay off your balances monthly, you get 1% back on your purchase and free service AND the credit card company loses money on you, like they lose money on me.

Posted by: MCN | Wednesday, February 24, 2010 at 10:34 AM

@MCN

With all due respect, I think my rates have gone up the past five or more years for the reasons I've suggested. While I don't pay off the entire balance every month, as I said earlier, I keep my balances low and pay on time. And my credit score has consistently remained around 790 for the past decade. Yet, my card rate has increased an average of ten percentage points during this time. And that's before government intervention. Sure, with low balances, my monthly interest charge isn't much. But I resent that, as a good customer, I'm being penalized. And no, I'm never late on any of my other bills.

Posted by: Wendy C | Wednesday, February 24, 2010 at 11:19 AM

Wendy, I don't know why your rates have risen. With a variable rate card, your rates are going to change but they've dropped so that isn't the driving factor. One reason rates have risen is that default rates have risen. Also, the effective interest rate on all balances to the issuer is much lower than the charged rate, for reasons I won't go into.

The simplest solution for you is this: either pay off your balance completely and save the finance charges, or play The Balance Transfer Game, and get 0% financing after you pay a 1.5% BT fee. There is simply no reason why you should be paying finance charges when 0% financing is available to someone with a FICO like yours.

Posted by: MCN | Wednesday, February 24, 2010 at 11:35 AM

MCN wrote:

"You should be able to shop around and play the Balance Transfer Game for free."

Um, nope, they're now tacking on larger balance transfer fees.

And this:

"Wendy, I don't know why your rates have risen."

Even people with excellent credit have seen their interest rates go up in the last few months as the credit card companies prepared for the credit card bill to go into effect. They'll no longer

be able to rake in so much from the fees that were keeping their business so profitable, and they're darn sure not going to trim their bottom lines, so they're going to find new ways to go through unwary consumers' pockets.

The best option, really, is to limit one's credit purchases so you can pay the card issuers in full each month, and keep enough money in an emergency fund to cover unpredictable but necessary expenditures (like a major car repair).

If they raised the rate on a card you'd like to keep using, it doesn't hurt to call the company and threaten to close the card. It's more expensive for them to find a new customer than it is for them to cut you some slack.

Posted by: Heron | Wednesday, February 24, 2010 at 11:58 AM

@Jimmy G:

Don't go putting words in my mouth!

I never said I was for Davis Bacon.

I never said I was against Davis Bacon.

I merely pointed out that it was a Republican law passed & signed originally & designed to prevent black contractors from getting federal construction jobs.

@quotidian:

A bit touchy are we over bringing up Hoover's name?

He was a man that could be brought to tears over starving Belgians after WWI, but was blind to starving Americans after 1929!

Posted by: Garry | Wednesday, February 24, 2010 at 11:59 AM

I recently returned some clothing purchased with cash to Carson Pirie Scott. The salesperson had to ask another employee the procedure for handling a cash return, and then found that there was not enough cash in the drawer to reimburse me. The amount of the return was less than \$150. She explained that cash purchases were very rare in her department.

Posted by: MJR | Wednesday, February 24, 2010 at 12:06 PM

If you're PO'd at the card companies, either pay cash or don't carry a balance. Very simple.

Card issuers have lost gazillions over the past years as the economy has weakened. Even in good years, when I was at Citi we were writing off over \$6 bil a year, and that excluded accrued interest and fees. That drives finance charges higher.

Credit cards issuers are not charitable institutions.

Someone up there said that credit card issuers were issuing credit "irresponsibly". That is damned silly.

One tactic consumers like to use is to max out on their balances just before they go BK. As an unsecured creditor, the issuer gets zip in the bankruptcy. No one cries for the issuer, of course.

If you're PO'd because your rates have risen ahead of the legislation, maybe that should suggest to you that some of the legislation at least is a bad idea and raised costs, not to mention restricting credit to those who most need it, i.e., risky, poor consumers. Such is the law of unintended consequences.

Posted by: MCN | Wednesday, February 24, 2010 at 12:18 PM

There are some good outcomes from the credit card law: The due date has to remain the same from month to month, and card issuers have to notify customers of impending interest rate changes further in advance.

I'm not crying any tears for the banks, but Americans need to educate themselves about how to use credit wisely, too.

Posted by: Heron | Wednesday, February 24, 2010 at 12:27 PM

@Garry

"Don't go putting words in my mouth!"

I merely pointed out that it was a Republican law passed & signed originally & designed to prevent black contractors from getting federal construction jobs."

But you are not against it? I am willing to say that I am against it even though it is (according to you) a Republican law.

Posted by: Jimmy G | Wednesday, February 24, 2010 at 12:35 PM

@Wendy C,

I agree with your concern and I welcome you to the ranks of people who don't want to pay for others irresponsible behavior. Keep in mind that the federal government had to bail out the banks and lenders because the government essentially forced them to issue credit to people who couldn't pay it back (due to "fair lending" laws and other misnamed legislation).

Credit card companies who take unnecessary risks should be allowed to fail and the consequences of such failure would be less serious than in the case of banks.

If you're concerned about being overcharged because credit card companies are issuing cards to those who rack up debt that they can't pay off (and I don't blame you because I am too), I'm sure you'll join me in opposing laws that force lenders to extend credit to people with low incomes, shaky credit histories, or whatever criteria Congress dreams up on that particular day.

Posted by: Greg J. | Wednesday, February 24, 2010 at 01:04 PM

@Jimmy G:

It's not my word or opinion that Davis Bacon was a Republican passed law, it's a fact that it's a Republican passed law!

From Wikipedia: "The act is named after its Republican sponsors, James J. Davis, a Senator from Pennsylvania and a former Secretary of Labor under three presidents, and Representative Robert L. Bacon of Long Island, New York. The Davis-Bacon act was passed by Congress and signed into law by President Herbert Hoover on March 3, 1931."

Posted by: Garry | Wednesday, February 24, 2010 at 01:11 PM

@Garry

OK. I am convinced that it was a Republican-passed law. But I am opposed to it. You don't seem to be willing to say that you are also opposed to it. And, as someone above asked, why doesn't Obama repeal this racist law?

