Uncommon Sense

How teens get sucked into credit-card debt

Card companies are now soliciting high school students, who too easily find themselves buried in red ink.

By MP Dunleavey

Editor's note: Columnist MP Dunleavey and six other women have come together online to strip away the myths surrounding money, lay bare their assets and liberate themselves from debt. Follow the quest for financial fabulousness of these "Women in Red" in Dunleavey's column on MSN Money and on her message board.

Like a lot of hard-working women, Andrea Alba has moments of financial despair.

Between juggling three jobs, paying her bills and trying to get out of debt, she feels overwhelmed. "I just want to pay everything off," she says. "I wish I didn't have to struggle so much."

But Alba is no debt-weary baby boomer. She's only 19 and a couple of years out of high school.

Her financial burdens may be heavier than other teens: She pays her own college tuition and also helps pay the rent and utilities at home.

But the sinker was signing that first credit card application before she had even graduated from high school. "It was fine at first," she says. "I used it mainly for gas. Then it just got deeper and deeper."

Within a year and a half of her 18th birthday, Alba was $2,500 in the hole -- and a card-carrying member of the newest and youngest group to spend beyond their means. Call them Teens in Red.

The slippery slope

It's no secret that many college students are quickly sucked deep into credit card debt. But now it seems the problem can start even before freshman year.
According to the JumpStart Coalition for Personal Financial Literacy, an educational organization, nearly a third of high school seniors reported having a credit card of their own or one co-signed by a parent.

Because young people under 18 technically can't apply for a credit card without a parent's co-signature, it's hard to know precisely how many teens have credit and how many are already in debt. And CardWeb.com, which monitors the credit card industry, doesn't yet track teen cardholders.

But according to surveys conducted by Robert Manning, author of "Credit Card Nation: The Consequences of America's Addiction to Credit," the number of incoming college freshmen with credit cards tripled between 1999 and 2002.

Those freshmen carry an average of $1,585 in credit card debt, reports student-loan lender Nellie Mae. Many, like Alba, started building up debt even before their adult lives began.

Soliciting teens and moms

I was shocked to learn that kids not yet old enough to drive are receiving card solicitations -- co-addressed to parents -- while they are still living at home.
Janet Bodnar, author of "Raising Money Smart Kids: What They Need to Know about Money and How to Tell Them," is appalled that her 16-year-old son regularly gets credit card solicitations -- even if they include her name on the address. She throws them out.

"I don't think it's healthy for teenagers to have credit cards before they go to college," says Bodnar, also deputy editor of Kiplinger's Personal Finance magazine.

She disagrees that young people learn financial responsibility by using a credit card. "Most kids can't hand in a paper on time, let alone pay a bill on time," she says.

"This is funny money to them. It's not real. It's a license to spend, and they're not learning how to manage money on their own."

Teens need training

Most teens are vulnerable to debt because they lack a clear understanding of how credit works, says Laura Levine, JumpStart's executive director.
Adam Wehr's struggle with debt began right after he graduated from high school. He signed up for a card with a $500 limit. "I was really good for the first six months," says Wehr. Then he signed up for another card, "and things got out of control." Within a couple of years he had eight credit cards and was nearly $10,000 in debt.

Wehr, now 22, says his undoing was that he had no clue how a credit card worked. "I was fooled by that minimum payment thing," he says. "I thought if I paid that, I was fine."

Interest rates? Late fees? "I had no idea," he admits. "I was totally oblivious to all that stuff."

Now, parents and teens concerned about the dangers of credit cards appear to be turning to a new breed of plastic cards: debit, prepaid and stored-value:

Debit cards are linked to a bank account;

Prepaid and stored-value cards are "loaded" with a fixed dollar amount, like a gift card.

Either way, teens can spend set amounts without racking up debt.

That sounds comforting. But some experts say prepaid cards like MasterCard's MYPlash, the Visa Buxx card or the new FIRM card (the Financial Independence Responsibility and Management Card, co-sponsored by Visa USA) may make young adults more financially vulnerable.

When operating on a cash basis, young people still don't master the tricky nature of credit, says Levine.

Besides, many of the cards have hidden fees, and they may compromise teenagers' privacy, says Manning, a professor of finance at Rochester Institute of Technology. "They're very scary. (Credit companies) are getting all this personal information about your child and putting it into a database, the better to market to them when they turn 18."

How to help teens protect themselves

Boost their financial IQ: A typical mistake parents make is expecting children to make the leap from a childhood savings account to managing a credit card, says Levine.
"They need to know how credit works: What do you do when the bill comes? Why is it important to pay on time? How do interest rates work?" Levine says.

Bodnar recommends first helping kids manage cash through their own checking accounts, then adding an ATM or debit card before graduating to a credit card.

Set limits: Parents can also step in by setting limits on credit. Erin Zimmerman was 17 when her parents co-signed for her first credit card. She didn't mind the $300 limit, she says, because her parents explained how interest rates worked and how quickly she could get into financial trouble if she overspent. "They said it was like digging a hole." Zimmerman, 18, is now a freshman at New Mexico State University, Las Cruces. She says she's seen other young people get into hot water: "They don't get the fact that you have to pay it back."

Demonstrate the debt trap: Bodnar says that one way for young adults to grasp the slippery nature of compound interest is to have them play around with a debt calculator. There's nothing like watching how minimum payments on a $1,000 balance -- $20 a month at 12% interest -- mean six years of debt. That's two years longer than it takes to graduate.

A growing number of groups are warning teens about the perils of credit cards, using Web sites and basic personal finance classes (see links at right).

Hip-hop mogul Russell Simmons launched a nationwide Get Your Money Right Tour with the Hip Hop Summit Action Network. But if you can't get tickets for your teen, that's OK. Michael Wood, of Teen Research Unlimited, urges parents to remember that, when it comes to money habits, you can be your child's best resource.

But that may require some change on the part of the grownups. "What is the message being passed onto young people? You don't have to look any further than the way today's adults treat plastic to see what kinds of messages are being passed on to teens," says Woods.