<p>�</p><p>By Barbara Kiviat Tuesday, May. 12, 2009</p><p align="justify">The problem with the credit-card industry isn't just credit-card companies � it's you too. This week the Senate takes up a bill that would seriously clamp down on some of the industry's most unsavory practices, a piece of legislation that President Obama has said he wants on his desk by the end of the month. The bill, which builds on rules issued by the Federal Reserve Board and other agencies at the end of last year, would do away with interest-rate hikes on existing balances, prohibit issuers from putting customer payments toward lower-rate balances first and abolish the practice of raising a customer's interest rate because he was late paying a bill to someone else.</p> <p align="justify">Credit-card companies, though, may not be the only ones we need to be protected from. Every penny of Americans' nearly $1 trillion in revolving debt started with someone � some individual person � whipping out a piece of plastic and making a decision to use it. We could consider that free will and just call it a day, but there's plenty of reason to believe the story isn't so simple. There are piles of evidence that people are bad decision makers when it comes to how they use credit cards. Even when presented with full and fair information, they often make decisions that are not in their own economic best interest � a reality only partly taken into account by the new rules and pending legislation.</p><p align="justify">Consider the teaser rate. More than a third of consumers pick one credit card over another based on which issuer has the lowest introductory interest rate. And yet people often do so in a way that leaves them with higher finance charges over time. In one study, University of Maryland economists Haiyan Shui and Lawrence Ausubel watched people pick a card with a teaser rate of 4.9% for six months over a card with a teaser rate of 7.9% for 12 months. That would make sense if the people then paid off their balances within six months. But many didn't � the average balance for the year was $2,500, with plenty of folks paying more in interest charges than they would have had they opted for the other card, considering the rates on each spiked to 16%. </p><p align="justify">It is easy to chalk that up to simple human carelessness. Certain economists, though, have another way of looking at that and similar findings. They see a systematic psychological breakdown � as a species we're just really bad at understanding costs that come later on. Instead, we assign a disproportionate amount of importance to what's immediate and tangible. We lock eyes with that initial low rate and can't look away. (And, yes, credit-card companies get that.)</p><p align="justify">It's the same thing with that laundry list of fees that come with cards. We think that we're not going to be the ones to go over our credit limit or miss a payment and trigger a penalty rate, so we give those fees little to no weight as we're deciding which card to sign up for � even though they eventually make a big difference in what we pay. "We don't tend to take into account future costs," says Oren Bar-Gill, a law professor at New York University who has studied credit-card contracts and customer behavior. "Consumers don't really know how much they're paying for their credit card." </p><p align="justify">Once we've got our card in hand, our behavior becomes riddled with irrationalities. In one experiment, Drazen Prelec and Duncan Simester of the Massachusetts Institute of Technology found that people were willing to pay twice as much for basketball tickets when they were using a credit card as opposed to paying cash. Credit-card spending just doesn't feel like real money. In another study, Nicholas Souleles of the University of Pennsylvania and David Gross of the consultancy Compass Lexecon calculated that the typical consumer unnecessarily spends $200 a year in interest payments by keeping a sizable stash of cash in savings or checking while at the same time carrying a credit-card balance. In

our heads, the two don't line up.</p><p align="justify">The seeming solution would be to make clear to consumers exactly how much their credit cards are costing them. In fact, over the past few decades, there has been a massive push in that direction, from the Truth in Lending Act to the "Schumer Box," which gives a one-page summary of credit-card terms in a font size dictated by the Federal Government (it needs to be large enough to catch your attention). Credit-card statements that were a page long in the early 1980s now easily run to 30. That's a lot of information. And yet America's overreliance on consumer debt has happened anyway. Why? Disclosure itself may not be enough considering the well-entrenched forms of human thinking we're dealing with. "There have been a lot of disclosure policies over the past 20 years, but they've had a limited effect on improving the market," says the University of Maryland's Ausubel. "The problem isn't in the availability of information. The problem is in the processing of the information." </p><p align="justify">What we need to do, that argument continues, is frame information about how much credit cards cost in a way that really drives the point home. In 2007, a group of Senators introduced a bill that would have required credit-card companies to state on each billing statement how long it would take a person to pay off his balance and how much it would cost in principal and interest should he make only the minimum required payment each month. (That's another psychological trip-up: having a low minimum payment printed on the statement in a big font ratchets down our perception of how much we should be paying off, meaning we carry higher balances for longer.) That bill never went anywhere, but a similar provision is in the bill currently before the Senate. </p><p align="justify">The difference is that we'd be telling people not just about a particular credit card's characteristics but about what those characteristics mean in terms of human behavior. It would be similar to Federal Trade Commission rules that require auto manufacturers to say how many miles per gallon cars get whether a person is driving in the city or in the country. Depending on a person's behavior, the cost changes � and that is made clear right on the sticker. </p><p align="justify">Economist Richard Thaler and legal scholar Cass Sunstein, who now heads the White House Office of Information and Regulatory Affairs, think we should go even further. In their book Nudge, they sketch a system in which once a year credit-card companies would be required to break out all the fees, interest and other charges customers paid over the past 12 months. That information would come on a person's statement as well as electronically for easier comparison shopping. "By knowing their precise usage and fee payments, customers would get a better sense of what they are paying for," write Thaler and Sunstein. Ostensibly, people would then spend more reasonably. When a new sofa goes from costing $500 to $700 � and the pricing is transparent enough for people to realize that � fewer buy it.</p><p align="justify">The beauty with that sort of system is that it doesn't impose heavy-handed rules on people who don't need them. After all, 42% of households with credit cards pay off their bills in full each month. Telling people the cost of using their credit cards, in a way they can understand and internalize, levels the playing field and lets each person make an informed, unhindered decision for himself.</p><p align="justify">Source: http://www.time.com/time/business/article/0,8599,1897362,00.html</p>