Excess Credit Expense Index: How Much Americans Overpay on Credit-Card Debt (and How to Stop It)

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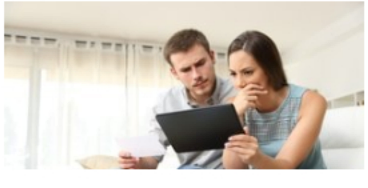
The Excess Credit Expense Index shows that Americans could save $72.5 billion on credit-card debt if they made this change.



HIGHLIGHTS

- Americans are using short-term credit to pay for long-term debt
- Credit-card debt, in particular, exceeds $1 trillion
- The gap between credit card interest rates and

Rising debt is a concern for millions of Americans, and many households are getting used to carrying debt more or less permanently now.

Yet a new study by MoneyRates shows that many are making the problem worse by paying far more interest than necessary.

How much worse?

According to the Excess Credit Expense Index, Americans could save a total of $72.5 billion every year by using debt more efficiently. This extra cost comes from using the wrong type of debt for the nature of how people are borrowing.

What Does the Excess Credit Expense Index Measure – and Why?

The Excess Credit Expense Index measures how much Americans could save by shifting their debt balances to more cost-effective forms of debt. In particular, it looks at the interest-rate gap between credit cards and personal loans.

Here's why:

Credit cards are designed to be a convenience, a means of accessing short-term credit as an alternative to cash. Consequently, interest rates on credit cards are quite high in comparison to other types of debt.

But Americans are not using their cards for short-term credit.

Even though interest can be avoided by paying off a credit card every month, the steady growth in the amount of outstanding credit-card debt shows that people are not paying off their balances every month. Instead, they are letting the balances accumulate.

Americans currently owe $1.086 trillion on their cards. Essentially, credit cards are being used to handle long-term debt.

> **Credit Card Debt Statistics:** Twenty years ago, Americans owed $610 billion on their credit cards. At the end of 2019, that total was $1.086 trillion, an all-time high.

Personal loans, on the other hand, are designed to handle debt over an agreed-upon term with fixed payments that offer potential savings. And, at the end of a personal loan, the debt is paid off in full.

The saving potential of using a personal loan as an alternative to credit-card debt comes from the fact that personal loans have consistently offered lower interest rates than the average credit-card rate:

> **Over the past 20 years, rates on 24-month personal loans have averaged 11.30%, while the average rate charged on credit-card balances has been 14.07%. That means personal loans have generally been 2.77% cheaper than credit cards.**

Compare Personal Loan Rates and Apply Online:

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Bank/Institution	APY	Loan Term	Max Loan	
LendingClub	6.95 - 35.89%	36 - 60 months	$40,000	Type: Personal Loan SEE MY RATE Advertiser Comments
Payoff	5.99 - 24.99%	0 - 60 months	$35,000	Type: Personal Loan SEE MY RATE Advertiser Comments
freedomplus	5.99 - 29.90%	24 - 60 months	$40,000	Type: Personal Loan SEE MY RATE Advertiser Comments
LENDINGPOINT	15.49 - 35.99%	0 - 36 months	$25,000	Type: Personal Loan SEE MY RATE Advertiser Comments
upgrade	6.98 - 35.89%	36 - 60 months	$50,000	Type: Personal Loan SEE MY RATE Advertiser Comments
AVANT	9.95 - 35.99%	24 - 60 months	$35,000	Type: Personal Loan SEE MY RATE Advertiser Comments
PROSPER	6.95 - 35.99%	36 - 60 months	$40,000	Type: Personal Loan SEE MY RATE Advertiser Comments
OneMain Financial. LENDING DONE HUMAN	25.10 - 35.99%	24 - 60 months	$25,000	Type: Personal Loan SEE MY RATE Advertiser Comments

How the Excess Credit Expense Index Measures the Interest-Rate Gap

The case for using a personal loan as an alternative to credit-card debt is even more compelling because the gap between personal loan rates and credit card rates has been widening in recent years.

> **As of late 2019, the average personal loan rate was 10.21% while the average being charged on credit-card balances was 16.88%. That difference means the cost advantage of personal loans is now 6.67%.**

The Excess Credit Expense Index measures the potential extent of the interest-rate advantage by applying that 6.67% to the $1.086 trillion owed on credit cards.

