Deferred Dreams:

How Unmanageable Debt and Abusive Debt Collection Hinder Savings and Economic Security in Arkansas

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About the Author

Janie Ginocchio, MPA, is the director of public policy and advocacy for Southern Bancorp Community Partners.

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Author's Note

This policy brief was intended to be released in spring 2020 and does not incorporate data or recommendations directly related to the economic impacts of the COVID-19 pandemic. It is our hope that the information in this brief illustrates the significant economic barriers Arkansans faced before the public health crisis and guides policy makers in addressing the underlying inequities that keep households from achieving financial resilience.

Introduction

While discussions about household economic security often focus on income and wealth in the form of appreciable assets and investments, it is important to remember that liquid assets in the form of savings are the cornerstone of financial stability. Adequate savings protect individuals from economic shocks.[1] Savings also allow people to take advantage of opportunities for economic mobility and accumulating wealth, such as paying for higher education, starting a small business or buying a home. Those who moved up the economic ladder had six times higher than median liquid savings, eight times higher median wealth, and 21 times higher home equity than those who did not move up.[2]

Despite the importance of savings and its role as both a financial bulwark and catalyst, there is a savings crisis in the United States. According to recent data from the Federal Reserve, almost 40 percent of Americans do not have enough savings to cover an unexpected $400 expense, with 27 percent indicating they would have to borrow money or sell an item, and 12 percent would not be able to cover the expense at all.[3] Almost half of the households in Arkansas – 567,316 – did not keep emergency savings in 2018.[4]

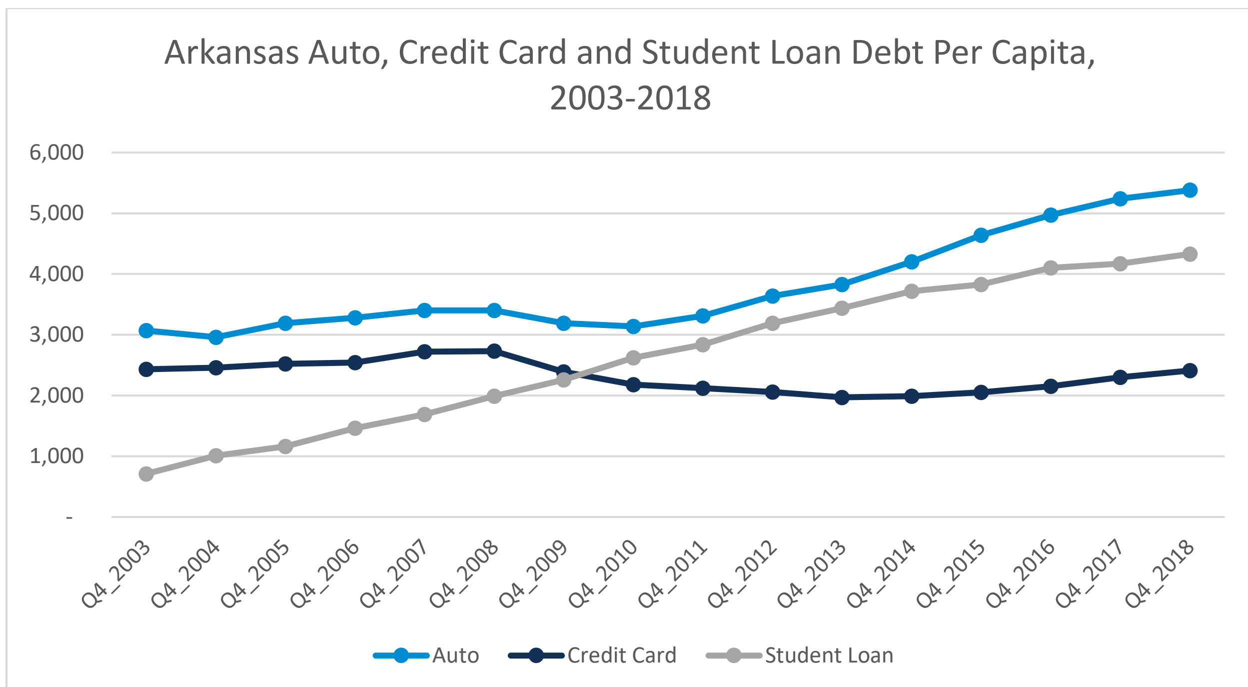
An individual may have a range of experiences that make saving difficult, such as insufficient income or not having a relationship with a mainstream financial institution. However, researchers have found that chronic, unmanageable, non-mortgage debt is a substantial roadblock to savings and financial security, and abusive debt collection practices can amplify the problem.[5, 6] This brief will examine how unmanageable debt and abusive debt collection practices undermine Arkansans' ability to save, and will provide policy recommendations to protect consumers.

