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THE CONSUMER FINANCIAL HEALTH CRISIS

Wage Stagnation, Rising Costs,
and the American Household
Debt Trap

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Executive Summary

Debt is no longer a tool for getting ahead. For millions of American households, it has become a survival mechanism — the only way to pay rent, cover medical bills, and keep the lights on when wages have failed to keep pace with the real cost of living.

The United States is not facing a debt problem alone. It is facing a structural income-cost imbalance that debt has masked for decades. A durable solution must improve wage formation, address cost structures, reform credit market incentives, and improve access to debt resolution pathways.

Why People Are Suffering: The Root Causes

From the end of World War II through the early 1970s, productivity growth and worker pay moved in tandem — underwriting the expansion of the middle class and broad-based economic security. That relationship collapsed. Since 1979, productivity has grown 92.4 percent while typical worker pay has risen only 33.6 percent (Economic Policy Institute, 2025). The economy became dramatically more productive. Ordinary workers were largely left behind.

The result is a widening, structural gap between what households earn and what they must spend to remain financially stable. Housing, healthcare, transportation, education, and childcare have all grown faster than wages. At the same time, AI may also amplify financial instability across a far broader segment of the workforce, precisely the households already carrying the most debt and the fewest buffers. Without complementary policies, AI-driven income disruption will accelerate debt dependence. For these reasons, households have had no choice but to borrow money, not to get ahead, but to stay in place.

"What was once an income-supported consumption system has evolved into a credit-supported survival system."

This crisis operates on several mutually reinforcing levels:

- The Wage-Productivity Gap: Typical workers have been largely excluded from the gains of a far more productive economy for nearly five decades.
- The Living Wage Shortfall: MIT's Living Wage Calculator estimates a single adult in San Jose needs \$37.93/hour for basic self-sufficiency — more than double California's

\$16.90 minimum wage. In Milwaukee, the living wage is \$22.02 against a \$7.25 minimum.

- The Household Debt Burden: Total household debt reached approximately \$18.8 trillion in 2025 Q4, including \$1.28 trillion in credit card debt alone (Federal Reserve Bank of New York, 2026). Required debt payments consumed 11.32 percent of disposable income — and climbing.
- The High-Cost Credit Trap: When income falls short, households turn to credit cards, payday loans, auto-title loans, and installment lenders — products that stabilize in the short term while compounding long-term fragility. In 2025, 7 percent of adults used a payday, pawn, auto-title, or tax-refund anticipation loan, with usage rising to 13–15 percent among several higher-use income and demographic groups. In the auto market, 30.9 percent of Q1 2026 trade-ins carried negative equity, with average monthly payments for underwater buyers hitting a record \$932 (Federal Reserve, 2026; Edmunds, 2026; Wall Street Journal, April 2026).
- The Household Debt Burden: When debt becomes unmanageable, households face an opaque, complex, and often punishing credit system. A household carrying \$30,000–\$37,000 in unsecured debt at 27%–30% APR making near-minimum payments can pay over \$96,000 in total — more than three times the original balance — and remain in debt for roughly three decades.

The Financial Stress Cycle

The system now follows a consistent and economically destructive pattern: income shortfall → borrowing → retrenchment → delinquency → reduced demand.

This is not merely a household budgeting problem. It is a macroeconomic transmission channel affecting retailers, lenders, housing markets, labor markets, and public fiscal pressures.

In 2025 Q4, 4.8 percent of outstanding household debt was in some stage of delinquency — a figure rising quarter over quarter. Credit card delinquency rates at commercial banks reached 2.94 percent, well above pandemic-era lows and trending higher (Federal Reserve, 2026).

Key Statistical Findings

92.4% vs. 33.6%	Productivity growth vs. typical worker pay growth, 1979 Q4–2025 Q4 (EPI, 2025)
\$18.8 trillion	Total household debt in the New York Fed consumer credit framework, 2025 Q4
11.32%	Household debt service as a share of disposable income, 2025 Q4 — and rising
\$37.93 / hr	Living wage needed for a single adult in San Jose, CA — vs. \$16.90 minimum wage
13%–15%	Use of payday, pawn, auto-title, or tax-refund anticipation loans among higher-use groups in the most recent Federal Reserve household survey — including adults with family income below \$25,000, adults with family income of \$25,000–\$49,999, Black adults, Hispanic adults, adults with disabilities, and adults in low- or moderate-income neighborhoods — compared with 7% of adults overall (Federal Reserve, 2026)
~\$96,000+	Illustrative total repayment cost for \$30K–\$37K in unsecured debt at 27–30% APR under minimum payments

What Must Change

A durable policy response must be comprehensive. Piecemeal consumer-finance fixes cannot solve a problem rooted in the interaction of wages, prices, and leverage.

A financially healthy consumer sector is a precondition for durable growth, stable credit markets, and broad-based economic legitimacy.