Posted by: Jimmy G | Wednesday, February 24, 2010 at 01:45 PM

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"And, as someone above asked, why doesn't Obama repeal this racist law?"

Because it favors the labor unions, that's why.

Posted by: MCN | Wednesday, February 24, 2010 at 02:10 PM

@GregJ

I'll agree with you on not issuing credit to those with shaky credit histories, but I don't think it's fair to limit credit to low income families, unless they prove to be irresponsible in managing their credit.

@MCN

Thank you for the credit card advice, I will research my options.

Posted by: Wendy C | Wednesday, February 24, 2010 at 09:03 PM

A quick and easy way merchants can save money on swipe fees is to make sure they are getting the best rates on credit card processing...by comparison shopping.

Much like you would go to Expedia to check out the different prices for plane tickets, TransFS.com lets business owners compare merchant account providers.

The website is free, and we also offer complementary statement analysis. Being business owners ourselves, we decided to do something about the overcharging in the industry. Check out TransFS.com to get the best deal on credit card processing. Users save an average of 40%.

ZORN REPLY -- I almost never allow commercial statements into the comment thread, but this one seems to be genuinely on point and even potentially useful, though, of course, I can't vouch for this service. What does anyone know about these services and if they lift the burden?

Posted by: Stella Fayman | Thursday, February 25, 2010 at 09:51 AM

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@Wendy C,

I think we're very close to agreement but I have one question for you. You wrote "I don't think it's fair to limit credit to low income families, unless they prove to be irresponsible in managing their credit." Do you really mean "limit" or do you mean "refuse to issue any credit at all" because there's a big difference. Also, I think the borrower should be forced to prove creditworthiness rather than the other way around. I think that a mortgage lender should, for instance, be able to deny a mortgage that would result in \$1,000 in monthly payments to a family earning \$30,000 per year on the grounds that the math simply doesn't make sense. In other words, the company should be allowed to make a fair assessment of whether the family could afford the payments. The problem with the government's role in the mortgage crisis was that it encouraged (and in many cases even required) mortgage companies to take bad risks on low income people. In my opinion, there is nothing wrong with a credit card company looking at someone's \$15,000 per year income and offering only a \$500 line of credit, for example, based on the company's independent assessment of the risks. When government steps in under the guise of helping low income folks, it hurts lenders and all of their customers, including the low income people themselves.

Just so you don't think I'm picking on poor people, let me add that when a mortgage lender offers a mortgage on a \$2 million dollar house to someone who makes, say, \$200K, and the borrower can't make the payments then I have absolutely zero sympathy for either party. They made a bad bargain and should have to live with the consequences. Neither should be bailed out.

Posted by: Greg J. | Thursday, February 25, 2010 at 10:53 AM

@Greg J

I'm sorry, after posting I saw how misleading that sentence was and should have followed up with a correction. I did mean refusing credit to low income families. I don't think it's fair to say people under a certain yearly income should be denied credit, I'm living proof that some who make a lot less can be very responsible with their finances. And yes, I agree credit lines should be issued with an eye to a person's ability to pay. But, if that person proves to be responsible, over time, those limits should be raised.

And though I agree with your assessment on how mortgages should be handled, please don't tell me it was the government's fault that the housing market collapsed. I think fault lies at the doors of the lending institutions and their infinite greed.

Posted by: Wendy C | Thursday, February 25, 2010 at 11:23 AM

Wendy, credit limits are often raised to borrowers who show a steady history of non-delinquency.

I am also on line with GregJ and must beg to differ with you regarding the government's role in the mortgage fiasco with was central in its demand for more lending to low income borrowers and purchase at Fannie and Freddie (both of which are disaster areas) of mortgages issued to those borrowers. It created the demand and provided the supply.

Posted by: MCN | Thursday, February 25, 2010 at 11:43 AM

This and other threads dealing with economic issues keep reminding me just how much in conflict the human mind's innate subconscious models of the world are with scientific models. In situations where we think we are being "good" (the fact that our calibration of ourselves is proven to be very biased is another topic), but are treated the same as someone who we think was "bad", or just worse than we were treated before, we feel wronged and reach out for a club to correct the wrong ("there ought to be a law").

A complex economy, with all the specialization and division of labor, with myriads of economic agents, is not something that existed when the evolution was shaping our brain structures (our operating system and built-in apps, if you will). Hence we have zero intuition about how the economy really works. We do not innately sense it. We have impulses, knee-jerk reactions to what happens to us or what we observe, but these reactions were shaped by a very different environment of small bands of humanoids hunting and gathering in the African savanna. These impulses were "on the money" back then (that's why the evolution selected them), but not so in the current environment. Much like our impulse to overeat was a very useful adaptation back then, when food scarcity was the norm, but is a danger to people in industrialized countries now.

In the sphere of our relationship to the environment, our innate intuitions, our build-in models of physics are just as much at odds with science as in the sphere of relationships with others (which is where economics resides). It's not just that no one has intuitive grasp of the Theory of Relativity or quantum mechanics, experiments show people don't have intuitive grasp of Newtonian physics either. For example, on an intuitive level we can not help feeling that a ball tossed up is subject to two forces, one pushing it up and one pulling it down and it starts falling back when the latter exceeds the former. Even after we learn the scientific answer -- there is only one force (gravity) acting on the ball -- we can't change this intuition, because it seems to be pretty well hardwired by the evolution. Yet, when confronted with this discord of innate intuition with natural science, most of us let the science "win".

In the economic sphere, even though plenty of science exists, most people do not automatically supplant their innate intuitions (by definition erroneous) with science driven conclusions. Witness the struggle MCN is having trying, very patiently, very respectfully, very lucidly, to nudge some of the posters here from their knee-jerk reactions to a more factual and logical view. My guess is MCN is not immune to having the "I have been wronged, there ought to be a law" reactions to situations people are complaining about, he simply has learned the scientific interpretation of such occurrences and that keeps him from acting out in a way that may intuitively seem like in his own best interest, but really is not.

