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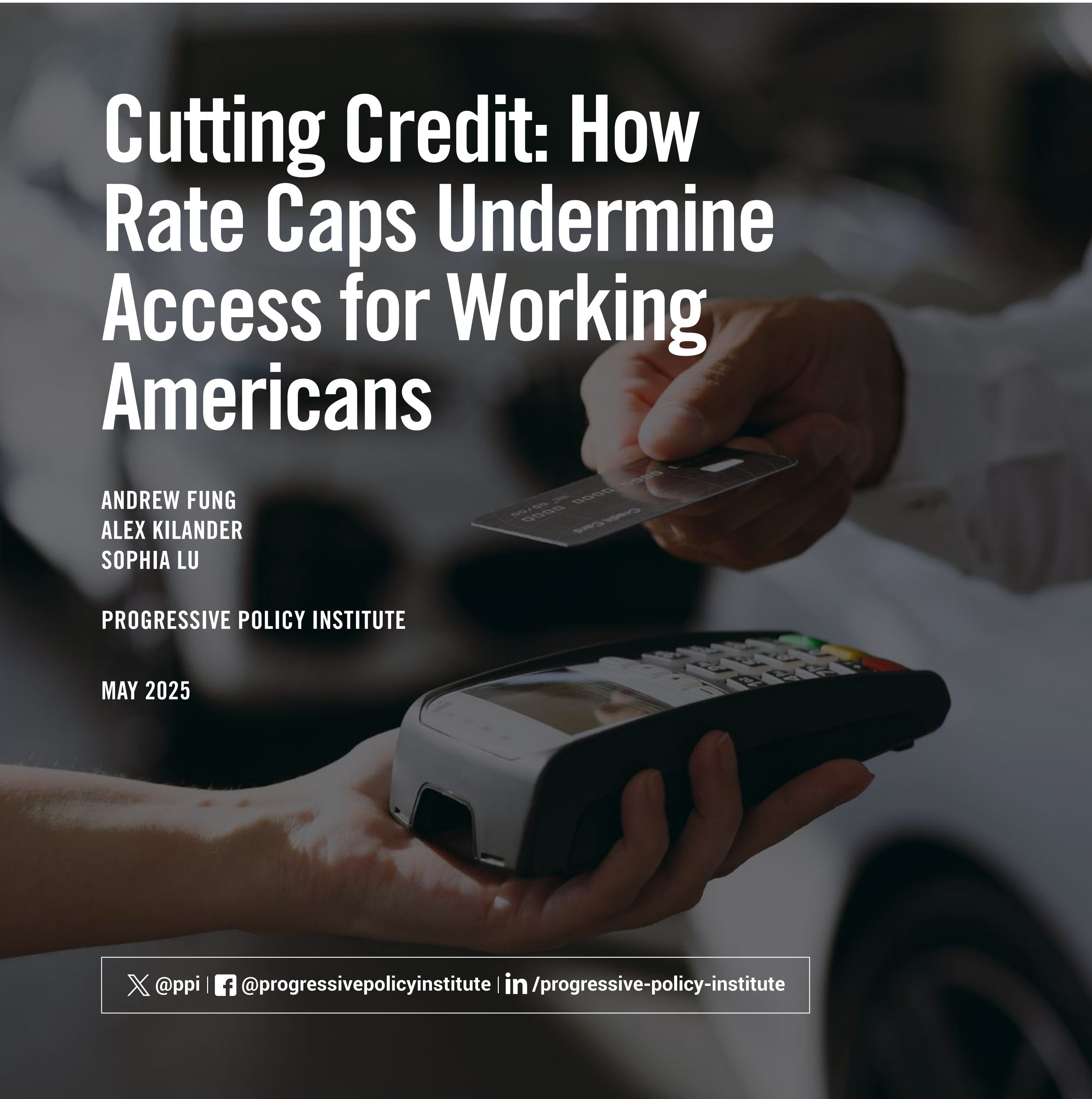

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ANDREW FUNG
ALEX KILANDER
SOPHIA LU