Here's how the index is calculated:

- Americans owe over $1 trillion in credit-card debt – $1,086,304,050,000 to be exact.
- The average interest rate charged on credit card balances is 16.88%.
- Applying that interest rate to the total amount of credit-card debt yields an annual interest cost of $183.4 billion on credit-card debt.
- Instead of carrying this debt on their credit-card balances, consumers have the option to apply for personal loans. The average interest rate on a personal loan is 10.21%.
- Applying that personal loan interest rate to the total credit-card-debt balance would result in an annual interest charge of $110.9 billion.
- The difference in the interest cost on credit-card debt and what that cost would be at an average-personal-loan rate comes to $72.5 billion.
- That $72.5 billion represents the potential savings American consumers could realize if they handled their debt more efficiently by carrying it on personal loans rather than on credit cards.

The resulting $72.5 billion represents the extra interest Americans are paying over the course of a year by carrying long-term debt on their credit cards instead of in personal loans. To think of this number more optimistically, that $72.5 billion also represents the amount Americans could save by shifting their credit-card balances to personal loans.

Between the rising level of outstanding credit-card debt and the growing gap between credit-card and personal-loan rates, this excess amount of interest has grown steadily over time. A decade ago, it was $29.3 billion, and 20 years ago it was just $7.7 billion.

Personal Loans vs Credit Cards: Everything You Need to Know

Debt Growth Comes in Many Forms

The growth in credit card debt is just one example of how American consumers have escalated their borrowing.

In addition to owing over $1 trillion on their credit cards, Americans owe $1.19 trillion on car loans according to the Federal Reserve. Student loan debt represents an additional $1.64 trillion, and a total of $12.64 trillion is owed on residential mortgages.

Since debt has become such a big part of personal finance, it is especially important to make good decisions about how to handle that debt. Credit-card debt is generally more expensive than personal loans or any of the other forms of borrowing mentioned above.

That means credit-card debt should be avoided where possible, even if it means taking on other forms of debt. The $1.086 trillion in credit-card balances Americans have accumulated suggests people are not doing a good job of avoiding credit-card debt. The cost of those poor decisions is now $72.5 billion per year in excess interest expense.

How to Stop Overpaying on Credit-Card Debt

The steady rise in credit-card debt suggests that the $1.086 trillion Americans currently owe on their cards is being carried more or less permanently. This means it is incurring interest charges year after year.

While any borrowing is going to cost money, the problem with this huge amount of credit card debt is that the high cost of credit card interest rates causes people to pay more than they have to for their debts.

Since credit-card balances have come to represent a form of long-term debt for many people, they could save money if they used a form of credit better suited to long-term debt. For some, borrowing against equity in their homes could be a cost-effective option, but even people without home equity could use a personal loan as an alternative to long-term credit card debt.

Better up-front planning would allow people to use a personal loan for the type of major purchases they are unable to pay off right away. Plus, paying off a personal loan can help improve your credit score. Even if people fail to plan ahead in that way, they could also use a personal loan to refinance their credit-card debt and lower their interest expense.

If you want to avoid the high interest cost that comes with carrying long-term credit-card debt, here are some alternatives:

1. **Budget before you borrow**
   The best way to reduce the amount of interest you pay is to limit the amount of time it takes to pay off your debt. One problem with credit cards is that, unlike a loan that has set monthly payments over a predetermined schedule, credit cards have flexible payments that allow people to take longer to pay down their debt. Thus, people may end up just paying higher rates with credit cards, but they are often paying those rates for longer periods of time.
2. **Exceed the minimum monthly payments**
   One way to reduce the amount of time it takes you to pay off your credit card balance is to pay more than the required minimum monthly payments. Those payments are designed to earn credit card companies more money by prolonging your debt. Exceeding the minimum monthly payment cuts down on the amount of interest you pay overall.
3. **Refinance with a personal loan**
   As noted, personal loans generally have cheaper interest rates than credit cards, so you may be able to save money by using a personal loan to pay off credit card debt. Better yet, if you are making a major purchase that you know will take some time to pay off, finance it from the start with a personal loan rather than charging it to your credit card.
4. **Use home equity to pay off credit card debt**
   If you have equity in your home, another option is to borrow against that equity as an alternative to credit-card debt. Whether you do this via a home equity loan or cash-out refinancing, the interest rate you pay should be considerably lower than it would be on a credit card. However, before you borrow against home equity, make sure you have a solid plan to repay the debt since it means putting your home up as collateral.

MoneyRates will continue to track the Excess Credit Expense Index over time. The intention is that the sheer size of the excess interest Americans are paying will draw attention to the potential benefit of making better choices regarding the debt they carry.

If you choose to borrow money, recognize that it is going to cost you. However, since you have some choice over how much it will cost, why not make a choice that saves you the most?