An interesting and important question for the evolutionary cognitive psychology is why there is such a disparity between our high acceptance of scientific knowledge in our dealings with nature and low acceptance of it in our dealings with people. My ad hoc theory is that the evidence for natural science efficacy is of a sort that is a lot easier for human minds to accept. The planes do not fall out of the sky on a regular basis, and that re-enforces our trust in the science that lead to the design of those planes. By its nature, the economy doesn't present us with such easy to digest evidence. Even past experience doesn't seem to deter us. Witness the most current Obama's Nixonian leanings towards price controls. I wouldn't be surprised if Wendy C. gets a lot of her "there ought to be a law" wishes and we all will take a backward step to the pre-industrial times. The good news: our overeating instinct will come handy again.

Posted by: Boris Gendelev | Thursday, February 25, 2010 at 12:36 PM

To deny that the government played a huge role in promoting and extending loans to people who shouldn't have gotten them is to deny reality.

Posted by: quotidian | Thursday, February 25, 2010 at 12:43 PM

i know this is an old conversation...

but i was wondering how much credit card transactions "save" as far as robberies and mismanagement goes.

If a store (presumably a small one, as bigger ones have too many employees) is robbed of cash, do the stores get it back? Or is it usually lost revenue?

Also, if an employee takes cash in a transaction (maybe charges more, or whatever), it could be hard to trace, especially for a small business. Hard to cheat with a credit card, no?

Just a thought...

Posted by: JP Paulus | Thursday, February 25, 2010 at 12:47 PM  
@Wendy C.

I think we're in agreement on extending credit to low income people and I'm in partial agreement with your point about lender greed.

But the lenders were only greedy because government allowed them to be greedy! By essentially forcing the lenders to take bad credit risks and by backing up those risks by bailing out the lenders, the government created moral hazard. If the lenders were operating without government interference, they would have only taken appropriate risks knowing that they were on the hook for any risks that didn't work out. If you are keeping the profits you make on risks that turn out well and if the government is bailing you out of risks that turn out poorly, of course you're going to be greedy. Wouldn't you take a ton of investment risks if the taxpayers would bail you out on your mistakes? I know I would. When government interferes with market mechanisms, companies do things that are greedy but rational, given the rules under which they are operating.

Posted by: Greg J. | Thursday, February 25, 2010 at 01:20 PM

Boris, I'm not sure if you're complimenting me, or damning me with faint praise.

At least I know something about credit cards. And microeconomics. And finance. So I got that going for me.

Posted by: MCN | Thursday, February 25, 2010 at 01:28 PM

MCN, definitely complimenting you on your valiant effort to transmit factual and logical view of these topics in the face of such a strong human tendency to roll with pre-historic instincts.

Posted by: Boris Gendelev | Thursday, February 25, 2010 at 02:06 PM

Funny how quickly we label others acting in their own interest "greedy", particularly anonymous others, and even more so those whom we can dehumanize by making them sound like some sort of machine - "credit card companies", "banks", "corporations", etc. But when we ourselves act in our own interest, such as looking to pay the least for whatever product we want, aiming to earn the most for whatever job we perform, we use other labels: "frugal", "successful", etc.

Posted by: Boris Gendelev | Thursday, February 25, 2010 at 02:17 PM

Greg, the government wasn't forcing the lenders to sell overpriced homes at dangerous interest rates to people who couldn't afford them. They happily embraced the sub prime mortgage surge.

<http://ezinearticles.com/?The-Real-Estate-Market-Crash-of-2008---How-Did-We-Get-Here?&id=1425372>

Posted by: Wendy C | Thursday, February 25, 2010 at 02:26 PM

@Wendy C.

There are two components to this: regulations that encouraged/forced lenders to take bad risks and the understanding that government would bail out institutions who engaged in reckless behavior. These components are related.

Of course the lenders embraced the subprime mortgage surge. Their bad bets were being effectively covered by the government (or institutions that had the backing of the government if they, in turn, failed after the risks were bundled and sold as securities) and they were profiting off their good bets. That's my point. We agree.

Fannie Mae and Freddie Mac were public/private hybrids that were required to lend to low income individuals who couldn't possibly afford their mortgages. Other federal regulations encourage home ownership regardless of income, which has the unintended effect of creating bad credit risk. The lenders are pretty much ok with this as long as they get bailed out. The reckless buyers are ok with this because they can walk away from their mortgages. The taxpayers, as usual, are left holding the bag.

Posted by: Greg J. | Thursday, February 25, 2010 at 02:44 PM

Wendy,

Even this lightweight article you are referencing, points in the same direction Greg is pointing. "Some of the money was borrowed from central banks." is one statement you should have paid closer attention to. At the end of the line, it were Freddie and Sally, and I am not talking about anyone's cousins, but rather the children of Uncle Sam, that were financing the subprime market. "But when interest rates started to rise, people stopped buying homes." is the other. That one is particularly telling, since it is the Fed that by lowering interest rates created the "easy money" risk taking environment and it is the Fed that by raising the rates that broke the bubble.

Posted by: Boris Gendelev | Thursday, February 25, 2010 at 02:48 PM

For those interest, Commentary magazine had an excellent article on the subject six months or so back.

Thomas Sowell's new book, The Housing Boom and Bust, also has first rate explanations.

Posted by: MCN | Thursday, February 25, 2010 at 02:53 PM

MCN, I'm curious: Do you think the economy is perfectly capable of regulating itself if the government leaves it alone?

Posted by: Heron | Thursday, February 25, 2010 at 03:23 PM

Heron: No, not all. But this economy is vastly overregulated (and over taxed).

Posted by: MCN | Thursday, February 25, 2010 at 05:18 PM

Heron, I am wondering if the way you (and most people) pose this question puts you on the wrong thinking path. The "self regulation" analogy, which conjures up images of either an entity with intentional behavior (such as a person regulating his caloric intake) or manmade machinery (a boiler regulating its internal temperature) or parts of anatomy (the heart regulates the flow of blood), can go only that far in describing free market economy the very essence of which is change rather than stasis.

You also have to be clear about what you meant about government leaving it alone. For example, unless the Fed is abolished, unless FDCI insurance is abolished, other "deregulation" would appear small inconsequential or even dangerous (if it rewards risk taking while still protecting against losses).

Posted by: Boris Gendelev | Thursday, February 25, 2010 at 05:39 PM

@Greg J

"Other federal regulations encourage home ownership regardless of income, which has the unintended effect of creating bad credit risk."