- Reconnect wages to productivity through policies that increase labor market competition, expand worker mobility, and share productivity gains more broadly
- Reform housing costs directly — expanding supply, modernizing zoning, and aligning subsidies with affordability

- Strengthen credit market resilience — greater pricing transparency, earlier hardship modifications, and reduced dependence on penalty-fee revenue models
- Improve access to debt relief — encourage economically coherent pathways out of unsustainable debt such as expanded access to federally regulated debt settlement and improvements to the tax treatment of forgiven debt
- Build AI-transition policy before displacement translates into new debt dependence — workforce support, portable benefits, income stabilization

I. Historical Context: The Wage-Productivity Disconnect

From the end of World War II through the early 1970s, broad-based productivity growth and typical worker compensation generally moved together. That relationship underwrote the expansion of the middle class, household formation, homeownership, and the widespread belief that economic growth would be broadly shared.

The late 1970s marked a decisive break. EPI's productivity-pay tracker shows that from 1979 Q4 through 2025 Q4, productivity increased 92.4 percent while hourly pay for typical workers increased only 33.6 percent — productivity grew roughly 2.7 times as fast as typical pay over that period (EPI, 2025).

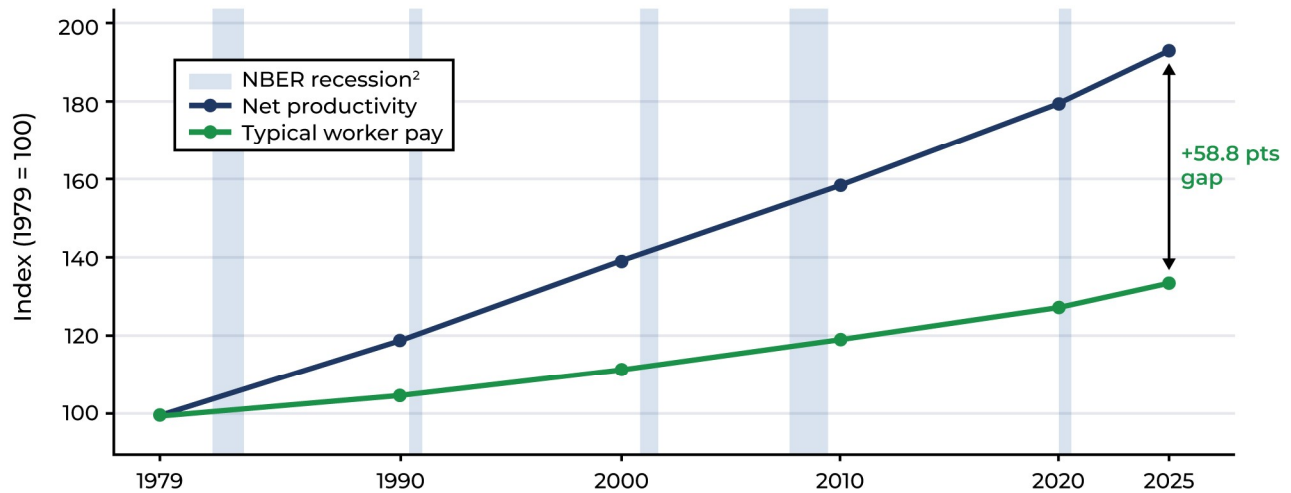
The divergence reflects a structural reallocation of economic gains away from typical labor compensation and toward capital income, profits, and higher-end compensation. Several forces explain this:

- Globalization increased competitive pressure on labor-intensive sectors and weakened the leverage of workers in industries previously protected by domestic concentration (Autor, Dorn & Hanson, 2016).
- Skill-biased technological change raised returns to highly educated and asset-owning workers while reducing demand for many middle-skill occupations. Automation can reduce employment and wages in exposed labor markets even when it raises aggregate productivity (Acemoglu & Restrepo, 2020).
- Weakening labor-market institutions: The union membership rate was 10.0 percent in 2025, far below the private-sector rates that prevailed during decades when productivity gains were more broadly shared (BLS, 2026). Framing this as a labor market competition issue rather than a partisan debate, the practical consequence is reduced worker bargaining capacity.
- Shareholder primacy and financialization: Corporate governance shifted toward dividends and buybacks rather than broad-based investment in workers (Lazonick, 2014; Krippner, 2011).

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The wage-productivity gap is therefore an institutional outcome, not a neutral market inevitability. When productivity and pay separate for decades, households must find other ways to fund living standards. Debt, dual incomes, lower savings, and delayed household formation all become mechanisms of adaptation.

Figure 1. Productivity has far outpaced typical worker pay (1979-2025)



Source: Economic Policy Institute productivity-pay tracker Q4 benchmarks.