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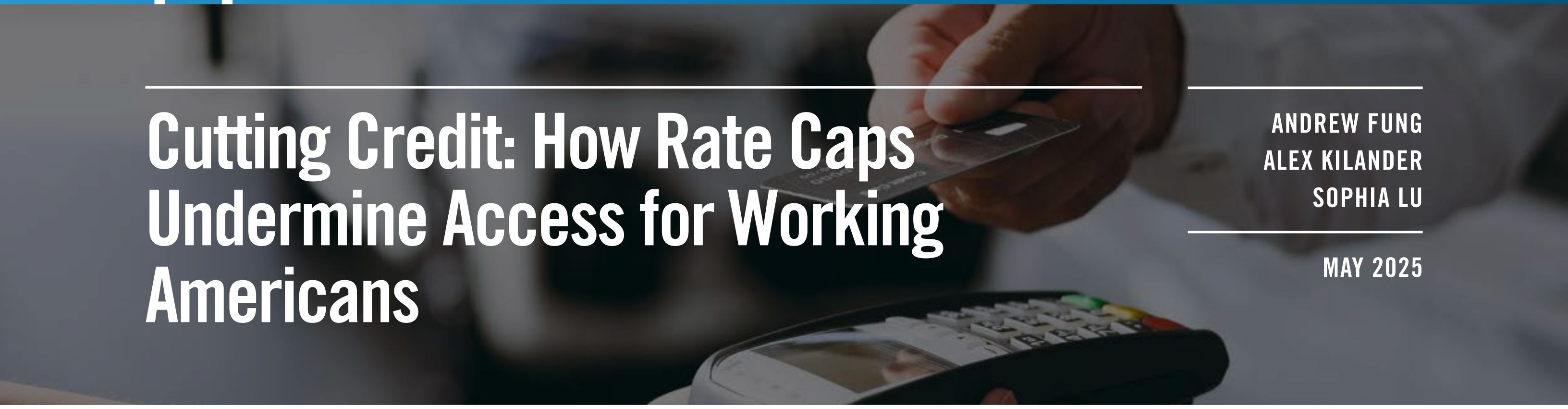

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INTRODUCTION

As the inflation rate surged throughout 2021 and 2022 and put pressure on consumers' wallets, another important trend was underway: credit card interest rates were rising. With the Federal Reserve raising the federal funds rate substantially to combat inflation, credit card interest rates climbed sharply in 2022 and 2023 as a result of the increased costs of lending, rising from an average of 14.51% in Q4 2021 to 21.19% just two years later. However, even as inflation subsided and prices stabilized, credit card interest rates remained elevated.

Why is this the case? Ultimately, credit card interest rates reflect the state of the broader consumer credit market. In recent years, that market has started showing signs of stress, particularly among less creditworthy borrowers, who have higher credit card debt and more frequent delinquencies. Higher market-wide risk — alongside a still high federal funds rate — has caused banks that issue credit cards to raise interest rates and keep them high.

Consumer discontent with these high rates has spurred a bipartisan effort to address the issue. In February 2025, Senator Bernie Sanders (I-Vt.) and Josh Hawley (R-Mo.) introduced legislation that would cap credit card interest rates at 10% for five years, claiming that the bill would provide "working families with desperately needed financial relief."[1] A 10% cap was also floated by Donald Trump on the campaign trail, to provide relief "while working Americans catch up."[2]