But Greg, many of these loans were made to middle and upper middle income families, they were offered homes way out of their price range. And were duped into believing they could afford the payments, regardless of variable rates. As for your statement:

"But the lenders were only greedy because government allowed them to be greedy! By essentially forcing the lenders to take bad credit risks and by backing up those risks by bailing out the lenders, the government created moral hazard."

How did they know the government would bail them out two years before this became an issue?

And Boris, thank you for your usual condescending conclusions. But, I would much rather receive pointed reprimands from Mike than your nonsensical responses.

Posted by: Wendy C | Thursday, February 25, 2010 at 06:47 PM

Boris, I was really just trying to pick MCN's brain. (I wish I could come up with a less punitive-sounding metaphor, but I just spent an hour and a half at choir practice, and I'm spent.)

Posted by: Heron | Thursday, February 25, 2010 at 09:40 PM

--@Wendy. An honest thing for you to say would be that you grasp of logic is tenuous. Otherwise you would be able to point out in what my responses are nonsensical. And how is it

condescending to point out that the article you use to bolster your otherwise uninformed and unreasoned statements actually implies quite the opposite?

BTW, how were middle and upper class families duped into believing they could afford payments? Were they numerically illiterate (are you using yourself as an example?)? If there was "duping", the Fed did it by creating housing price inflation. That made people believe their houses will go up in value and they would have equity to use.

How would financial institutions know they would be bailed out? Because it happened before. No memory of the Savings and Loan bailout?

Posted by: Boris Gendelev | Thursday, February 25, 2010 at 10:25 PM

Posted by: Boris Gendelev | Thursday, February 25, 2010 at 02:17 PM

Excellent point regarding greed.

Now, is a union that insists on higher pay and benefits, and more employment for its members, when the company that its members work for is tottering (e.g., the UAW and the domestic auto industry) or the public entity that employs its members is running a huge deficit (the CTA, the Chicago public schools) greedy? And, by extension, are its members greedy?

I think that greed is not confined to just the corporate entities that we take such pleasure in demonizing.

Posted by: DaveB | Friday, February 26, 2010 at 10:36 AM

The auto unions have done an excellent job in reducing employment for their members.

Posted by: MCN | Friday, February 26, 2010 at 11:00 AM

MCN, they certainly have. I've often noted that given the choice between all the jobs they could want at \$24 an hour, and no jobs at \$40 an hour, they'll take those \$40 jobs every time.

Posted by: DaveB | Friday, February 26, 2010 at 01:24 PM

Of course, people should be free to negotiate contracts in groups. Most of the problems with unions stem from the special status and protection they are given under the labor laws.

My point about the use of the word "greed" was that we too readily attach it anyone acting in self-interest, if we don't like the outcome (i.e. it impinges upon our interests). It would help if before labeling someone "greedy" we took care to demonstrate that he or she is acting in bad faith. If the word is used as synonym for self-interest, it loses its meaning at best and muddles thinking and discourse at worst.

In her particular example, Wendy simultaneously claims that her credit card issuer is greedy, i.e. acting in bad faith in pursuit of self-interest, and very stupid by not correctly assessing Wendy's true credit risk (and thus presumably of countless others), and in doing so actually hurting own interests. It was already mentioned, how given the competitive nature of the industry, the chances of either being the case are low. Wendy is also not taking into account the fact that risk is only part of the credit card profitability equation. For a credit card company to be interested in lowering the rate or increasing the limit, the contribution from the expected increase in usage has to be greater than the projected cost bad debt. In their data analysis, Wendy may well fall into a segment where the increase in bad debt is projected to be low, but the additional usage increase even lower, making it a bad idea financially.

Posted by: Boris Gendelev | Friday, February 26, 2010 at 02:01 PM

Boris, yes and no, as people can be both greedy AND stupid. In the case of credit cards companies, however, they act reasonably intelligently. I will say that even I was unhappy with some of the practices being used while I was at Citi (some of them are now banned).

However, as an aside, one that got a lot of negative publicity was when an issuer raised the rate on a customer who demonstrated bad credit behavior on a different card. Now, this sounded "unfair" to many people, including people in Congress who chose to ignore the facts. Those facts are that, if you go 90+ days late on one card, your chances of going 90+ late on other cards increase significantly.

So the card carriers were acting reasonably in raising their rates on you. That didn't resonate with Congress, which seems to have never met a lender that it liked, unless it was in danger of going bankrupt or would lend money to poor credit risks in particular groups that Congress favored.

Posted by: MCN | Friday, February 26, 2010 at 02:56 PM

MCN, I didn't mean to imply that it is impossible to be both [bad faith] greedy and stupid. I was just accounting for both of the accusations that were leveled at that issuer.

Posted by: Boris Gendelev | Friday, February 26, 2010 at 04:12 PM

My references to data-driven customer segmentation and decision optimization rules are based on my own data mining and decision modeling practice in the target marketing industry. Data-driven business decisions about a customer are not made directly and solely on the basis of that customer's past, but on the basis of predictions about that customer's future, which come from models developed by correlating historical "past" vs. "future", and are adjusted for whatever overall trends are. Wendy may have the past free of delinquencies, but her history and other characteristics may be the kind associated with an average increase in delinquency in the future. Or, as it was pointed out, the overall level of delinquency rose, affecting everyone's likelihood of delinquency. Decision optimization is based on placing the right bets, not on being right 100% of the time about each customer. When the weatherman says there is a 70% chance of rain, and the cost of carrying umbrella on such days is less than the cost of getting wet on 7 out of 10 such days, you carry an umbrella.

Posted by: Boris Gendelev | Friday, February 26, 2010 at 04:31 PM

DaveB wrote:

I think that greed is not confined to just the corporate entities that we take such pleasure in demonizing.

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I agree. It was greed all around that caused the real estate crisis. Individuals who didn't do their homework, and took bank loans they had no chance in hell of repaying so they could buy bigger and better houses than they could afford, aren't blameless. The government's encouraging people to think homeownership is an unbridled good (by offering low-interest loans and tax incentives) played a role, too.

