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Southern Indebtedness

How Structural Inequities and Flawed Systems Keep People in Debt

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For more than 50 years MDC has brought together foundations, nonprofits, and leaders from government, business and the grassroots to illuminate data that highlight deeply rooted Southern challenges and help them find systemic, community solutions. Our approach uses research, consensus-building, and programs that connect education, employment, and economic security to help communities foster prosperity by creating an "infrastructure of opportunity"—the aligned systems and supports that can boost everyone, particularly those who've been left behind, to higher rungs on the economic ladder. Since 1996, MDC's landmark *State of the South* reports have shaped the economic agenda of the region, shining a spotlight on historic trends, deep-rooted inequities, and solutions that offer rural and urban communities a path forward. Read our past reports at www.stateofthesouth.org. Learn more about MDC at www.mdcinc.org.

Introduction

This paper is part of a three-part series on debt in the American South written by MDC with support from the Annie E. Casey Foundation and its Southern Partnership to Reduce Debt initiative. This paper focuses on the root causes of Southern debt. The second paper addresses the impact of debt on talent development for youth and young adults, and the third outlines policy options to reduce debt across Southern states.

The three papers were written before the Coronavirus pandemic. The pandemic has further illuminated and underscored gaps in our economic and societal fabric that can push people further into debt. Lost employment and a lack of a coordinated response by federal and state governments to halt private and public debt collections have left people in debt without protections from wage garnishment and judgments that will leave families in disparate financial conditions.

Consumer debt in the nation reached $13 trillion at the end of 2018. At the same time, news reports boasted record unemployment and stable economic growth.[1] These competing narratives point to a much more complicated story of structural inequity: the economy is working for some, but not many. In order to survive, people are using debt to fund basic needs and offset minimal wage increases and, in some cases, wage shortfalls. Underneath the "stable economic growth" is a silent financial insecurity, muffled by the use of personal debt to pay for the expenses of living day-to-day.

We need a nuanced understanding of how consumer debt is propping up the economy so we can focus on more effective interventions and employ more accurate measures to evaluate those interventions. Acknowledging the reality of the consumer debt crisis is a prerequisite to identify accurately policies and practices to address the structural causes of increased debt burden among the most disadvantaged. Evidence missing from popular narratives include:

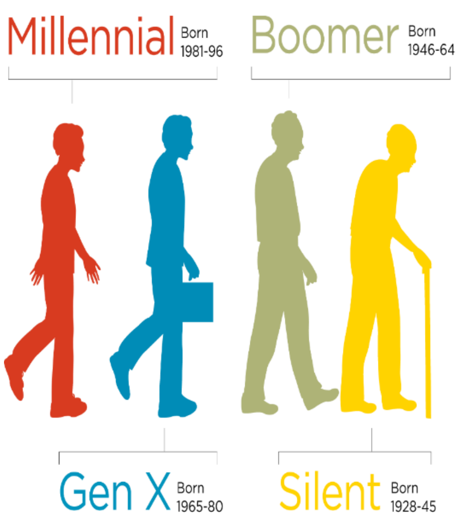
- Forty percent of Americans had trouble paying for food, medical care, housing, or utilities in the last year[2]
- Seventy percent of low- and middle-income households surveyed by the Center for Responsible Lending reported relying on credit cards for basic living expenses, medical expenses, or car and house repairs.[3]
- The personal savings rate of the average American household is below 10 percent, even accounting for personal savings of wealthier families. Nearly half of Americans have no retirement savings and more than 60 percent do not have $500 of cash on hand for emergencies.[4]
- Average incomes of the top five percent of households grew by 13.2 percent in 2018. In comparison, average incomes in the bottom fifth fell by 3.2 percent during the same time period; incomes in the fourth quintile grew at less than half the rate of the top earners, just 5.6 percent.[5]

For many Americans, it is practically impossible to live debt-free in the United States. Debt is often the only way to meet daily needs—the only means keeping them financially afloat, and a mode of survival that is fraught with risk. As this paper explains, the debt crisis is even more acute in the American South. Articulating how more than half of Southerners are economically insecure amid apparent good economic news (the topic of this paper), and understanding the impact of debt on long-term talent development for youth and young adults (our second paper) is critical to developing and implementing effective policy changes in Southern states (our third paper).

Who is in debt?

To change the negative impact of debt, it is important to understand who is most likely to be adversely affected by debt accumulation, not just how debt occurs. Different types of debt affect people differently. Age and life transitions often play a large role in the type and amount of debt a person is likely to accumulate. As in the case of mortgages and student loans (depending on the degree type and marketability in the local economy), debt can be an accelerator for wealth-building opportunities. Detrimental debt such as credit card debt, student loans for degrees with low ROI, and predatory loans can threaten economic security.