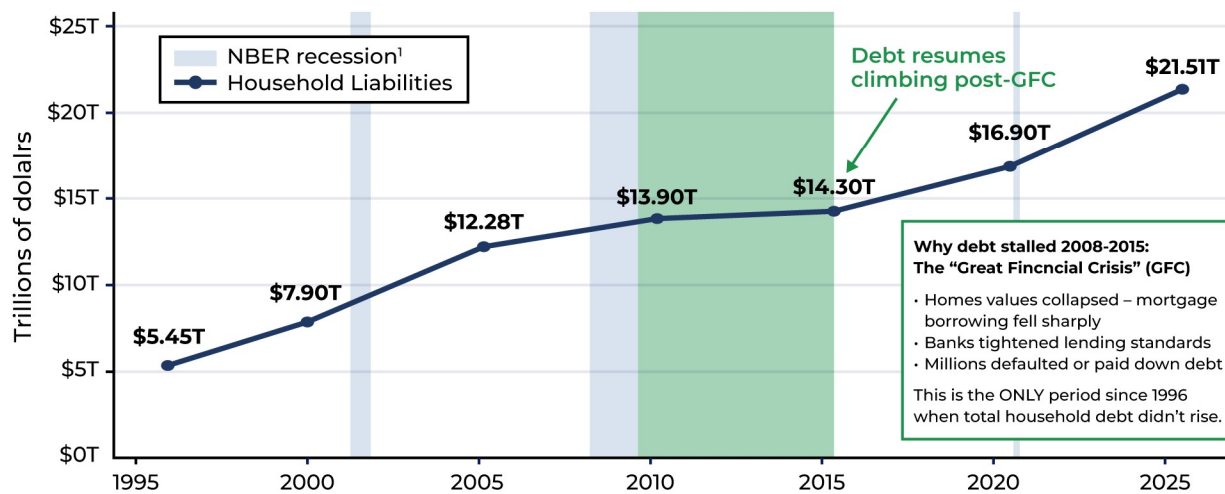
² Shaded areas reflect official U.S. recession periods as designated by the National Bureau of Economic Research (NBER). nber.org/research/business-cycle-dating

II. The Expansion of Household Debt

Household debt has become the primary balancing mechanism for an economy in which earned income often fails to cover the real cost of participation. In the Federal Reserve's broad Financial Accounts framework, household and nonprofit liabilities reached \$21.51 trillion at year-end 2025, up from roughly \$5.45 trillion at year-end 1996 (Federal Reserve, 2026, TLBSHNO).

In the New York Fed's consumer credit framework, household debt reached approximately \$18.8 trillion in 2025 Q4 — up \$4.6 trillion since the end of 2019 (FRBNY, 2026).

Figure 2. Total household liabilities nearly quadrupled since 1996

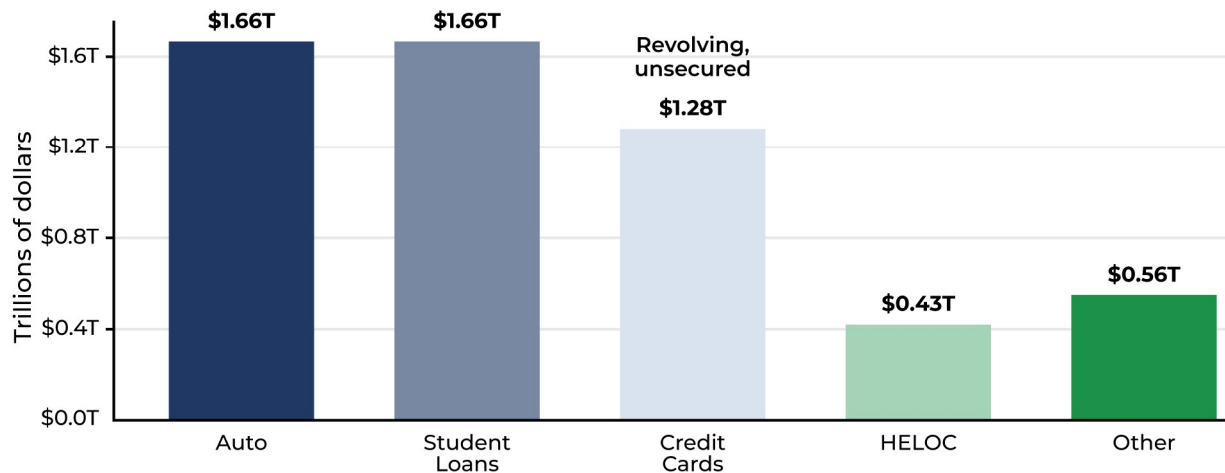


Source: Federal Reserve Financial Accounts (Z.1) / FRED series TLBSHNO. Shaded blue areas reflect official U.S. recession periods as designated by the National Bureau of Economic Research (NBER). nber.org/research/business-cycle-dating

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According to the FRBNY Q4 2025 report, the composition of debt breaks down as follows: mortgage balances totaled \$13.17 trillion; auto loans and student loans each totaled \$1.66 trillion; credit card balances reached \$1.28 trillion; HELOCs totaled \$433 billion; and other consumer loans \$564 billion. Non-housing debt has become increasingly consequential for monthly cash flow.