Auto, Student Loan Debt at Their Highest in Arkansas

Americans have the highest debt levels ever, even when adjusted for inflation.[7] Total non-mortgage debt, which is comprised of credit cards, auto and student loans, is now at $4 trillion in the United States, and the average debt per capita is $11,880.[8]

In Arkansas, as illustrated in Figure 1, the per capita debt amounts for 2018 were at the highest levels in 15 years, with auto loan debt increasing 75 percent, from $3,070 in the fourth quarter of 2003 to $5,380 at the end of 2018. Student loans rose 509 percent, from $710 per capita in the fourth quarter of 2003 to $4,330 in the last quarter of 2018. Credit card debt per capita remained relatively flat over the same period.

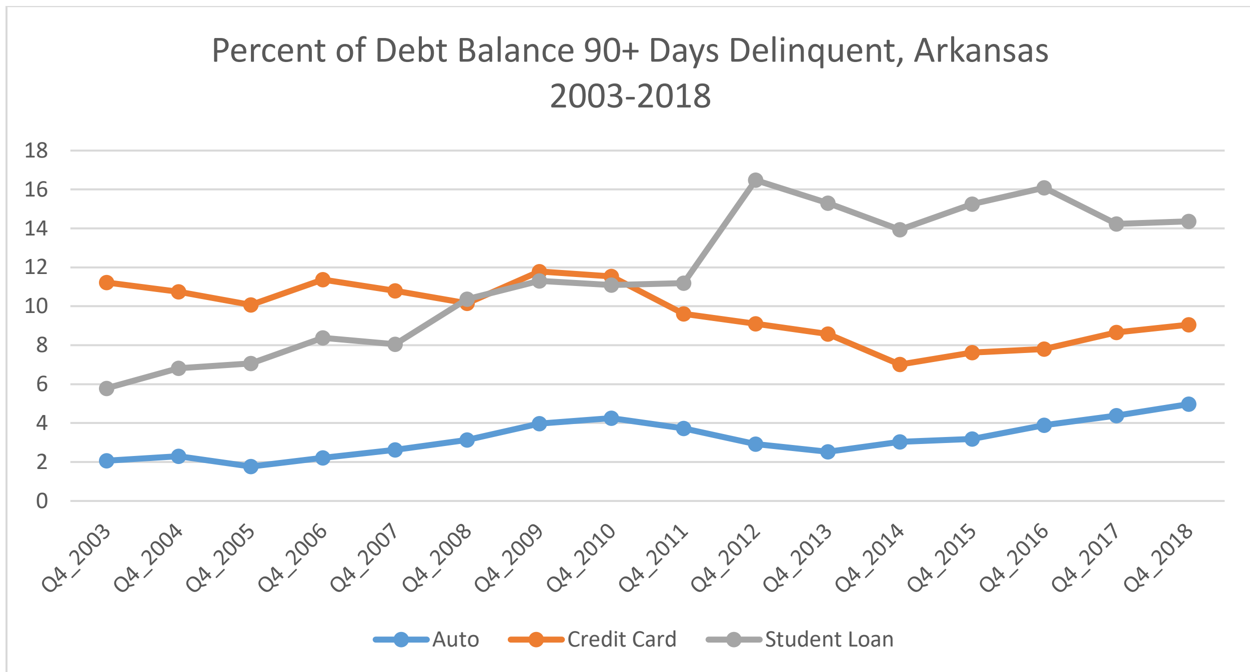
Figure 1. Per Capita Non-Mortgage Debt in Arkansas