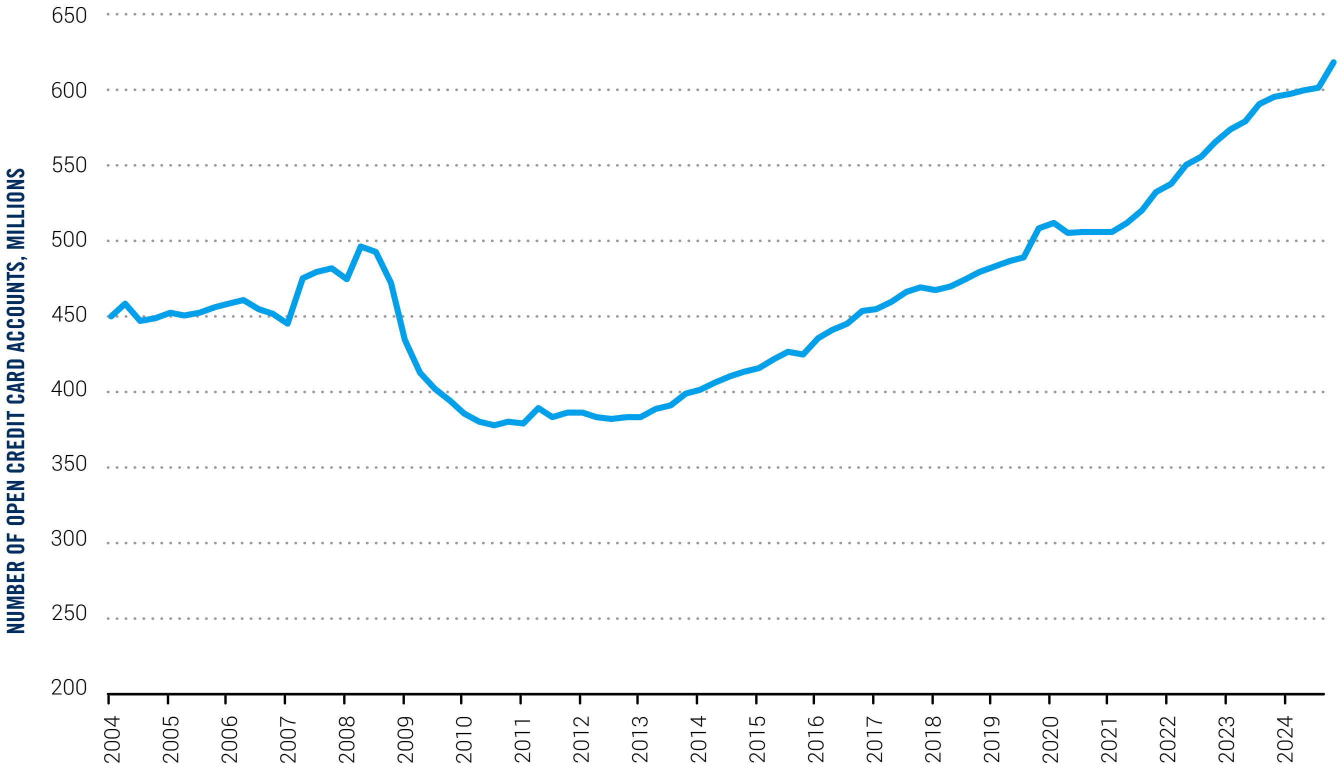
However, limiting credit card interest rates to an arbitrary 10% effectively deprives credit card issuers of their most powerful tool to manage risk. As a result, a rate cap would dramatically reduce access to credit for the very people it aims to protect, just as the economy teeters on the precipice of a recession. By significantly limiting their ability to qualify for and use credit, it would even cause many consumers to turn to predatory alternatives such as payday lenders.

The following sections of this paper dive into the consumer credit market and evaluate the different options policymakers can use to make it function better for working Americans. First, it reviews the current state of the market, highlighting the important role that consumer credit plays in the economy, how credit card issuers decide upon interest rates, and breaking down why interest rates have risen in recent years. Second, it explains the economics of rate caps, and how working-class Americans would bear the brunt of a cap's consequences. Lastly, the paper explores some better policy alternatives to protect consumers, including greater transparency, better financial capability for households, and alternatives to traditional credit.

THE CREDIT CARD MARKET TODAY

Today, more Americans than ever have credit cards. As the most accessible and widely used form of credit for most borrowers, credit cards are now deeply integrated into our physical and digital lives. As of the end of 2024, there were 617 million credit card accounts in the United States, a 22% increase since 2019.[3] At the same time, this trend has coincided with record-level credit card debts. Collectively, borrowers' credit card debt totals approximately $1.2 trillion — a historic high.[4]