Figure 3. Non-mortgage household debt by category, 2025 Q4

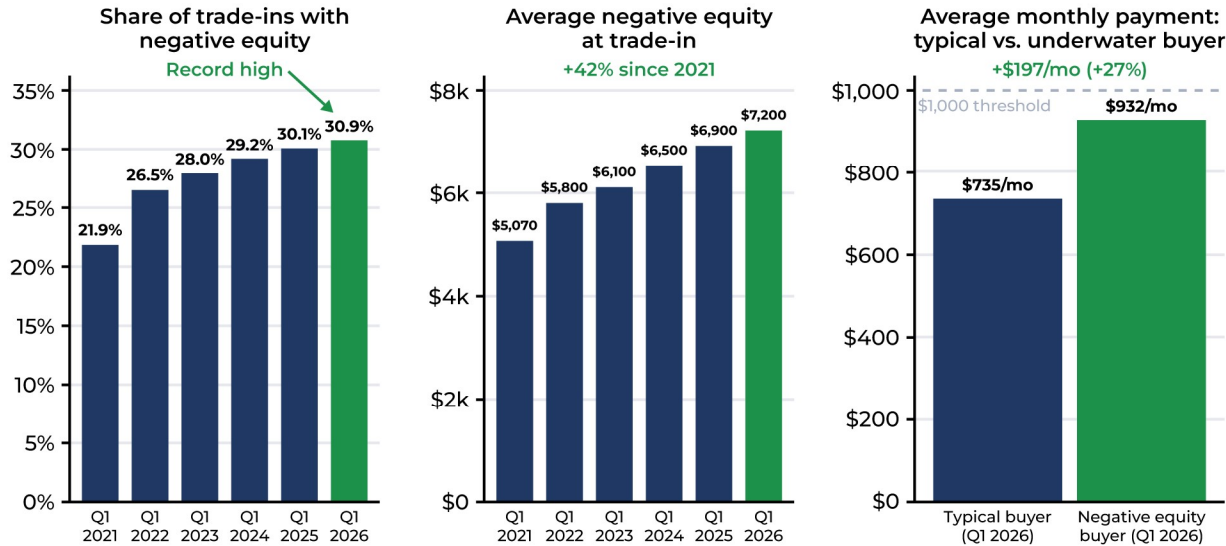


Source: Federal Reserve Bank of New York, Quarterly Report on Household Debt and Credit, 2025 Q4. Mortgage debt (\$13.17T) excluded to show non-mortgage categories, which total \$5.60T; credit-card balances are revolving, unsecured, and carry the highest interest rates.

Debt growth does not necessarily mean wealth creation. Borrowing increasingly serves defensive purposes: bridging rent burdens, covering medical bills, replacing volatile income, financing transportation to work. Under those conditions, borrowing functions less as investment and more as a substitute for wage adequacy.

Another area of concern is the auto loan market. The auto loan market is now bearing the full weight of the pandemic pricing bubble. In Q1 2026, 30.9 percent of trade-ins carried negative equity which is the highest share in several years. The average amount owed at trade-in reached \$7,214, a 42 percent jump from five years prior. For buyers rolling that debt into a new loan, the consequences are severe: Edmunds data shows these borrowers financed an average of nearly \$56,000, roughly \$12,000 more than a typical buyer, producing average monthly payments of \$932, the highest ever recorded. Average loan terms reached 70 months in Q1 2026, with some stretching beyond eight years. As Edmunds put it: 'Many consumers who rolled debt into their last purchase are now finding there is no easy exit as they've been carrying the cost of pandemic-era prices into an already expensive market.' (Wall Street Journal, April 2026; Edmunds, 2026.)

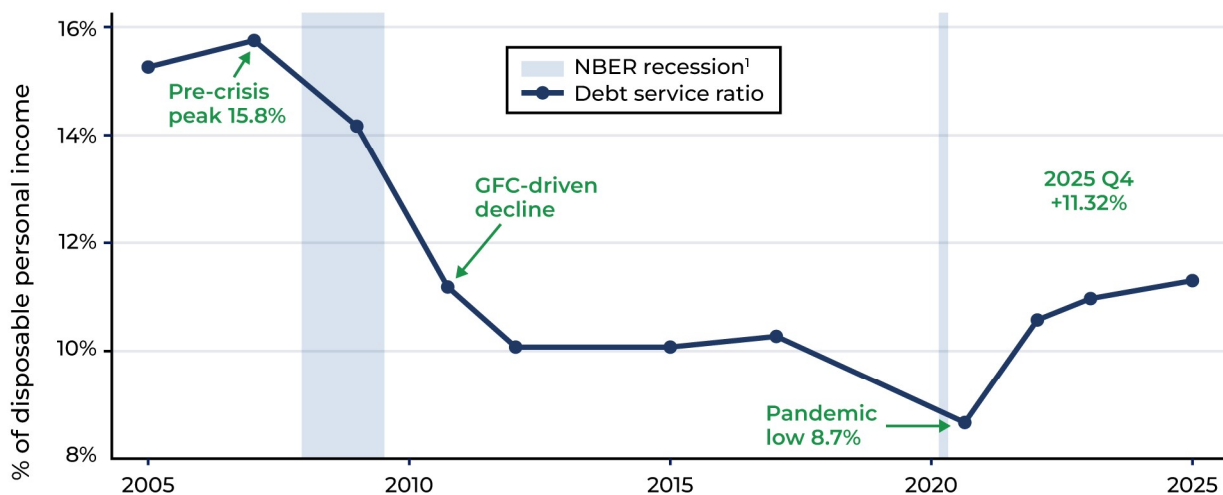
Figure 3a. The pandemic auto debt trap: negative equity metrics, Q1 2021-Q1 2026



Source: Edmunds Q1 2026 data, as reported by The Wall Street Journal (April 2026) and U.S. News (April 2026).