Source: State Level Household Debt Statistics 2003-2018, Federal Reserve Bank of New York, March 2019

As Arkansans take on more debt, they are finding it harder to manage it. According to Prosperity Now's 2019 scorecard for the state, 25.7 percent of Arkansans have debt in collections, 12.7 percent fell behind on bills, and 17.6 percent have at least one account that is 90 days past due.[9] As shown in Figure 2, while credit card delinquencies have fallen in the last 10 years – from a high of 11.8 percent at the end of 2009 to 9 percent at the end of 2018 – the percentage of auto loan balances in delinquency more than doubled between 2003 and 2018 (2% to 5%). The percentage of student loan balances in delinquency nearly tripled (5.8% to 14.4%) during the same period.

Figure 2. Arkansas Auto, Credit Card and Student Loan Delinquencies



Source: State Level Household Debt Statistics 2003-2018, Federal Reserve Bank of New York, March 2019

Drivers of Unmanageable Debt

Examinations of chronic debt and its consequences frequently focus on the choices an individual makes regarding their income and spending, but people often make decisions based on the best information they have at the time and within constraints set by the policies and systems in which they live.[10] There are a number of economic factors that contribute to the rise in unmanageable debt, including rising costs of living, stagnating wages, and income volatility.

Nationwide, the cost for education, health care, cars and housing have increased substantially in the past three decades, after accounting for inflation. The average per capita personal cost for health care went up 276 percent between 1990 and 2017, while the average loan amount for a new car is now more than $32,000, an 11 percent increase over the last 10 years.[11] Prices for used cars have also risen: the average price for a 10-year-old vehicle is up 75 percent compared with prices in 2010.[12] In a state where public transit is inadequate in cities and nonexistent in rural areas, owning a reliable vehicle is a necessity.

Average home costs increased 188 percent between 1990 and 2017,[13] which, when coupled with tighter mortgage loan restrictions enacted in the wake of the 2008 housing crisis,[14] created more competition for rental housing, inflating rents at a rate faster than wages.[15] In Arkansas, the home ownership rate dropped 2 percent between 2009 and 2016, with almost 31,000 more people renting in metro areas, which is lower than the national rate, which dropped more than 3 percent. In rural areas, there was a 1 percent decrease in homeownership; nationally, homeownership in rural areas dropped 2 percent.[16] Only 43 percent of Black Arkansans own a home, compared with 71 percent of whites.[17]

As a result, median gross rents in Arkansas non-metro areas went up almost 4 percent between 2009 and 2016, and 1.2 percent in metro areas. Almost 40 percent of rural Arkansas households were rent burdened in 2016, meaning more than 30 percent of income went to housing, and in urban areas, 42 percent were rent burdened.[18]

Paying such a high proportion of income on housing leaves little left to save. Recent studies show that 64 percent of the rent-burdened had less than $400 cash in the bank, and half of the rent-burdened had less than $10 in liquid savings, compared with about 50 percent of homeowners, who had more than $7,000.[19]

In regard to higher education, tuition costs at US public colleges and universities have risen 549 percent since 1999 (not adjusted for inflation).[20] The average net cost of college in Arkansas was a 29 percent share of the overall median income in 2017.[21] For Black and Latinx families, the share rises to 44 percent and 33 percent, respectively.[22]

Decreased state support for higher education and reduction of other federal student aid programs has increased college costs, shifting more of the cost burden to the student, who is then forced to borrow more.[23, 24] The state of Arkansas increased higher education funding by almost 4 percent between 2011 and 2017, but the Higher Education Price Index increased almost 15 percent between 2008 and 2017, necessitating tuition and fee increases between 13 percent and 36 percent in the state.[25] In 2017, the Arkansas General Assembly passed legislation that created an outcomes-based funding formula for public colleges and universities and gave $9.4 million in additional one-time funding. However, it was reported in August 2019 that 18 out of 34 schools were expected to lose money under the new formula compared with funding they received before the change.[26]