It's just emotionally easier to point a finger at a bank official who's making millions despite making irresponsible decisions in an attempt to please shareholders, than someone who's living on a shoestring and thinks he'd be happier if he owned a house.

Posted by: Heron | Friday, February 26, 2010 at 05:18 PM

@Heron is so right as far as who is always emotionally easier for us to blame.

But what also bothers me is how easily, with a 20/20 hindsight we jump to describing actions that ultimately had bad outcomes as irresponsible. The Fed created a price inflation bubble, particularly in the housing market, which amounted to misinformation about the long-term value of real estate. Had the bubble gone on longer or was deflated much less violently (as happened previously), banking executives who refused to ride it would have been blamed for irresponsibly reducing shareholder value, restricting access to credit and housing, etc. As it happened, number of other mostly government induced factors came together to create a perfect storm and the bubble burst very violently. But how many people would have predicted both the dimensions and the timing of that and done so on the basis of evidence and reasoning that would have convinced others? I think the answers are a handful and none respectively.

Posted by: Boris Gendelev | Friday, February 26, 2010 at 05:52 PM

@Wendy C,

Boris has beaten me to the punch and I agree with his explanation but let me add some color commentary.

Not only did history tell lenders that they would be bailed out but Fannie Mae and Freddie Mac have implicit government guarantees that they will be bailed out. These institutions are sponsored by the government and given mandates by the government, and were responsible for the worst part of this mess.

Of course middle and upper income people were offered mortgages that they couldn't afford. I have a couple of middle and upper income friends who were in this situation. Clearly, everyone got carried away. But the reason they got carried away is that the pricing and credit mechanisms were distorted by government interference. Credit was easy because rates were purposely set too low by the Fed. Fannie Mae and Freddie Mac are such huge players in the mortgage market that private lenders have no choice but to react to the signals they are getting from them. The homebuyers who fell into this trap should be criticized for being stupid (or at least uneducated), greedy, and unrealistic. The lenders should have known better too. What about the construction companies who overbuilt? Yep, they got carried away too. But the proximate cause of all of this irrational exuberance was the government manipulating credit and prices. Even homebuyers who figured out that this wouldn't last forever had incentive to try to flip houses to suckers who would be left holding the bag. Even lenders who could see a crash coming had incentive to squeeze out as many commissions as possible from people who shouldn't have been allowed anywhere near a mortgage. If you don't like greed, stay away from capitalists (the old saying "the worst part of capitalism is capitalists" is so true). As a taxpayer, if you don't want to be left picking up the tab for financial meltdowns, don't support government intervention in markets.

Posted by: Greg J. | Friday, February 26, 2010 at 05:59 PM

Greg J., I would say the root cause of our economic troubles is how many people in our society think they can achieve happiness by buying stuff.

Posted by: Heron | Friday, February 26, 2010 at 08:38 PM

Denouncing materialism is the luxury of the well fed and well sheltered. But you are right, Heron, there wouldn't be any economic troubles if no one bought any stuff. There wouldn't be any economy.

If there is a minute grain of truth in Heron's statement, it is that just like we have a no longer so good for us instinct to overeat, we may have inherited from our primeval evolutionary ancestors an instinct to hoard possessions. In the circumstances of already having a lot compared to what was available in their environment, this instinct might be making us overestimate how much happiness an additional possession would add. But unlike overeating, which today has a negative utility, overbuying at worst gives us a smaller utility than we hoped. It's not obvious to me how that leads to economic troubles.

Posted by: Boris Gendelev | Friday, February 26, 2010 at 09:34 PM

@Heron,

I would say that is one of the root causes of our moral troubles but it doesn't necessarily hurt the economy.

Posted by: Greg J. | Saturday, February 27, 2010 at 03:31 PM

Greg J., I think you nailed it. Thanks.

Posted by: Heron | Saturday, February 27, 2010 at 04:49 PM

@Greg J

"Not only did history tell lenders that they would be bailed out but Fannie Mae and Freddie Mac have implicit government guarantees that they will be bailed out. These institutions are sponsored by the government and given mandates by the government, and were responsible for the worst part of this mess."

They were responsible for the worst part of this mess? Then why was the Fannie/Freddie bailout priced at \$200 billion while the TARP bailout came to \$700 billion? Not counting the \$150 billion for AIG.

<http://www.stimuluspackagedetails.com/time.html>

And because Bush Sr bailed out the S & L's, it was assumed Bush Jr would bail out these other lending institutions? Well, he did, so I'll let that one go.

As for the rest of your comments, I'll have to agree there's plenty of blame to spread around. I surely would have never bought a home based on a very low down payment coupled with a variable rate, yet the banks made it too easy for many to think they could afford what they could not. And it's not only the Fed's fault, though Greenspan admitted they did not foresee this kind of fallout. And I'll agree with your statement 'the worst part of capitalism is capitalists' I disagree that government regulations aren't necessary.

As an aside, I believe the root cause of our economic success depends upon people trying to achieve happiness by buying stuff. Would we be the country we are today if people only bought what was necessary? BTW - I have some swamp land in Alabama for sale. Interested?

Posted by: Wendy C | Saturday, February 27, 2010 at 06:50 PM

Wendy C, I admire you for your tenacity.

Posted by: Heron | Saturday, February 27, 2010 at 07:14 PM

Wendy,

The biggest danger the economy and prosperity are people like you, who have the hubris to think they know what is or isn't necessary for others to buy (or do, or make, charge, etc.). The "there ought to be a law to make people do what I want" sort.

Coupled with economic ignorance and illogical thinking it is particularly appalling. Regarding your illogic about Fannie/Freddie bailout size being connected to their culpability: if I shoved you into the path of an oncoming train, would the fact that I didn't die be evidence of me not being culpable?

Posted by: Boris Gendelev | Saturday, February 27, 2010 at 09:40 PM

--- "if I shoved you into the path of an oncoming train, would the fact that I didn't die be evidence of me not being culpable?"

No, you would still be charged with first degree murder.

Be careful, Boris, you're fast approaching a line I don't think you want to cross.

Posted by: Wendy | Sunday, February 28, 2010 at 04:54 AM

Once again, Wendy, you show mechanical reading ability, but no comprehension. That was an example to point out to you that you can't judge culpability, but the state of health of the perpetrator, which is exactly what you did when you wrote about smaller (but still huge) Freddie Mac bailout.