The debt service ratio provides broader context. Required household debt payments consumed 15.0–15.8 percent of disposable income in the mid-2000s, fell after the financial crisis, dropped further during the pandemic period, and then began rising again — reaching 11.32 percent in 2025 Q4 (Federal Reserve, 2026, TDSP). That burden remains below the pre-2008 peak, but the trend has reversed direction.

Figure 4. Debt service burden: fell during recessions, rising again without one



Source: Federal Reserve / FRED series TDSP. Shaded areas reflect official U.S. recession periods as designated by the National Bureau of Economic Research (NBER). nber.org/research/business-cycle-dating

Debt becomes destabilizing when it scales faster than disposable income and when its growth reflects the financing of necessities rather than the accumulation of productive assets.

III. Rising Delinquencies and Financial Distress

Delinquency data offer one of the clearest real-time windows into consumer strain because they capture the point at which financing structures stop functioning as intended. The 2025 Q4 New York Fed report noted that 4.8 percent of outstanding household debt was in some stage of delinquency, 0.3 percentage points higher than in the prior quarter (FRBNY, 2026).

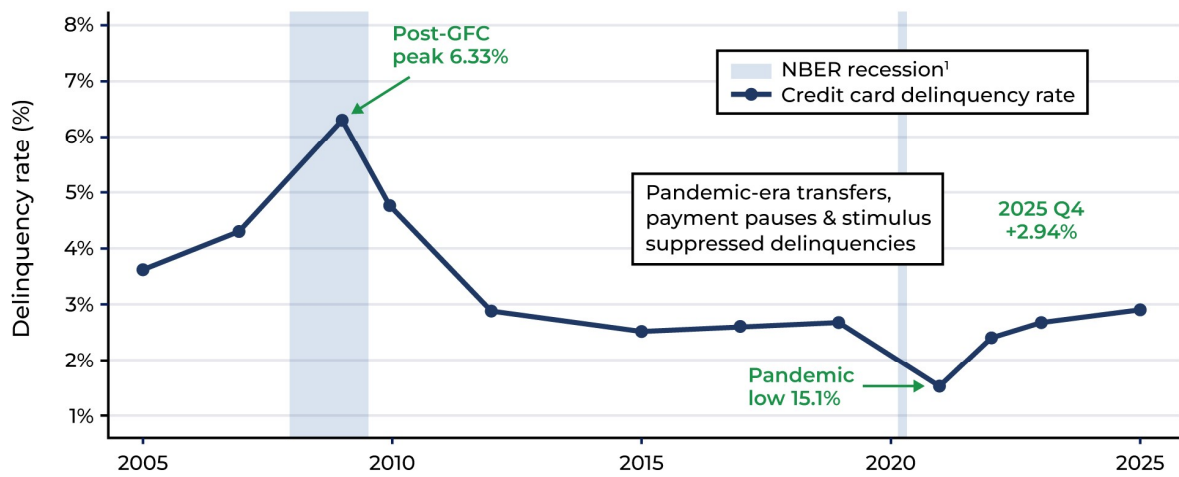
For bank credit cards, the delinquency rate stood at 2.94 percent in 2025 Q4 — below the post-financial-crisis peak of 6.33 percent in 2009 Q4, but materially above the extraordinary pandemic-era lows of 1.53 percent in 2021 Q3 (Federal Reserve, 2026, DRCCLACBS). A rate below the 2009 peak does not imply benign conditions. The pandemic temporarily distorted repayment behavior through transfers, payment pauses, and modified lender practices.

The CFPB's analysis of credit card late fees underscores the uneven distribution of distress. Repeat late fees are concentrated among economically vulnerable borrowers and disproportionately affect consumers in low-income and majority-Black neighborhoods (CFPB, 2022).

Financial stress is not experienced as a neutral average — it is amplified where cash-flow volatility is greatest and where households have the least ability to absorb fees, credit-score deterioration, and collection pressure.

Delinquency is best understood as a lagging symptom of an earlier problem: the breakdown of cash-flow resilience. By the time balances become 30 or 90 days past due, the household has often already exhausted easier adjustments — cutting discretionary spending, drawing down savings, or shifting balances between products.