FIGURE 1: CREDIT CARD ACCOUNTS, 2004-2024



Source: NY Fed Consumer Credit Panel/Equifax

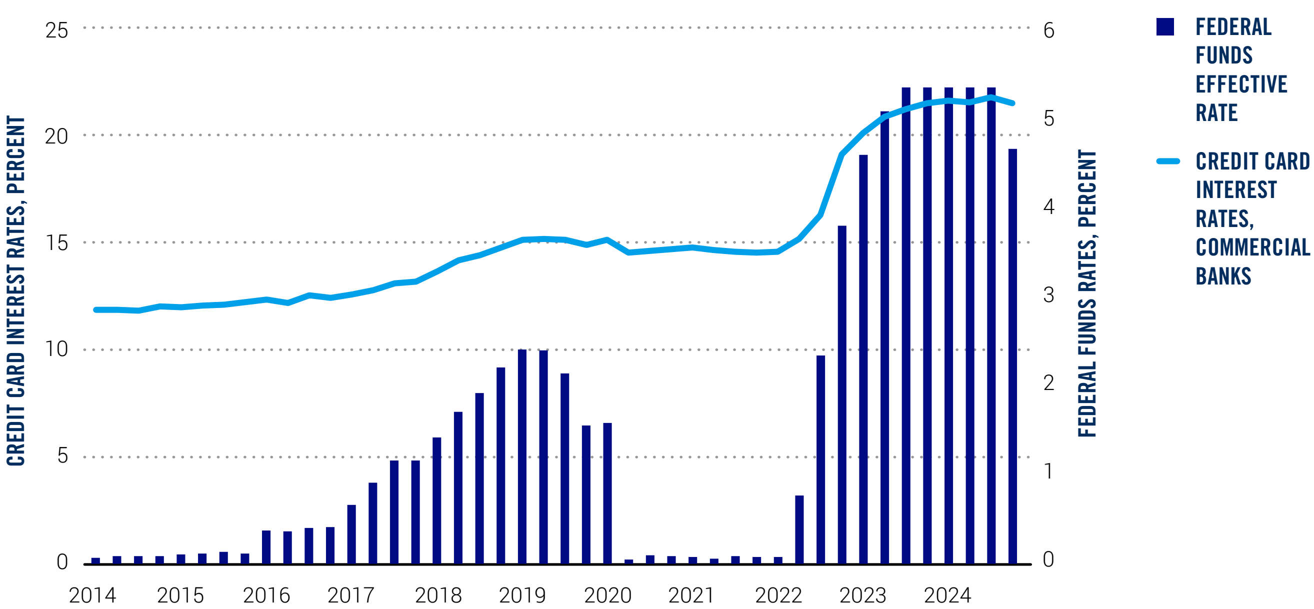
Credit cards generate revenue in several ways, but the largest source of profit is interest charged on carried credit balances.[5] On one extreme, borrowers who pay their entire balance each month do not generate any interest revenue for banks; on the other, borrowers who accumulate balances and ultimately fail to pay create losses that must be absorbed by issuers (known as charge-offs). The customers who generate the most profit for bank issuers fall between these extremes: people who accumulate large carried balances with interest but continue to pay.

Issuing credit cards is risky, and issuers — typically institutions like banks or credit unions — have several tools at their disposal to modulate the risk of a given loan, including credit limits and myriad fees. However, their main risk management tool is interest rates. The higher interest rates offered to borrowers reflect not only the risk of a given applicant, but also the issuer's attempt to protect themselves from losses while maintaining the opportunity to profit.

Last year, credit card interest rates reached their highest levels in at least 30 years.[6] As of November 2024, The Fed reported that the average commercial bank interest rate on credit card plans was 21.5%, a significant surge from 14.5% just three years prior. Inflation was the main driver. In the first half of 2021, prices began to rise rapidly, continuing their upward trajectory until peaking in June 2022 and eventually stabilizing in mid-2023. To combat inflation, The Fed, led by Chairman Jerome Powell, raised the federal funds rate, or the rate at which banks and credit unions loan money to each other overnight. Doing so made it more expensive to borrow money and added costs for the banks issuing loans.

While credit card interest rates remained stable through 2021, they too began to rise in mid-2022, jumping a dramatic 2.8 percentage points between August and November. Rates eventually stabilized around 21.5% in mid-2024, where they have stayed since.