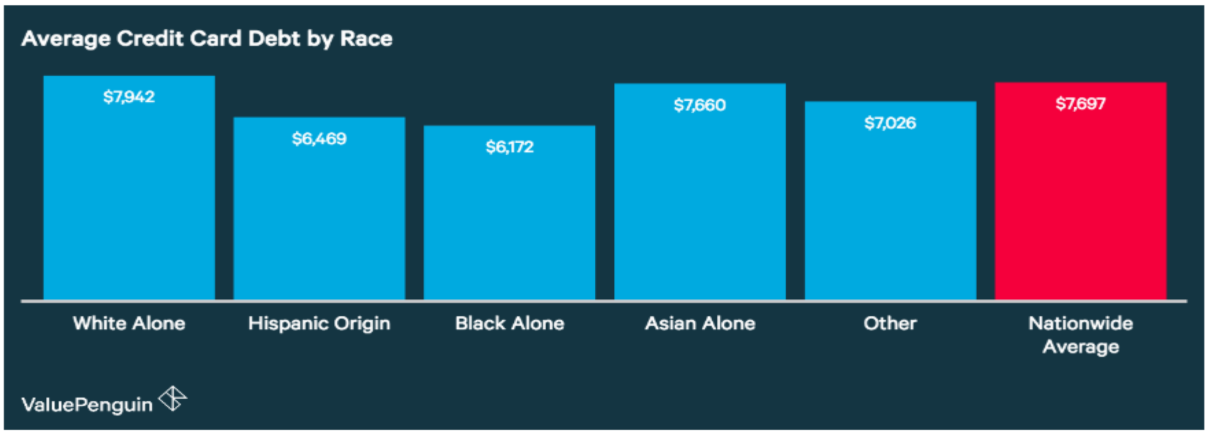
The highest source of debt for millennials is education financing. Student loans account for 28 percent of their total debt, followed by credit card balances for those ages 18-24. However, debt shifts as young adults age and move into the prime of their lives. Older millennials aged 25-34 are more likely to have credit cards as their leading source of debt (25 percent), followed by student loans (16 percent) and mortgages (3 percent). Generation X tends to have a greater portion of debt tied to a home mortgage (about 32 percent). Credit card debt is the second source of debt for this age group, followed by car loans, and education, which both account for about seven percent each. Baby Boomers are similar to Gen Xers with their top three sources of debt being mortgages, credit card bills, and car loans. Millennials and Generation Xers are more likely to accrue medical debt due to health insurance coverage gaps, lack of adequate benefits, wage stagnation. and the prevalence of higher student loan debt balances.[6]



However, while young adults are accumulating debt at the same *rate* as their peers in earlier generations, they are accumulating debt *earlier* in life and most often in the form of student loans, auto loans, and credit card debt, and at a time when they are likely to be the most financially insecure. Increased debt burdens are altering lifestyles of younger generations. According to the Urban Institute, about one in five adults in America have past-due medical bills—one in four for people younger than 65. Younger adults are often disproportionately affected by insecure work and zero-hours contracts, which can make income erratic. They also suffer from recent public benefit changes and work requirements, which can be especially harsh on young, single parents.

Debt and racial inequity

For people of color, debt is likely to be more burdensome because of inherent racial disparities in borrowing. Borrowers of color are more likely to have higher interest rates across the board—varying from mortgage loans, student loans and auto loans—and are more likely to fall victim to predatory borrowing. Black borrowers do not possess more total debt, but they are more likely to be rejected by private financial institutions and more likely to acquire debt with higher interest rates, which result in more limited buying power in the future.[7]



Source: U.S. Census Bureau; U.S. Federal Reserve; 2013 Survey of Consumer Finances; and Data collected from S&P Global Market Intelligence complied by ValuePenguin

Racial inequities exacerbate wealth-building disparities. The difference in ROI of postsecondary education for black and brown students versus white students is illustrative. People with postsecondary degrees are able to weather economic storms better than those without a postsecondary credential. However, the rising costs of tuition coupled with the lack of savings often means students of color are more likely to take out higher student loan amounts to attain a postsecondary credential than their white counterparts. This puts them at a greater disadvantage later when workplace and wage discrimination limit their ability to earn incomes that allow them to thrive and repay student debt. People of color are more likely to default on their loans because of wage stagnation, higher interest rates, lower pay (even with credentials), and their increased likelihood to take jobs to meet immediate financial needs with a low raise rate.