Figure 5. Credit card delinquency: spikes in recession, now rising without one



Source: Federal Reserve / FRED series DRCLACBS. Shaded blue areas reflect official U.S. recession periods as designated by the National Bureau of Economic Research (NBER). nber.org/research/business-cycle-dating

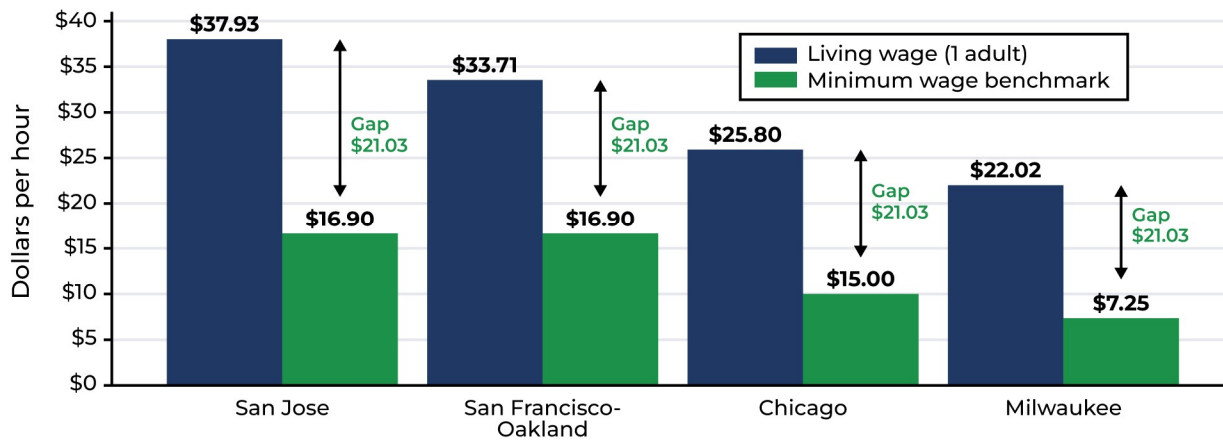
IV. The Living Wage Gap

Median and average income statistics can obscure whether households can actually cover basic costs in a specific place. The MIT Living Wage Calculator addresses that problem by estimating location-specific expenses for food, housing, transportation, healthcare, internet, civic participation, and taxes across multiple household types (Glasmeier, 2026).

Metro Area	Living Wage (1 adult)	Minimum Wage Benchmark	Annual Housing Cost (1 adult)	Gap: Living Wage vs. Min. Wage
San Jose, CA	\$37.93	\$16.90	\$31,440	124%
San Francisco-Oakland, CA	\$33.71	\$16.90	\$27,462	99%
Chicago, IL	\$25.80	\$15.00	\$17,251	72%
Milwaukee, WI	\$22.02	\$7.25	\$12,387	204%

Source: MIT Living Wage Calculator metro pages, February 15, 2026 update. Gap column = (living wage – minimum wage) / minimum wage.

Figure 6. Living wage vs. minimum wage by metro area



Source: MIT Living Wage Calculator, February 15, 2026 update.

Housing is the largest single driver. MIT's metro tables show annual housing costs of \$31,440 for a one-adult household in San Jose, \$27,462 in San Francisco-Oakland, \$17,251 in Chicago, and \$12,387 in Milwaukee. The Harvard Joint Center for Housing Studies similarly documents a persistent national affordability crisis: elevated prices and mortgage rates continue to keep ownership out of reach for less affluent households (JCHS, 2025).

The living wage gap is the bridge concept linking labor-market outcomes to household leverage. It explains why working households can remain financially distressed even when headline employment is strong. A nominal wage increase in a high-cost labor market does not necessarily improve real stability if housing, transportation, childcare, insurance, and taxes absorb the gain.

V. The High-Interest Credit Trap

High-cost credit products provide short-term liquidity but impose long-term costs. When households use credit to fund recurring necessities and revolve balances at high annual percentage rates, the products become mathematically punitive. Small cash-flow deficits compound into long-duration obligations because minimum-payment structures extend payoff periods while preserving interest revenue.

Credit Cards: Monetizing Financial Fragility

A household carrying a \$6,000 balance at a 30 percent APR making near-minimum payments can remain indebted for well over a decade and pay total interest that rivals or exceeds the original principal. The problem is not individual decision-making; it is the interaction between high rates, fee structures, and households that have limited alternatives.

For a growing number of households, the credit card debt trap is not hypothetical—it is a recurring monthly reality.

The damage is not evenly shared. Late fees and repeat late fees fall most heavily on borrowers in low-income and majority-Black neighborhoods — precisely the households least able to absorb them — so the cost of falling behind is layered on top of the cost of the debt itself (CFPB, 2022).

