International reported that whereas in 1988, the average household filing for bankruptcy had debt that was 3.5 times its income, in 1997, the debt had risen to 5.3 times its income. Thus, the debt-to-income ratio rose 50% for those filing for bankruptcy. In real terms, it was the debt level, not the income, that did the rising.

The 'subprime' market

But even after a household has fallen into bankruptcy, the City of London and Wall Street financiers will resign it as a customer, but now at interest rates that could go to twice as high as before.

This is the "subprime" market, a kind of "junk bond"-rated market for households. Duff and Phelps, a credit-rating agency based in Chicago, rates customers who are prospective borrowers, on the basis of A through D. An A customer has a good credit rating; B through D are subprime. A B-rated prospective customer is someone who *may have experienced bankruptcy within the last three years.* A D-rated prospective customer, is someone who may have experienced bankruptcy within the last 12 months.

The subprime market has exploded in size: Billboards across America and late-night television advertisements trumpet their wares. Its stunning growth signifies two developments: first, how desperate households are to obtain credit, at whatever cost. Most subprime borrowings are for car or home purchases, or hospital bills. Most frequently, a customer does not enter the subprime market just to get an extra pair of Gucci shoes, not when it will cost him or her a 20 to 35% interest rate charge (there are exceptions). Second, it signals how shaky and close to implosion the consumer debt bubble is. On top of the highest level of credit card delinquencies and defaults in history, financial institutions are making loans to people who have been through bankruptcy once, or even multiple times, or who have impaired credit ratings, which makes lending to them risky.

The nature of the $4.875 trillion household debt bubble is that the bankers must feed it with new lending, bringing in temporary (and fictitious) earnings, just to keep the bubble aloft. This has increased the risk factor of the bubble many times over.

Subprime lending is most advanced in auto. At the start of the 1980s, its size was minuscule. By the end of 1996, subprime auto loans were approximately $70 billion outstanding. This represents 18.5% of the nation's $378 billion outstanding auto loans. Moreover, in 1995, it represented 21% of new auto loans, and has even extended to the car leasing market. In 1995, of all new auto leases, 14% were in the subprime market. When it comes to used cars, the ratio is higher: In 1995, of the vehicles sold from used-car lots, 52.8% carried subprime loans. (Some of these subprime loans are bundled together, and bonds are issued against them—a process called securitization—which are then hawked to the financial markets.)

The volume of subprime housing loans is estimated to be $50-120 billion. This is still less than 3% of the total volume of all home mortgages in America, but the growth of this subprime part of the market is brisk.

As for the credit card market, a number of leading banks compete to offer credit cards to subprime customers—but at a price. A financial analyst explained how it works. For a customer, coming out of bankruptcy, to get a new $2,000 subprime line of credit-card credit, he will be asked to put $500 to $1,000 on deposit in a savings account at the bank or financial institution issuing him the subprime credit card. He will also be told to pay a $25 annual fee. The interest charge on his new credit card will be 20 to 30%. But a percentage of the money that the bank lends him on the new credit card, is money that the subprime customer deposited in a savings account at the bank, as a condition for the loan, but on which he is only earning about 3% interest. Assume the customer draws out $500 on his new credit line—this is not new money, he already put that money in the bank; but. he will now have to pay 20 to 30% interest on the $500. When all the different features are added together, the subprime customer could be paying an effective interest rate of 30-35%.

There are some who think that this rate is not high enough. Robert Johnson, the founder of the Center for Consumer Research at Purdue University, told *EIR* on May 2 that the inter-

Credit card issuers wage terror campaign to collect

Banks and other issuers of credit cards are resorting to terror campaigns to collect their debt. For example, the Sears Roebuck retail firm, which issues a store credit card, is sending out letters to customers to pay off their Sears cards, even if the customers have already declared bankruptcy. It is not legal to ask a Chapter 7 bankrupt to pay off his old debt.

Sears sends out a "reaffirmation letter" to the bankrupt customer, which declares the Sears debt to be "nondischargeable." Sears threatens to prosecute customers with credit card fraud if they refuse to sign the letter.

A federal bankruptcy judge in Boston ruled in November 1995, and then again in February 1996, that Sears's method of collecting debt from bankrupts was illegal. Until recently, Sears continued the practice. Similar practices, which are legally a little more refined, are routinely engaged in by other credit-card-issuing financial institutions.

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