The cost of repaying student loans can impede young adults' ability to save. Forty-four percent of respondents in a survey by the National Association of Realtors indicated that student loan payments prevented them from saving for a down payment on a home, and more than 60 percent of respondents said they delayed or reduced contributions to retirement savings accounts because of their student loans.[27] This difficulty is even greater for those who did not complete their degree and are unable to realize greater earning potential.

Despite increased economic activity and record low unemployment rates in the post-recession period, wages have not kept pace with costs: the 2017 US median household income of $61,372 was only slightly higher than wages in 1999, when adjusted for inflation.[28, 29] The gap between income and expenses is such that 17 percent of Americans reported being unable to pay all of their bills in full every month.[30] In Arkansas, the gap is even greater: 41 percent of households did not make enough to afford basic needs in 2017.[31]

Additionally, with the rise of the gig economy and fewer full-time, salaried positions overall, more households must cope with income volatility – 20 percent of the population nationally and almost 19 percent of people in Arkansas are currently experiencing income volatility, according to Prosperity Now, although the Federal Reserve's national estimates are higher at 30 percent.[32] Inadequate and unstable incomes make managing monthly cash flows difficult, and common experiences such as waiting for bank deposits to become available can spiral into a financial crisis of returned checks and/or overdraft fees.[33] When incomes are unstable, any savings is often used to offset lower than expected wages, impeding opportunities to create long-term savings and greater economic mobility.[34]

Racial Disparities

Debt has a bi-directional relationship with the racial wealth gap. Historically, racist public policies such as segregation, early exclusion from wealth building programs such as the GI Bill and Social Security, job and wage discrimination, and redlining[35] have all served to prevent people of color, especially Blacks, from attaining financial security and accumulating wealth that can be passed on to future generations.[36, 37] Without wealth, Black families have fewer buffers against economic shocks and must borrow more money, often at higher interest rates, in order to purchase a home or send their children to college.[38] Continued discrimination in the job market and lower wages in comparison to their white counterparts (the average household income for white communities in Arkansas is $67,952 vs $49,701 in communities of color)[39] make it harder to stay current on debt payments and to eventually retire the debt.[40]

For example, among all students, the median undergraduate amount of loans for Blacks was 3.5 times greater than whites, and 20 years later, Black students at the median still owed 95 percent of the cumulative loan total, compared with whites, whose debt was reduced by 94 percent.[41] In Arkansas communities of color, 23 percent of student loan holders are in default, compared with 14 percent in white communities, according to the Urban Institute.

In terms of debts from all sources, 58 percent of those who live in communities of color have debts in collection, while only 35 percent of those in white communities face such difficulty, and twice the percentage of people in communities of color have auto (8 percent vs 4 percent) and credit card delinquencies (10 percent vs 5 percent) than white communities.[42]

Social Costs of Unmanageable Debt

When large numbers of residents struggle with debt and saving, it presents significant costs to communities in terms of workforce and residential stability.

Workforce

A high prevalence of debt impacts a community's workforce in several ways, including reducing the pool of potential employees and creating costs to employers through lost productivity and health care costs. Many employers use credit scores as part of the applicant screening process, so otherwise qualified applicants may not be hired because of their struggles with managing debt.[43]

Financial problems can have a negative effect on physical,[44] cognitive, emotional and relational well-being,[45] with debt associated with higher levels of psychological distress and depression.[46] Those with the fewest resources are more likely to experience the greatest distress, an effect that is not limited to adults in the household, but children, too.[47] Those who live in lower-income households are more likely to experience mental disorders across the lifespan, including major depressive disorder (MDD).[48] The World Health Organization has recognized MDD as one of the top five leading causes of disability, and a significant source of lost worker productivity and absenteeism.[49] MDD's cost to employers is estimated to be between $30.1 billion to $51.5 billion annually.[50]