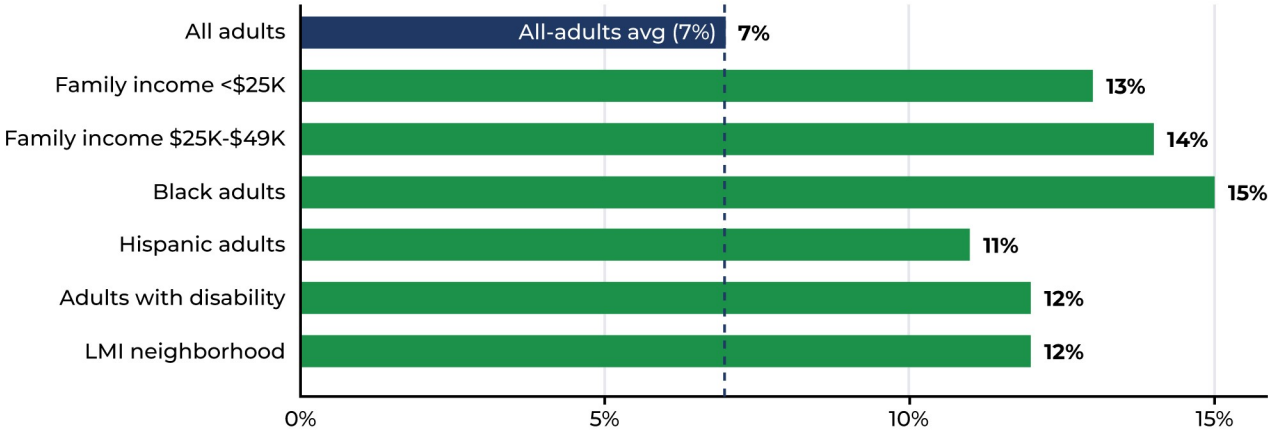
For these borrowers, a single missed payment can trigger penalty pricing, a lower credit score, and collection pressure, each of which makes the next payment harder to meet. The result is a cycle in which the households under the most strain pay the most to stay in it. The credit-card market frequently profits from volatility. Households that can pay in full each month use credit efficiently; households that cannot become fee and interest generators.

High-Cost Lending: Targeting Vulnerability

The high-cost credit ecosystem extends well beyond credit cards. Payday lenders, auto-title lenders, and installment lenders serve households that have exhausted conventional credit — but often at rates and terms that make recovery structurally difficult.

The Federal Reserve reported that in 2025, 7 percent of adults used a payday, pawn, auto-title, or tax-refund anticipation loan, up 1 percentage point from the prior year. Use was higher among several income and demographic groups: 13 percent of adults with family income below \$25,000, 14 percent of adults with family income of \$25,000–\$49,999, 15 percent of Black adults, 11 percent of Hispanic adults, 12 percent of adults with a disability, and 12 percent of adults in low- or moderate-income neighborhoods reported using one of these products (Federal Reserve, 2026).

Figure 7. High-cost loan usage concentrated among higher use groups (2025)



Source: MIT Living Wage Calculator, February 15, 2026 update.

Payday Lending: The Debt Cycle in Practice

Borrowers often take out multiple loans in sequence, using new borrowing to cover repayment gaps and accumulating fees that can exceed the original principal. What begins as short-term liquidity support becomes a repeated borrowing cycle. The structure of payday lending does not simply reflect financial distress — it can institutionalize it. Payday and similar high-cost products concentrate where liquidity is thin, banking access is limited, income volatility is high, and households have fewer lower-cost alternatives.

Current Events: Enforcement and Legal Action

Bipartisan concerns about high-cost installment lending have recently moved from policy debate to the courtroom. In March 2026, a bipartisan coalition of 13 state attorneys general, since joined by six more, sued OneMain Financial, alleging that the company placed unwanted add-ons into loans and charged hidden fees and interest. OneMain disputed the allegations (Associated Press, 2026; New York Attorney General, 2026). The action underscores growing bipartisan recognition that certain high-cost installment lending structures can add to systemic household instability.

The distributional implications are significant. High-cost credit does not affect households uniformly. It concentrates where alternatives are fewest, creating a feedback loop in which

the most financially vulnerable communities pay the highest effective rates — compounding the income-cost imbalances already documented in this paper.

Auto Lending and Credit Cards: Debt Layering in Action

Auto lending shows debt layering at its most visible, but the cycle does not end at the dealership — it ends on the credit card. The pandemic created a car-buying bubble: supply-chain shortages drove new-vehicle prices to historic highs, and buyers who financed at those prices now owe far more than their cars are worth. In Q1 2026, 30.9 percent of trade-ins carried negative equity — the highest share in several years — with the average shortfall reaching \$7,214, a 42 percent jump from five years earlier (Wall Street Journal, April 2026; Edmunds, 2026). Borrowers routinely roll those unpaid balances into a new loan at current rates, producing record payments and loan terms stretching beyond eight years.

But the deeper problem is where the shortfall ultimately lands. Auto debt is only the most photogenic layer. When negative equity, rising insurance, and stretched payments consume a household's budget, the gap does not disappear — it migrates to the one form of credit that requires no collateral and is always available: the credit card.