FIGURE 2: FEDERAL FUNDS RATE AND CREDIT CARD INTEREST RATES, 2014-2024, QUARTERLY

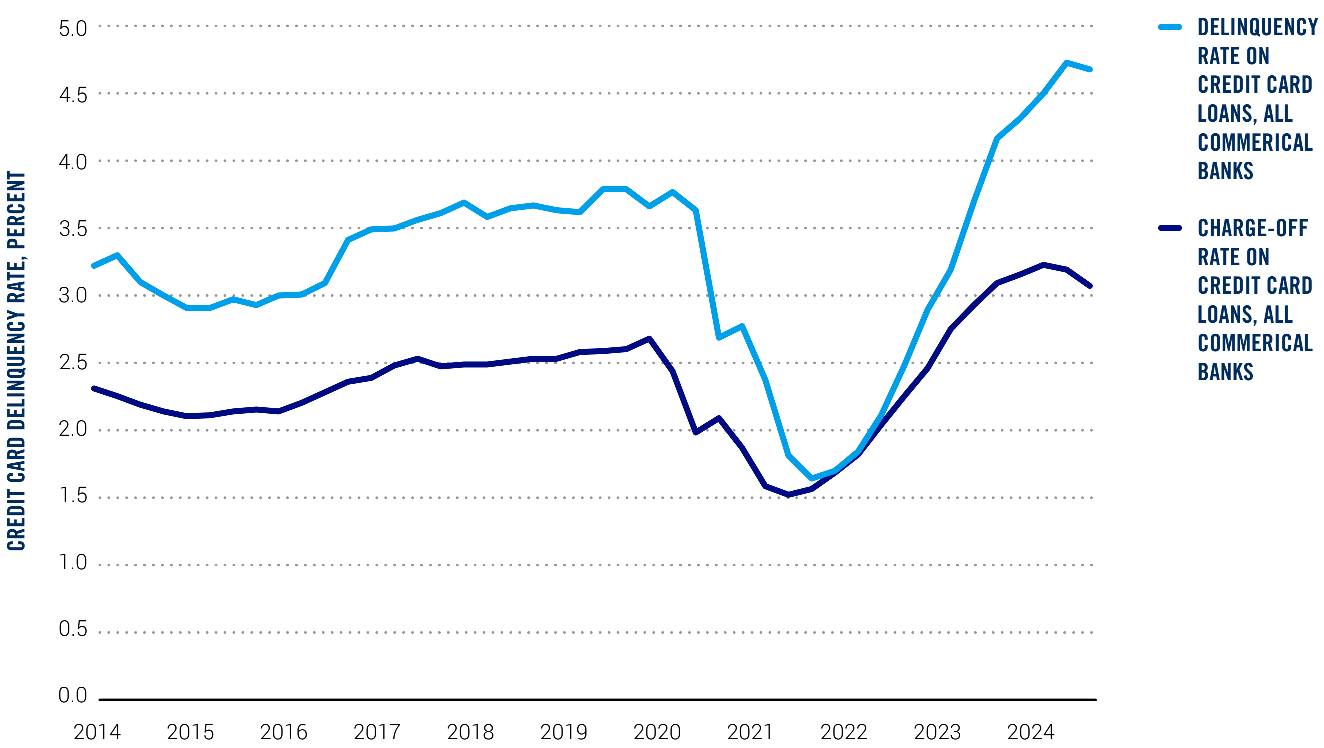


Source: Board of Governors of the Federal Reserve System

Two key factors explain stubbornly high rates. First, although inflation has largely subsided, the federal funds rate, which contributes directly to the cost and profitability of loans for issuers, has not returned to its near-zero levels from before the 2022 inflation spike. As Figure 2 illustrates, changes in credit card interest rates have tracked changes in the federal funds rate in recent years. Though The Fed did decrease the federal funds rate in 2024, it has kept it above pre-2022 levels to help counter sticky inflation in the wake of a spike.[7]

The second factor is that borrowers appear to be increasingly overleveraged in the credit market, causing issuers to keep rates at the levels reached in 2023 to protect themselves against defaults. In recent years, consumer spending has continued to rise even as pandemic-era programs and stimulus have ended. At the same time, the rate of credit card delinquencies, or the share of borrowers failing to make the minimum payments on time, has risen rapidly since 2021, reaching its highest point since the Great Recession in mid-2024. Credit card charge-offs, or balances that creditors write off as losses because they are unlikely to be repaid, faced a similar surge between 2021 and 2024.