Residential Instability

Households facing difficulty managing debt and saving are less likely to buy homes or more likely to delay making a purchase. For every $1,000 in student loan debt in an area, homeownership is reduced by one to two percentage points among young adults with student loans[51], and the median delay for buying a home is seven years, which increases the number of households that rent.[52]

Renters are more mobile and less likely to stay in a home for long periods of time, making them less likely to participate in the local community and less likely to vote in local elections.[53] In rural areas, there is an out-migration of prime age workers – an 11 percent reduction since 2000 – especially among the college educated, which is attributed to high student loan balances.[54] A recent analysis of Equifax/Federal Reserve Bank of New York Consumer Credit Panel data revealed that borrowers with the highest student loan balances were 41 percent less likely to stay in rural areas, and those who moved to urban areas were less likely to default on their loans, more likely to repay their loans faster, and more likely to own a home.[55]

Abusive Debt Collection Practices

When borrowers fall behind on their payments and move into delinquency, creditors have an escalating series of actions they can take to secure payment, and policymakers are tasked with balancing the interests of both the debtor and creditor in the debt collection process. The federal Fair Debt Collection Practices Act regulates third-party debt collectors and debt buyers, and sets the following parameters:

- Limits the number of times and places a debtor can be contacted regarding a debt
- Preserves the right of the debtor to request the collector stop contacting them or to have the collector contact their attorney
- Protects against harassment of debtors
- Gives individuals the right to dispute the validity of debts and request documentation
- Prohibits collectors from making false or misleading representations

Arkansas has its own Fair Debt Collections Practices Act, which mirrors the federal law and provides for state civil liability against third-party debt collectors or debt buyers who violate the act.

Despite these legal protections, individuals can find themselves on the receiving end of abusive debt collection practices. In 2017, Arkansans made 2,896 debt collection complaints to the Federal Trade Commission, with the largest percentage of complaints made in regard to collectors continuing to call after getting a stop calling notice (29%), making false representations about debt (27%) and calling repeatedly (24%).[56] Abusive debt collection practices are more likely to be used against marginalized populations, such as people of color, who are less likely to know and exercise their rights.[57]

Such tactics can be ineffective at best and counterproductive at worst, especially when they result in increased emotional or psychological distress for the debtor. Decisions on how and when individuals make debt payments are influenced by psychological factors beyond an ability to pay or rational calculations about reduction strategies,[58] including the need for agency, control, and a sense of fairness.[59] If an individual feels disrespected or pressured after communicating with a debt collector, they may stop engaging in the debt collection process or refuse to pay. In one survey about debt collection practices, 20 percent of respondents said they withheld a planned payment at least once after receiving an upsetting call from a collector.[60]

Pilot studies on the use of nudging, a technique developed from behavioral economics research, show promising results. Nudging is “influencing decision-making by leveraging self-interest without constraining the number of choices available or making certain options more expensive.”[61] In these studies, user-friendly and even kind debt collection notices were more effective than punitive messaging. One pilot demonstrated improvements of 20 to 30 percent in amounts collected and the number of loans written off.[62]

State Debt Collection Exemptions

Other state laws related to debt collection are exemption laws, whose intent is to protect part of an individual's wages and essential property from seizure after a judgment is entered against them in court. However, many states, including Arkansas, have outdated and ineffective exemption laws that leave families vulnerable to losing their homes and jobs, worsening their already precarious financial stability.[63]

Exemption laws traditionally protect the family home, vehicle and bank account up to a certain value and limit how much can be garnished from a person’s wages. Many people depend on state protections because they do not file for bankruptcy, which is the trigger for federal protections. In Arkansas, the family home is protected regardless of value if the debtor is the head of household, but there are minimal protections for wages and vehicles. The state follows the federal protection for wages, which currently exempts $217.50 per week (regardless of family size), which places a single person below the Federal Poverty Line (FPL) amount and puts a family of four at half of FPL.[64]