Posted by: Boris Gendelev | Sunday, February 28, 2010 at 09:21 AM

typo correction: "by the state of health"

Posted by: Boris Gendelev | Sunday, February 28, 2010 at 09:23 AM

My main problem with the economy is the widening gulf between the "haves" and the "have nots." I'll be curious to see if the people who serve on corporate boards will be given more power to rein in CEOs' salaries, and if so, if that'll help, or if executives will just find more workarounds to compensate for the changes.

Posted by: Heron | Sunday, February 28, 2010 at 10:42 AM

I very much like this Sunday's Doonesbury:

[http://www.doonesbury.com/strip/dailydose/index.html?uc\\_full\\_date=20100228](http://www.doonesbury.com/strip/dailydose/index.html?uc_full_date=20100228)

Posted by: Heron | Sunday, February 28, 2010 at 11:28 AM

In other words, Heron, [green] envy is your main problem.

The widening gap, if anything, is a symptom, and quite likely a symptom of a good thing, not a bad thing.

With a much greater ability to leverage talents, ideas, effort, capital and risk taking, those with the most talent, the best ideas, the biggest effort, the most savings (capital), the most tolerance for risk, have much improved chances at huge pay offs. (Note I said "much improved chances", not a "guarantee"; there is some randomness, but the more value you have to offer to others, the greater your chances.)

This greater leveraging ability is due to a) technology b) lowering of protectionist barriers, allowing labor and capital to flow more freely to where it can create the most value

Before any recording equipment was invented and before mass communications, a musician, no matter how brilliant, could deliver his product (his music) only to a limited audience. His earnings were thus very limited. With the ability to record and mass promote (communicate), the same musician can now deliver [entertainment] value to hundreds of millions. For giving this value to so many, he is rewarded handsomely. Alas, that does create a huge gap between his earnings and the vast majority of other people. Is that a bad thing? (It could be, I suppose, if the feeling of envy overwhelms the received value.)

This dynamic is the same for entrepreneurs and large-scale enterprise leaders. If they succeed, they can succeed on a much bigger scale than ever before. True business success comes about only when a lot of value gets created for other people, who in turn voluntarily pay (i.e. use the product of their labor) to obtain this value. Is that a bad thing?

However, I would not defend are the "haves" whose path to riches was through fraud, nor those who gain through the use of government power, such as protectionism, subsidies, bailouts, pork barrel programs, etc. That's not true business success, that's a few benefitting at the expense of many. Get the government hands out of the economy, and there will be much less of that.

The whole CEO pay issue is a red herring. There are not that many large companies, hence not that many CEO's for that to amount to anything in the economy. Calibrating their pay is indeed up to the shareholders of those companies and no one else, because it is there money, not any one else's.

Posted by: Boris Gendelev | Sunday, February 28, 2010 at 11:43 AM

How about those of us in the middle class, Boris? We're falling through the cracks.

Posted by: Heron | Sunday, February 28, 2010 at 12:54 PM

@Heron

Didn't you know, it's the responsibility of the middle class to pick up the tab for all of this. Nice cartoon selection.

Posted by: Wendy C | Sunday, February 28, 2010 at 01:25 PM

Huron,

We are in a serious [government policy induced] recession. By definition, on average, people are worse off right now than they were a couple years ago. It will take time for capital to re-adjust and the time it takes is made longer by the government attempts to "fix" the economy (bailouts, stimulus packages, extended unemployment benefits – all promoting further waste of capital.)

Middle class is not some special category of people that is owed something by some other group of people (who?). I hate to use a cliché, but life truly doesn't hold out any guarantees of anything to anyone. You could be the richest man on Earth and tomorrow die by in an accident or from a cancer. Life is full of cracks to fall into. Blaming others isn't helpful. We, the public, by voting or abstaining from voting, are responsible for being duped and giving power to those who turn our ignorance and knee-jerk reactions into policies ruinous to the economy.

The way you phrase things betrays your "zero sum" view of the economic activity. You think that if someone becomes richer, someone else is necessarily poorer and the sum of wealth stays the same. A look at the historical growth in the standard of living shows how patently wrong such a view is. In a real free market economy, aside from cases of fraud (and government redistribution, but then we couldn't call it a fully free market economy anymore) one's gain is not everyone else's loss. An honest person becomes richer by creating something of value that didn't exist before, something of value to others – a new resource to improve / enrich their lives in some ways (directly or indirectly, by making the use of other resources more efficient). And for that, others are willing to exchange resources they have (for most, it's the value of their past labor, accumulated and "stored" in a form of savings.) The honest free market wealthy become wealthy precisely and only because they increase the standard of living of large numbers of other people, i.e. by making others better off. Do free markets guarantee that every single individual becomes better off or doesn't become worse off? Of course not. Such guarantees are no more possible than guaranteeing that one doesn't die young by tripping on a curb, except by prohibiting curbs; or from a fall from stairs, except by prohibiting multi-story buildings, or in childbirth, except by prohibiting childbearing.

Posted by: Boris Gendelev | Sunday, February 28, 2010 at 01:50 PM

Wendy,

If by "all of this" you mean government bailouts, most of the burden is carried by those honest and hardworking people, entrepreneurs, executives, highly paid professionals who constitute top 10% of the income earners. They pay 68% of all Federal taxes. (Their share of income is 44%). The top 5% pay 57% of all the taxes. Unless you define middle class very very broadly, it is not the "middle" that pays the most for government follies.

Posted by: Boris Gendelev | Sunday, February 28, 2010 at 03:50 PM

Boris, you write as though anyone who has a good enough idea and works hard enough has what it takes to strike it rich in this country. I think those are important ingredients if one wants to succeed, but having the right connections and educational opportunities help a great deal.

I don't think the economy is good in and of itself, and that anytime the government influences the business world, that is by definition the wrong thing for it to be doing. I think there is some middle ground: The economy can self-correct to a degree, but some regulation is necessary if we want businesses to value more than the bottom line.