FIGURE 3: CREDIT CARD DELINQUENCY AND CHARGE-OFF RATES, 2014-2024



Source: Board of Governors of the Federal Reserve System

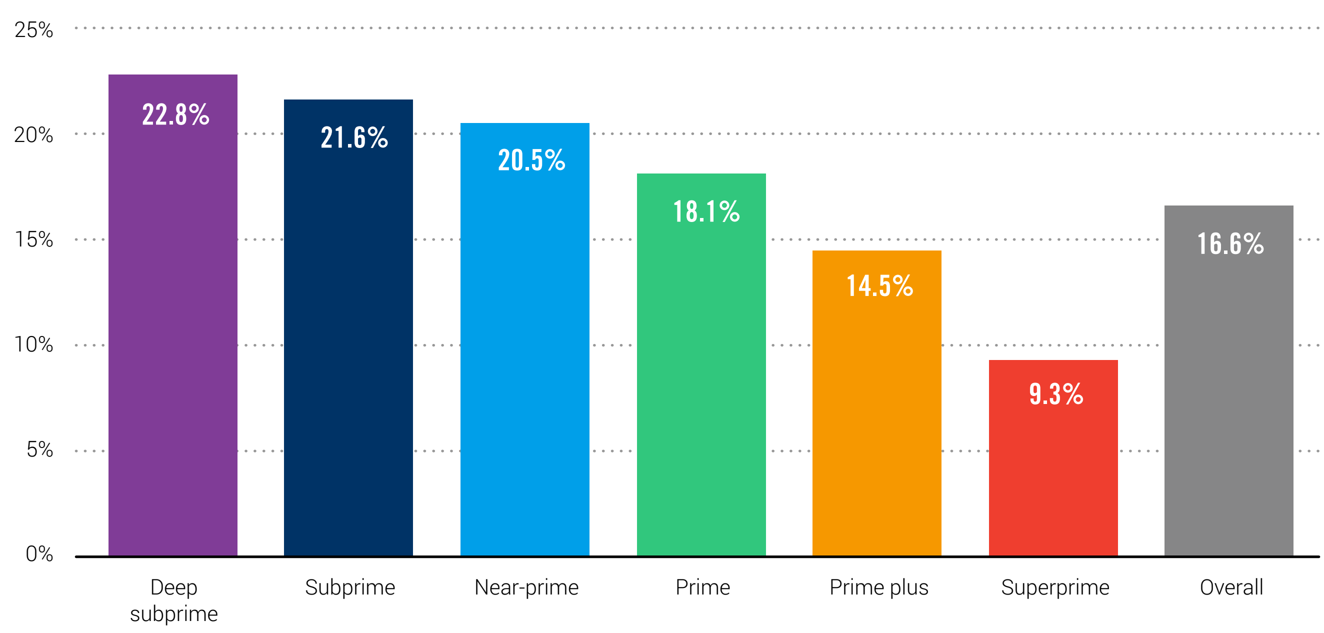
THE IMPACT OF AN INTEREST RATE CAP

The Sanders-Hawley bill proposes a seemingly straightforward solution to rising interest rates: mandating that all new credit cards have interest rates at or below 10%. While this may initially sound like a sensible solution to bring rates down, it would devastate credit availability for lower-income borrowers. That's because, rather than lowering interest rates for everyone, issuers would instead simply stop offering credit to applicants with lower credit scores or offer cards with extremely low credit limits, very high fees, or other poor terms.

In effect, the 10% limit on credit card interest rates is a price cap on an issuer's main tool for mitigating risk, placing a ceiling on the maximum price (in this case, a rate) suppliers can charge in a market. Price controls are among the most widely studied subjects in economics, and there is strong academic consensus that they are a tool poorly suited to lowering costs or resolving other issues in marketplaces.[8] If a price cap is set too high, for example, a maximum credit card interest rate of 90%, it would have little to no impact because few cards are issued with rates that high without any restrictions. If the cap is too low - below the average rates for the market - then issuers will often choose to offer few or no loans at that level because it is deemed too risky and therefore unprofitable for them.

The proposed Sanders-Hawley interest rate cap of 10% would be too low, making issuers reluctant to give cards to low-income people with low credit scores. As of 2022, the most current data available for effective interest rate by credit score rating, only borrowers in the highest Superprime category — those with credit scores 720 or higher — had an average rate below the 10% limit suggested by the cap.[9] Given that the median credit score is around 715 and that rates have risen across the board in recent years, it is likely that a small share of borrowers today have rates below the cap's level.[10]

FIGURE 4: ANNUAL EFFECTIVE INTEREST RATE, REVOLVING ACCOUNTS, 2022



Source: Consumer Financial Protection Bureau

The cap is so far below the prevailing market rates for most borrowers that it effectively fully removes interest rates as a tool for issuers. In addition to denying working-class borrowers access to credit cards, these changes could also result in diminished rewards programs and weaker protections for borrowers who do retain access to credit as issuers look to cut costs to maintain profitability.

Furthermore, the cap does little to address the potential role of market concentration in high interest rates. While it is unclear whether it has factored into persistently high rates today, there are concerns that concentration in the credit card market could potentially contribute to growing interest rates.[11] Rather than a distortionary rate cap, this is better mitigated through antitrust enforcement.

THE RISKS OF LOSING ACCESS TO HIGH-QUALITY CREDIT

If borrowers lose access to higher-quality credit options, they will shift to alternatives with far less regulation or consumer protections. As PPI has previously noted, the rapidly expanding "buy now, pay later" payment option, in which merchants allow consumers to split their purchases into several monthly installments, has become increasingly popular.[12] While it can offer some advantages to consumers over traditional credit cards, the buy now pay later industry is less regulated, less transparent, and often lacks important features such as a dispute resolution mechanism. If consumers are locked out of traditional consumer credit cards, then they would likely shift heavily to this relatively unregulated option.