A Southern lens on a national issue

The demographics and historical structural inequities in the South heighten the extent and impact of disparities in consumer debt in the region. Wage stagnation and the disproportionate growth of low-wage jobs have contributed to increased inequity both nationally and in the South. Southern metro areas have drawn significant population growth from the abundance of retail, service, and maintenance jobs. The economic development strategy favored by Southern states—economic incentives in the form of tax refunds and credits coupled with largely union-free workforces that prevent collective bargaining—have resulted in a boom in low-wage jobs.[8] This strategy has generated economic vitality for some and economic insecurity for others. This is the paradox of today's South.

Job growth fueled by the recruitment and expansion of companies that pay less than a family-sustaining wage has exacerbated income inequality in the South and makes it more difficult for people in the region to reduce the costs of financing debt.[9] Moreover, the jobs offered today do not provide the guarantees that workers once enjoyed and expected. This transformation is most obvious in the "gig economy" and contract jobs, which often provide inadequate benefits or no benefits at all. The number of self-employed individuals (many of whom are independent workers in the gig economy) soared by over 19 percent from 2005 to 2015.

The South saw the largest growth in the number of self-employed individuals (27 percent), followed by the West (21 percent). Gig workers, as independent contractors, do not receive benefits like health insurance; rather, they must procure them on their own.[10] Even in more formal attachments to employment, there have been significant changes in employment benefits, moving away from government- or corporate-supported pension plans to defined-contribution plans like 401(k) plans. These shifts result in reduced wages and salaries, often making it harder for low-income earners to safeguard their families and, ultimately, relying on debt to make up the gap.[11] And while this trend is not specific to the South, the lack of collective bargaining in Southern states has historically made it difficult for workers to bargain for wages and benefits that reduce income inequality.[12] These issues are eroding the financial security of families and contributing to the use of debt accumulation.

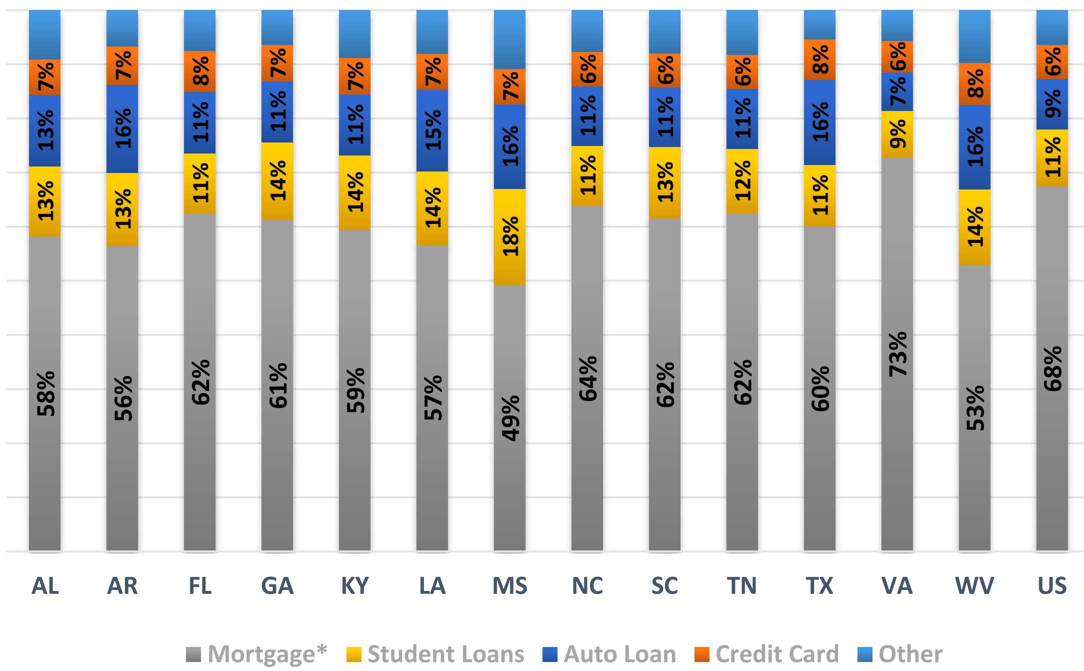
A brief look at consumer debt in Southern states

Trends in consumer debt show striking differences between the South and that of the rest of the nation:

- Student loan debt comprises the largest percentage of non-mortgage debt held by Southerners, likely because of the rising cost of education, unrestricted loan borrowing, and low returns to credentials in the labor market.[13]
- Southern states account for nine of the 10 states most burdened by credit card debt and penalties associated with this type of debt.[14] In many Southern states, the burden is so high that families making the median household income would need more than 18 months to pay off the balance in some states.