Posted by: Heron | Sunday, February 28, 2010 at 04:16 PM

As I recall, a few of those honest and hardworking people are doing time at Club Fed. Boris, I don't dispute your numbers. But the wealthy have many more options in investing and protecting their income compared to most middle income families. (We're not getting six and seven figure bonuses, either.) They're not exactly hurting.

Posted by: Wendy C | Sunday, February 28, 2010 at 04:57 PM

---Huron,

Please read what I wrote carefully, before distorting it.

I wrote: Note I said "much improved chances", not a "guarantee"; there is some randomness, but the more value you have to offer to others, the greater your chances.

BTW, the value of education as an incremental factor in the earning potential is hugely overstated. For the most part, education is a self-selection process. In other words, if you give college education to those currently not getting it, the vast majority of them will not have improved earnings. By far the biggest factors affecting earning potential are a) risk taking b) perseverance (at the expense of leisure, family time, etc.) At the end, the only way to make a lot of money honestly is to produce a lot of value for others. Not everyone with a potential to do that ends up in a position to do it, but that's not the fault of those who does, or for the most part, anyone's fault. There is just a lot of randomness in the world. There were probably many hardworking talented writers with the potential to produce the equivalent of Harry Potter. But there was room in the market for only a handful of such blockbusters. Who got to be a mega-success was pretty random, that is not predictable by analyzing data. But are we going to blame and punish those who succeeded and brought joy to many, for the fact that others, with similar potential and effort did not?

Wendy,

What percentage of high earning businessmen/entrepreneurs and professionals commit fraud or other forms of thievery? How does that compare with other income brackets? (Do you even know how many households constitute the top %1 of the earner?) Unless you actually have some facts to show that the top earners are largely or even disproportionately thieves, your statements can be taken for nothing more than pure unadulterated envy and as well as your own desire for thievery through income redistribution.

The tax burned percentages I referenced are obviously already after any kind of tax sheltering. It is actually what is paid, as a percentage of all the taxes paid. The point is, unless you are in the higher income brackets, you don't have much reason to whine about carrying the burden of the bailouts. And why is it, if you are hurting, you feel that those who [according to you] are not hurting, are responsible for your problems and have to be made to feel hurt too, or at least made to solve your problems? Again, you are blinded by envy and make pronouncements without regard to fact or logic, without grasp of economics, to cover up that envy is gnawing at you.

Posted by: Boris Gendelev | Sunday, February 28, 2010 at 05:55 PM  
@Huron, continued

Re: "I don't think the economy is good in and of itself, and that anytime the government influences the business world, that is by definition the wrong thing for it to be doing. I think there is some middle ground: The economy can self-correct to a degree, but some regulation is necessary if we want businesses to value more than the bottom line."  
Huron, you talk about the economy is some inanimate machine. The free economy is nothing more than people producing something and exchanging what they produced, consuming some things and saving up other things so that they can be used later or used to produce other things later. There is nothing else going on. The government is legitimately involved by being the sole agent of law and contract enforcement, which creates the necessary environment for people to transact with each other with confidence. The free market economy is nothing more than the sum total of free people freely pursuing their happiness. At least one rather relevant group of individuals in the U.S. history put their signatures on a document that clearly states that securing liberty and the right to pursue one's happiness are the reasons legitimate governments are formed. For the government to "influence" the economy, it has to abridge individual liberty (of people that haven't been found guilty of anything in a court of law), to interfere with their pursuit of happiness. And it is hubris of the grandest sort to imagine that a politician or a bureaucrat knows better what needs to be produced, what needs to be consumed, what the prices ought to be, who should be allowed to produce what, who should be able to buy what, who should be paid what, what resources ought to flow into what activities. Such information is not in principle available to anyone centrally, that's what free market pricing does.

What is it that the economy needs to be self-correcting from but can't? Large "corrections" happen for the following reasons: a) government interference distorting prices and therefore the flow of capital (price is the source of information in the market) b) external shocks, such as natural disasters or political events in other countries. In both cases, the problems are not with the market itself, but with intentional or random interference. But left alone, markets - that is myriads of people figuring out where available capital (productive goods) and labor should flow in order to improve their lives - recover from such shocks. Government "fixes" do nothing but delay the recovery. Again, the government can do nothing but redirect resources from one place to another. So we are back to bureaucrats and politicians being somehow smarter about what investments should be made where, who should be paid what, etc.? You don't really think that bailout money, or stimulus money, or extended unemployment benefit money represents some new resources that the magicians in government somehow conjured up out of thin air? No, all they are doing is taking resources from one place and putting it in another. That's not even a zero sum game; it's a negative sum game, because the market is the best mechanism for optimal (maximizing the sum of everyone's happiness) capital allocation.

You seem not to grasp the fact that without fraud or government interference the business bottom line gets bigger only one way: by creating more total value for its customers. What else would we (who is these "we", by the way) want businesses to value? Since behind businesses are people pursuing their own happiness, not some mysterious alien force, what right do "we" have to dictate to other people what they should value? Unless you are a shareholder and put your own resources at risk to build and keep that business running, what gives you that right? If you have such a right, why don't I have a right to tell you that you shouldn't value your paycheck so much, perhaps forcing to donate 30% of it (or 40%, if I feel like it) to causes of my choosing? I suspect you would find that objectionable.

Posted by: Boris Gendelev | Sunday, February 28, 2010 at 09:20 PM

--  
Boris, at least call me by the right screen name. It's "Heron," not "Huron." Thanks.

Posted by: Heron | Sunday, February 28, 2010 at 10:28 PM

My apologies, Heron. Apparently my bifocals are not strong enough. But what does "at least" refer to? Is it: "if you can't agree with unreason, at least ..." :-)?

Posted by: Boris Gendelev | Sunday, February 28, 2010 at 11:00 PM

Nah, Heron, I'm just not interested in taking the bait this time.

Wendy, what say you and I go have a few cocktails, and let Boris enjoy his own company? ;)

Posted by: Heron | Monday, March 01, 2010 at 09:45 AM

----  
Why, Heron, can't make up your own mind without Wendy :-)?

You are not interested because the facts and logic tell you I am right, but your instincts/knew-jerk emotions (the topic I addressed in my initial post on this thread) don't agree.

ZORN REPLY -- In real life perhaps you are not angry and contemptuous and smug and imperious, but, golly, you sure are online.