Arbitrary caps on credit card interest rates also would drive people to more predatory alternatives such as payday lenders. These loans are typically small amounts of cash intended to be repaid by the borrower's next payday, often within two weeks. While payday loans may appear as a quick solution to urgent financial needs, they carry steep costs — as a typical payday loan will have sky-high interest rates of 400% or more annually.[13] This interest and other associated fees can cause the loan balance to spiral out of control, leaving borrowers completely unable to repay their debts. When this happens, many borrowers take out additional payday loans to cover the original loan, trapping them in a cycle of debt difficult to escape. Research shows that over 75% of payday loan revenue comes from borrowers who take out more than 10 loans a year, demonstrating the long-term dependency and financial stress these loans impose on vulnerable borrowers.[14]

Similarly, check cashers and pawn shops impose significant financial burdens on their customers. Check cashers typically charge hefty fees — as much as 6% of the check's value – for the convenience of cashing paychecks or government benefits.[15] For low-income individuals living paycheck to paycheck, this fee can add up quickly, leading to a significant loss of income over time. Pawn shops, on the other hand, offer short-term loans in exchange for valuable items, such as electronics, automobiles, jewelry, and other items of value. If the borrower fails to repay the loan within the agreed period, they not only face high interest, but could forfeit valuable personal assets.

A major issue with these alternative lenders is that they are often poorly regulated, allowing them to engage in predatory practices with minimal oversight. Credit cards include a number of powerful consumer regulatory protections like fraud protection, dispute resolution, and fee restrictions which make it a safe credit option. However, in many states, payday lenders and check cashers operate in a gray area of financial regulation, leading to substantially higher risks for borrowers than traditional forms of credit. For example, in Texas, where they are mostly unregulated, payday lenders charge interest rates as high as 662%.[16] While some state governments have attempted to impose regulations on payday loans, these laws vary measurably, and in many cases, remain insufficient to curb harmful lending practices.[17]

Currently, those without access to traditional credit rely upon these types of predatory institutions at far higher rates than those that do.[18] If interest rates are capped and access to traditional credit is limited, it is likely that even more people will be forced to turn to these ultra-high-cost alternatives for borrowing. Ironically, the very people the interest rate caps aim to protect could find themselves more vulnerable to long-term financial ruin, leaving borrowers stuck in an ongoing loop of debt.

A BETTER WAY TO PROTECT BORROWERS

Instead of price controls, PPI urges policymakers to adopt the following suite of policies for working Americans:

Transparency and Oversight

When consumers have a clear understanding of how much they will pay over the life of a loan or credit card balance, they can better evaluate their credit and spending decisions. This includes providing detailed disclosures about interest rates, fees, and the full cost of credit in terms that are easily understood by someone with relatively little financial knowledge. Furthermore, enacting enhanced borrower protections that set clear terms around fees, payment structures, and penalties can also safeguard consumers from unexpected costs.

Prior laws have already made great strides on these fronts, including the Truth in Lending Act, the Fair Credit and Charge Card Disclosure Act, and the Credit Card Accountability Responsibility and Disclosure (CARD) Act.[19, 20, 21] Among many provisions focused on protecting consumers, these laws require lenders to fully disclose the terms of their loan, prohibited abusive practices like retroactive and unnotified interest rate hikes, and required that credit card issuers give consumers adequate time to repay balances before accruing interest.

While these laws made more information available to consumers, work remains to make that information more digestible for them. One study found that the typical credit card agreement was written at a reading level higher than the average American, and as a result, nearly half of American consumers were unable to understand the terms of their cards clearly.[22] Encouraging credit card issuers to lay out the fine print in clearer terms — whether through legal action or regulatory oversight — would enable consumers to more transparently evaluate their options when taking out a credit card.

Financial Education

We also need to boost financial literacy in America. Many citizens lack the knowledge needed to navigate the often confusing or opaque world of personal finance. In one survey arranged by the Global Financial Literacy Excellence Center, respondents could give correct answers to a set of very basic financial questions about saving, debt, and budgeting only 48% of the time.[23] According to another survey focused on credit cards, nearly a quarter of Americans didn't know whether they had any credit card debt, and nearly half were unsure what the APR was on their cards.[24] This is especially true among young Americans who lack the real-life experience of managing a household budget, making them more prone to a costly mistake that could follow them for years. Many enter the world of credit without a solid understanding of how interest rates work or the consequences of late payments, leading to delinquency rates that are higher than those of their older counterparts.[25]

Through financial education, consumers are equipped with the knowledge and skills necessary to navigate complex financial decisions, particularly when it comes to managing debt and using credit responsibly. According to one study that looked at a sample of 18- to 29-year-olds, those with exposure to financial education were less likely to carry high debt burdens, become delinquent on their loans, or declare bankruptcy.[26]

But as of 2024, only 25 states require personal finance courses to graduate high school.[27] While this growth is a significant step in the right direction — only eight required it a few years ago — there is still work to be done to ensure that financial programming is available and rigorous for American students.[28] And financial education does not need to end with high school graduation. Supporting the growth of workshops, online resources, and community initiatives dedicated to building financial capability can help young adults or distressed households make more informed credit decisions.