- Auto loan debt in Southern states increased by more than 50 percent between 2003 and 2017. Families take on loans with longer repayment terms, sometimes more than six years, and end up owing more on their vehicles than they are worth.

Figure 1: Composition of Household Debt in Southern States, Per Capita



*Excludes (HELOC)
Source: State Level Household Debt Statistics 2003-2017, FRBNY, February 2018

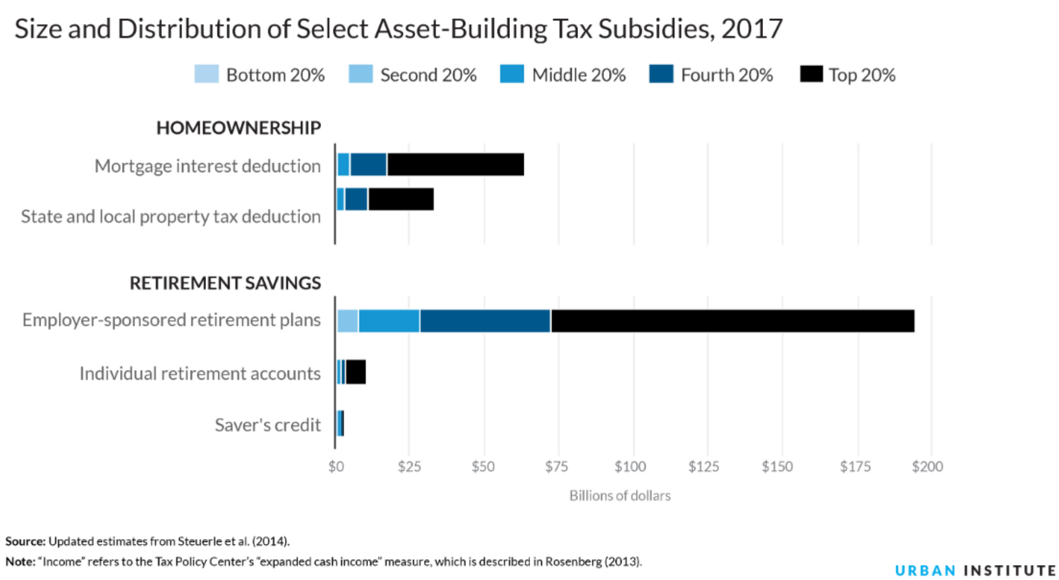
Removing these barriers requires strategic investments in the South's existing networks working to change these structural issues. Through its support of the Southern Partnership to Reduce Debt (SPRD), the Annie E. Casey Foundation is investing in programmatic and policy solutions that are working to mitigate the harmful effects of consumer debt. SPRD partners are developing innovative, scalable models to prevent and eliminate debt, as well as hold public institutions accountable for reducing debt burdens for their consumers and communities.

SPRD is a network of more than 20 state and local organizations working throughout Alabama, Arkansas, Georgia, North Carolina, South Carolina, Tennessee, and Texas to tackle consumer debt issues that perpetuate wealth and income inequality. Supported by a network of national organizations including the Aspen Institute, Asset Funders Network, the Center for Responsible Lending, MDC, National Consumer Law Center, National League of Cities, Prosperity Now, and the Urban Institute, state-level grantees are working in four main consumer debt types: student loans, medical debt, fines and fees, and high-cost lending.

A safety net for the affluent

Income inequality and inadequately funded systems in the region are the culmination of policies focused on privileging debt options for the wealthy rather than providing the supports for those most in need—who often use high-cost debt to create a safety net. Since 1994, government spending on wealth-building has more than tripled—from $200 billion in 1994 to $660 billion in 2018.[15] The costliest of those subsidies is the home mortgage tax deduction. A 2013 study by the National Priorities Project found that 77 percent of mortgage benefits go to households with annual incomes between $75,000 and $500,000.[16]

Public benefits to higher-income families are embedded in most property credits and tax deductions. About two-thirds of homeownership tax subsidies and retirement subsidies go to the top 20 percent of taxpayers, as measured by income. The bottom 20 percent, meanwhile, receive less than one percent of these subsidies. These policies also exacerbate wealth inequality and racial wealth disparities. Blacks and Hispanics, who have lower average incomes, receive fewer benefits from these subsidies than Whites, both in total amount and as a share of their incomes.



