PRESIDENT'S MESSAGE

Credit Cards on Campus

Paying for college in the 21st century has grown increasingly expensive. Both public and private schools of higher education have ratcheted up their tuitions, and campus housing costs have also gone up. Meanwhile, student loans, while still widely available, don't always cover the full cost of a college education. To fill in the gaps, many students are turning to a financial instrument that wasn't available to most of them just a couple of decades ago — credit cards.

In this issue of *Region Focus*, we examine the consequences of student debt, especially credit card debt. Are young people getting in over their heads? We consider the market for unsecured student borrowing from the perspective of both the consumer and the creditor. In looking closely at the question of whether youth debt is a big problem, we come away with a more ambiguous answer than you might have read elsewhere.

The most urgent question to address is whether creditors are unfairly taking advantage of a naïve population — young people with no significant income. The evidence suggests that this isn't happening, or at least that it isn't widespread. While studies show that most college students do have credit cards, their balances are actually lower today than they were in the late 1990s.

I have written before in these pages that protecting some borrowers at the expense of limiting the availability of credit to the many is rarely a good idea. In my mind, the case of student debt is no exception. Yes, there are cases when borrowers are victims of unscrupulous creditors. But to restrict credit based on wide-ranging characteristics — such as an adult borrower's age — is to use an overly blunt instrument. A better, more precise set of tools are the metrics that credit card issuers themselves use in deciding who is creditworthy and on what terms.

In fact, creditors have used technological advances to develop highly sophisticated systems for screening customers. As a result, credit cards now offer much lower rates than in years past and are available to a wider range of potential clients. This is not a bad thing. It has allowed a whole new set of people to smooth their consumption in line with their expected future earnings. Though it might at first seem counterintuitive that credit cards would be available to students with no regular income, this practice is actually based on the reasonable assumption that students will soon enter the work force and become loyal customers.

I do not mean to downplay the very real issue of whether Americans are consuming too much and saving too little, especially those nearing retirement. But on the subject of student debt, I would point out an interesting observation. As our article notes, students' credit card balances tend to rise the closer they get to graduation. This is entirely rational, and the sort of thing that shouldn't alarm us. Knowing they are about to complete their studies and begin drawing a paycheck, most students seem to be making sound judgments about their future ability to pay down debt loads. Likewise, credit card issuers are pragmatically raising balance limits on older students, whose likelihood of being able to repay statistically increases with graduation.

Additionally, if there is one kind of debt economists generally agree is "good," it's the sort taken on to finance education. The payoffs from investments in human capital are overwhelmingly positive. This premise holds even today, amid rising tuition costs. We should be encouraging more people to invest in their future earning power, and the best way to do that is to earn a college diploma. In this light, the emergence of credit cards in financing college ought not to be such a cause for concern. Amid rising tuitions and campus living expenses, credit cards and student loans together constitute a bundle of tools that students use on their way to a bachelor's degree and beyond.

Targeted policies to curb abusive credit card lending practices are in place. Useful, too, can be educating youthful consumers about the sometimes unforgiving world of unsecured debt. Helping would-be cardholders better understand the basic trade-offs — both the benefits and the costs — of taking on credit card debt would be beneficial not only when they are making such immediate choices but also when they are confronted with future financial decisions. Unnecessarily broad restrictions, on the other hand, are more likely to harm the general welfare than improve it. From a typical college student's perspective, having a credit card might be a much better situation than not even being eligible for one.

JEFFREY M. LACKER
PRESIDENT
FEDERAL RESERVE BANK OF RICHMOND