Expanding CDFIs

Community Development Financial Institutions (CDFIs) offer one crucial credit alternative to traditional financial institutions, particularly for underserved communities.[29] CDFIs are mission-driven institutions designed to provide affordable and accessible financial services to individuals who may be excluded from the mainstream banking system, often due to low credit scores, limited financial history, or living in areas with fewer banking options. Policy initiatives that encourage the growth and support of CDFIs — especially the credit unions and community development banks among them that issue credit cards — can create a more inclusive and accessible financial ecosystem, without forcing low-income consumers to choose between predatory lenders and the high interest rates of traditional credit card issuers.

One of the most significant advantages of CDFIs is their ability to offer loans at lower interest rates compared to traditional banks or predatory lenders like payday loan services, since they are not purely profit-driven entities. They can provide individuals with limited access to the traditional financial system the ability to secure credit for essential needs, without falling into the cycle of debt associated with high-interest payday loans or credit cards. CDFIs also can provide holistic financial support to their clients. For example, some offer financial counseling, budgeting workshops, and credit-building programs to ensure that their clients are not only receiving credit but are also equipped with the knowledge to manage it effectively.

By offering products that cater to those who are often overlooked by larger financial institutions and helping to promote financial education, CDFIs play an essential role in the financial ecosystem by giving an option to those stuck between rising interest rates at traditional institutions and its unregulated and predatory alternatives. Yet despite bipartisan federal support through the Department of Treasury's CDFI fund, CDFIs are unable to fully meet demand for their services, with only 40% from one Fed survey saying they could adequately meet the financial needs of the populations they serve.[30] The most commonly cited reasons, beyond the higher costs of capital from the Fed's interest rate hikes, were insufficient operating funding, staffing or lending capital. Rather than gut funding for the fund — as the Trump administration has chosen to do by ordering it eliminated to the maximum extent possible under current law — policymakers should instead look to fill in these gaps and ensure that CDFIs remain available to those that need them, something PPI has long supported.[31, 32]

CONCLUSION

As credit card interest rates have risen rapidly over the last few years, many Americans have expressed frustration. While proposals to cap credit card interest rates at 10% for the next five years in response to this surge may sound like a way to help working Americans struggling with high interest rates, it would accomplish precisely the opposite. Enacting a strict price control that sets interest rates well below the current average would likely cause lenders to sharply limit credit access for higher-risk borrowers, such as the working-class Americans that it intends to help. By reducing access to high-quality credit, this legislation would not only damage working Americans' financial security and resiliency but also push them towards dangerous low-quality credit options like payday lenders, check cashing, or pawn shops. Rather than making the situation even worse with a distortionary rate cap, policymakers should instead embrace policies to boost institutional alternatives, financial literacy, and transparency for working Americans.

ABOUT THE AUTHORS

Andrew Fung is a Senior Economic & Technology Policy Analyst with the Progressive Policy Institute. His work focuses on the intersection of the economy, technology, and innovation. He graduated from American University with a Master's in Public Policy and B.A.s in Political Science and Economics.

Alex Kilander is a Policy Analyst with PPI's Center for Funding America's Future. Prior to joining PPI, Alex worked at the Treasury Department in the Office of the Secretary and as a staffer for the House Appropriations Committee. Alex graduated from Princeton University with a Bachelor of Arts in Public and International Affairs.

Sophia Lu is a Google Public Policy Fellow with the Progressive Policy Institute. Her work explores how emerging technologies may be directed towards facilitating across the board economic growth and greater civic participation, with a particular emphasis on the creative economy. She is a junior at Georgetown University's School of Foreign Service pursuing a BSFS in Science, Technology, and International Affairs (STIA).

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PROGRESSIVE POLICY INSTITUTE
1919 M Street NW,
Suite 300,
Washington, DC 20036

Tel 202.525.3926
Fax 202.525.3941

info@ppionline.org
progressivepolicy.org