For those families able to meet the eligibility requirements of social safety net programs to meet their basic needs, programs often have negative long-term outcomes by only focusing on short-term needs and not encouraging wealth-building and economic mobility. In some cases, these programs discourage saving by imposing a reduction in benefits when families achieve modest increases in income or acquire a few thousand dollars in assets (known as "benefits cliffs").[17]

Shifting focus in these programs to encourage savings and wealth building would significantly benefit families in the South—a region with the worst economic mobility odds, where state governments offer the least amount of cash assistance for families living in poverty, and where the purchasing power of cash assistance programs goes the least to support basic needs.[18]

In case of emergency

Families are most prone to punishing debt accumulation when emergencies happen, which is most evident for the uninsured or during medical emergencies. Uninsured individuals who are hospitalized experience a host of financial setbacks—including reduced access to credit, a 170 percent increase in unpaid medical bills, and a more-than-double likelihood of bankruptcy. According to data from the 2012 Medical Expenditure Panel Survey (MEPS), the annual cost of inpatient care for a person aged 18 to 64 who was hospitalized was approximately $15,000 and the annual cost of all types of care for that person was $25,000. Studies using survey data suggest that the uninsured often have difficulty paying medical expenses, become delinquent on their medical and non-medical bills, and are more likely to be contacted by collection agencies.[19]

Medicaid expansion would close a key health insurance coverage gap and reduce medical debt. Only five Southern states have expanded Medicaid, as permitted by the Affordable Care Act (ACA). According to studies, Medicaid expansion results in lower medical debt, reduced personal bankruptcies, increased financial well-being, and freed-up resources to be spent elsewhere—including for basic goods and services like groceries, rent, education, and savings.[20] States that forfeited federal Medicaid expansion dollars left millions of people nationwide in the coverage gap: they earn too much to qualify for Medicaid, but not enough to qualify for ACA Marketplace premium tax credits. Roughly 90 percent of those in the coverage gap live in the South.[21]

Climate change and family financial health

Health crises are not the only emergencies families need to anticipate. Scientists are clear about the changes to the climate and environment that climate change will bring, making it a looming emergency, particularly in the South. Many Southern communities are vulnerable due to proximity to water and low-lying land. In addition, temperatures in the region are increasing, which will affect agricultural crops and food prices. Devasting hurricanes and floods already have displaced families and changed migration patterns in states like Louisiana, Georgia, and Texas.

These disasters have huge impacts on families' financial health. For example, while living in a community hit by a medium-sized natural disaster leads to a five percentage-point increase in the share of people with debt in collections after one year, this negative effect doubles to 10 percentage points after four years. [22] Medium-sized disasters, which are less likely to receive long-term public recovery funding, appear to lead to larger and more consistently negative effects on financial health than large disasters, a phenomenon that is most prevalent among individuals and communities that were struggling financially before the occurrence of the natural disaster. Paired with higher rates of poverty and lower levels of educational attainment that make bouncing back from economic setbacks, like damaged homes or lost jobs, more difficult, and policies that don't adequately support recovery, environmental events can have long-term economic effects on individuals, families, and communities. In 2018 alone, two major hurricanes—Florence and Michael—hit Southern communities with devastating effects.[23]

Economists and climate scientists expect these disasters and their after-effects to aggravate economic inequality and transfer wealth from poor counties in the Southeast to well-off communities in the Northeast and on the coasts.[24] Climate change is forecast to impose the equivalent of a 20-percent tax on county-level income because of increased utility costs and negative impacts on coastal real estate.[25]

Conclusion

Reducing the effects of debt on the most vulnerable requires policies that address those most likely to be affected by debt. This includes victims of poverty, but also Millennials and Gen Xers who are in the labor market in early- and mid-career during a tenuous economy and employment situation, especially in the South. Without a targeted response, these individuals will suffer in the short-term and the region will suffer in the long-term by not investing in them.

The dominant narrative about people with high amounts of debt or in default is flawed. We need to shift the narrative from individual financial irresponsibility and blame to understanding and addressing structural inequities. MDC emphasizes the necessary of "reading reality truthfully." When it comes to consumer debt, reading reality truthfully is particularly important in the South, where the historical and geographical landscape places a higher burden on those with the least ability to weather economic storms. A more realistic narrative is more likely to inspire more effective interventions that change the structures that limit the potential of individuals and the Southern region. Parts 2 and 3 of this series explore interventions in the talent development system and state policy that support a South where all people thrive—which is MDC's vision for the region.

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