The only protection in place for a car is a $500 wildcard exemption that can be used for vehicles, tools or household goods. When people lose their mode of transportation to work, this has a ripple effect on other creditors such as a landlord or utility company.[65]

Other states in the South have more robust protections, such as banning wage garnishment altogether, automatic inflation adjustments for wage protections, and separate car exemptions that range from $5,000 to $9,999. Table 1 compares Arkansas, Mississippi, Texas, Oklahoma, Tennessee, Alabama, Georgia, Louisiana, Florida, North Carolina and South Carolina on these protections.

Table 1. A State Comparison of Select Debt Exemption Protections[66]

	Arkansas	Mississippi	Texas	Oklahoma	Tennessee	Alabama	Georgia	Louisiana	Florida	North Carolina	South Carolina
Ban wage garnishment			X							X	X
Automatic inflation adjustments						X					X
Separate car exemptions ($5,000-$9,999)		X		X	X	X		X	X		
Family home protection regardless of value	X*		X	X					X		

**Only when debtor is head of household.*

Policy Recommendations

Reduce the burden of student loan debt by reinvesting in higher education. On the state level, Arkansas should increase the base funding provided by the state and use the outcomes-based formula to provide supplemental monies based on performance in order to prevent further tuition increases. Federally, funding levels should be improved to increase the availability of non-loan financial aid options, such as Pell grants.[67]

Increase federal protections for student borrowers. The US House Financial Services Committee passed three bills aimed at aiding student borrowers, who currently have the fewest consumer protections.[68] The Student Borrower Protections Act (HR 5294), a bill by Rep. Alma Adams (D-NC), would enhance student loan servicing oversight and provide borrower protections with respect to credit reporting.[69] The Fair Student Loan Debt Collection Practices Act (HR 5827), sponsored by Rep. Al Lawson (D-FL), would amend the Fair Debt Collection Practices Act to protect borrowers from collection attempts on federal student loan debt when payments are not required under an income-driven repayment plan, and the Private Loan Disability Discharge Act of 2019 (HR 4545) by

Rep. Madeleine Dean (D-PA) would amend the Truth In Lending Act to require private loan servicers to discharge student loans in the case of a borrower's permanent disability.[70]

Support more students in navigating repayment option enrollment by making the Arkansas Student Loan Authority's (ASLA) Default Management Program affordable for all public colleges and universities and increase public awareness about the program. ASLA currently contracts with 17 colleges and universities to help those in danger of default in the first three years of repayment stay out of default by contacting them and counseling them on their options, such as income based repayment and forbearance. Since the program was introduced in 2013, the state's default rate dropped from 19 percent to 10.4 percent in 2019, moving Arkansas' ranking from 49th to 27th.[71] The program is fee-for-service with no state support, and costs range from $10,000 to $50,000, depending on school size and number of borrowers, which presents a cost barrier for smaller schools. Providing state support to help offset the cost, especially for small, high-default schools, will help further reduce the state's default rate and benefit thousands of borrowers struggling to make payments under their current repayment plan.

Modernize debt collection exemptions.[72] The wage exemption should be tied to the state minimum wage with a periodic auto-increase with inflation. Additionally, there should be minimum bank balance exceptions to prevent debt collectors from skirting the wage exemption by seizing direct deposits from employers. A separate car exemption to protect vehicles valued at or below $5,000 should also be created to protect an individual's ability to maintain employment. All exemptions should be self-executing where possible, which reduces the burden on the debtor to ensure all available protections are used. Updating exemption laws will benefit not only the individual and their family, but also society by helping people stay in their homes and jobs – keeping families together and reducing the need for public assistance.

By working together to create a public policy environment that protects consumers from overly burdensome debt and abusive debt collection practices, we can strengthen the financial security for thousands of Arkansans. This in turn will expand their capacity to pursue higher education and purchase homes without fear of failure, allowing them to plant deep roots in their communities and the state, which is a benefit for all.

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