Posted by: Boris Gendelev | Monday, March 01, 2010 at 10:21 AM

@Heron

We might have to settle for a beer and a shot type of establishment. I don't think we're acceptable to the bourgeoisie.

Posted by: Wendy C | Monday, March 01, 2010 at 10:44 AM

Oh, I dunno, Wendy, there's something to be said for visiting places that cater to the upper crust; they might throw us a few crumbs, after all. How about high tea? (Or are you more of a coffee drinker?)

Posted by: Heron | Monday, March 01, 2010 at 11:16 AM

-----@ZORN Re. "In real life perhaps you are not angry and contemptuous and smug and imperious, but, golly, you sure are online."

You are absolutely right, Eric. At times, I am at fault for not taking the time to word things in a way that would not elicit strong negative emotions. At times, like a teenager in a summer camp (my wife and daughter often tell me I am; that's when they don't call me a pit bull), I am doing it on purpose, to shake people out of their mental ruts. And in all this I am probably not calibrating the effects very well, because here I am writing this with a smile, but the smile doesn't get posted (:-) is an ineffectual substitute). What can I say, Eric, I am a poor communicator and I know it. (In business, I have a partner who writes proposals and does presentations.)

Heron and Wendy, there was never any personal offense meant in anything I said. Just trying to jolt you into re-examining opinions that are in great concert with your (and most people's, including mine) instinctive emotions, but not necessarily so with reality / true nature of things. So best wishes at the Workers Paradise Bar :-).

ZORN REPLY -- I'm sure we all come across on these boards as a bit testier and more blunt than we would in real life. I'm pretty sure, after years of experience, that it's not possible to browbeat people into changing their minds or to shock them out of their "mental ruts." Then again, anyone who looks at the media landscape can't help but come to the conclusion that bombastic certitude is more popular and seems therefore to advance the ball more than the "you may have point yet I see things somewhat differently" style of debate.

It seems undeniable that Hannity alone is more popular than "Hannity and Colmes" was -- not that that program was a feast of reason.

Yet in person or in these small-audience venues, I don't think you -- or your opponents -- start to change minds until you establish that you're listening as well as shouting. That goes for everyone.

Posted by: Boris Gendelev | Monday, March 01, 2010 at 11:27 AM

Boris, regarding your bifocals comment: Have you tried increasing the font size of the text in your web browser? My vision's terrible, and changing the default font size has made a big difference.

Just remember: Your interpretation of reality varies from others', and the way others see it is equally valid. We all have our cloudy lenses.

I'm more likely to be open to being jolted into re-examining the tenets I hold dear by people I know well. How about you?

Posted by: Heron | Monday, March 01, 2010 at 11:55 AM

"Yet in person or in these small-audience venues, I don't think you -- or your opponents -- start to change minds until you establish that you're listening as well as shouting. That goes for everyone."

I'm assuming you're including yourself in this observation.

I will admit I sometimes react inappropriately, but it usually happens when I feel my opinions, or me personally, are treated with contempt. I usually try to disagree without being disagreeable, I'm not always successful.

I think we get along on this blog pretty much most of the time. Certainly this blog is more civil than most. Greg J and I are almost total opposites, yet we manage to converse without too much rancor.

Posted by: Wendy C | Monday, March 01, 2010 at 12:27 PM

Heron,

Thanks for the font size suggestion. I tried View/Text Size, but a lot of Web pages are apparently not programmed to adjust (for example, this one doesn't seem to react at all), and others become distorted. Is there another place to manipulate fonts?

I will respectively disagree about relativity of truth / equal validity of all opinions and viewpoints. Given that everything we know and think is through the lens of our brain, such subjectivism is a tempting conclusion to make. But there is plenty of empirical evidence that there is reality / nature of things independent of us and our minds and that fundamental brain structures are pretty much the same across all people, affording us an opportunity to take in and "sense" inputs in basically the same way. The differences appear to be not so much in how we "take in" the world or subconsciously process information (resulting in instincts/emotions), but more in the learned "software" of the brain, in the "programs" we use to "make sense" of things, to sort through what the subconscious bubbles up to the top.

I tend to be convinced by a combination of factual/experimental data and logic. I have undergone some major changes of view just by reading books. For example, I used to think, without giving it too much thought, that we are rational beings, with reason being our primary way of dealing with the world. I shed that opinion when presented with experimental cognitive psychology evidence as well as reasoning about the evolutionary shaping of the brain as an organ. I used to think we control our destinies, now I think we do influence them statistically, but pure randomness plays a huge role in life. As a result, even the reasons for my libertarian positions have changed dramatically and some of the stances on specifics issues changed as well. For example, while I am still on balance against criminalization of narcotics (a useful position if you want to avoid serving a month on a state grand jury), I see some reasons to control and in some cases even punish, that are consistent with the protection of liberty. Etc.

To Eric I would say that we shouldn't underestimate how much our behavior is driven by subconscious innate programs "developed" eons ago and good for our survival (or more to the point, propagation of the genes that wrote them), but no longer good for us in the current environment. The tendency towards and liking of the confrontational communication style (at least among males) may be one such program. When we behave consistent with it, it naturally generates emotions we like to re-experience -- that's the brains mechanism to increase the changes that we behave according to its innate programs -- so we keep doing it. An observation that this behavior is pervasive can't be taken as evidence that it is a successful way to communicate today. No more than an addicted smoker's chain-smoking is evidence of smoking being good for him.

Posted by: Boris Gendelev | Monday, March 01, 2010 at 01:13 PM

Recommended reading, if anyone is interested:

- Steven Pinker's "The Stuff Of Thought", "How the mind works", "The Blank Slate" (He even explains why people use throw-away phrases, like I just did - "if anyone is interested"). A lot of him can be found as "books on tape" or in video-taped lectures on youtube.

- Robert Burton's "On Being Certain: Believing You Are Right Even When You're Not"

- Leonard Mlodinow's "The Drunkard's Walk: How Randomness Rules Our Lives"

- "Yes!: 50 Scientifically Proven Ways to Be Persuasive"

Posted by: Boris Gendelev | Monday, March 01, 2010 at 01:25 PM

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