The distribution of this strain is K-shaped. Affluent households can absorb a bad trade-in or a high APR; lower- and middle-income households often cannot and end up cycling the residual debt onto cards with no clear path out. What looks like an auto problem is, for the household, a growing pile of unsecured, high-interest debt.

Together, revolving credit, installment debt, payday lending, and rolled-over auto loans are facets of a single dynamic: short-term stabilization mechanisms that deepen long-term fragility. And they converge on the same endpoint — unsecured credit-card debt, the layer with the highest rates, the fewest protections, and no collateral to surrender. This is not a story about consumer irresponsibility. It is a system in which income volatility and cost pressure are increasingly monetized through debt, and in which the card is where the bill finally comes due — which is precisely the debt the next section turns to resolving.

VI. Choosing the Right Path Out

When unsecured debts become unmanageable, households generally face a limited set of resolution paths. Each carries tradeoffs in cost, duration, credit impact, legal protection, tax treatment, and psychological burden. The policy question is not which pathway is universally superior — it is whether the current system provides households with transparent, low-friction, economically coherent pathways out of unsustainable debt. These paths include continued minimum payments, credit counseling and debt management plans, debt settlement (also called debt relief), and bankruptcy. Debt settlement is a federally regulated option — governed by the Federal Trade Commission's Telemarketing

Sales Rule — in which a provider negotiates with creditors on the consumer's behalf to reduce principal balances and limit the further accrual of interest and penalties. Many consumers who enter debt settlement already have impaired credit, including delinquencies and charge-offs. While the settlement process may have a credit impact at the start of the program, this is often a result of pre-existing credit damage.

Like every option discussed here, there are tradeoffs, which the comparison below sets out. Among these options, debt settlement and bankruptcy reduce the principal owed, while credit counseling and debt consolidation lower the interest rate or restructure payments but repay the balance in full.

Understanding the Costs: A Representative Household

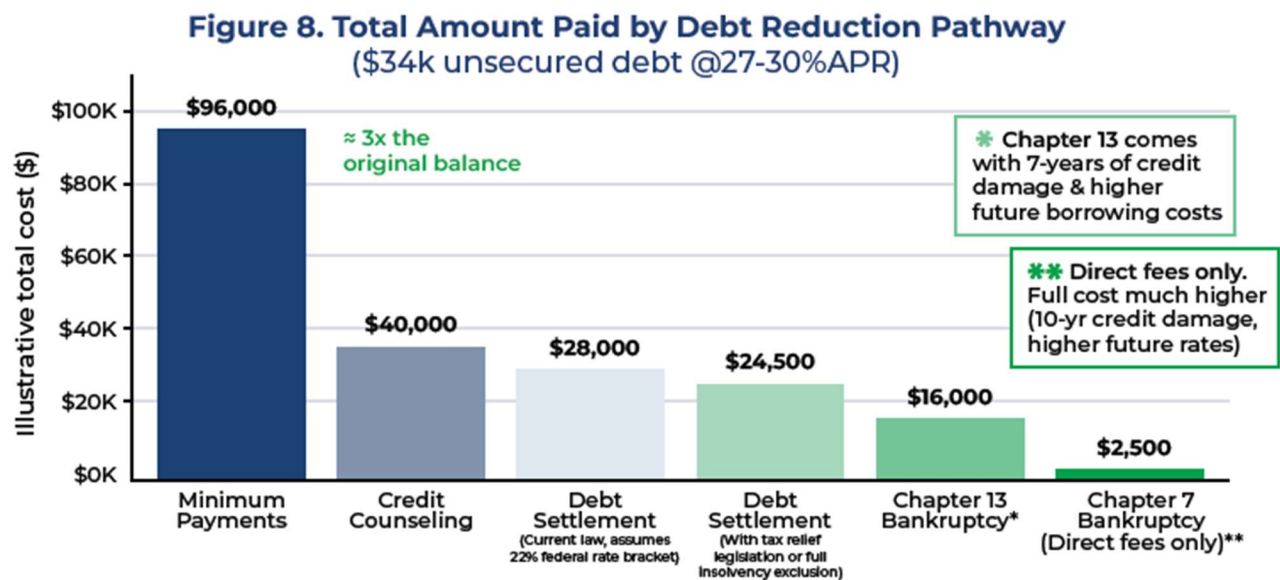
The comparisons below are modeled for a representative household carrying \$30,000–\$37,000 in unsecured debt at average interest rates of approximately 27–30 percent APR, with limited savings and moderate-income stability. This profile is increasingly common.

The below table assumes \$30,000–\$37,000 in unsecured debt at 27–30% APR. Minimum-payment totals assume the most common issuer formula — the greater of \$35 or 1% of the balance plus that month's interest and fees — at 27% APR, under which a \$30,000 balance takes roughly 30 years to repay; totals rise with the balance and at higher APRs (about \$128,000 on \$37,000 at 30%). Figures illustrate the structural cost of minimum-payment dependence; in practice accounts typically default or charge off well before payoff. Settlement reflects typical 40–60% principal repayment plus fees.

Chapter 7 direct fees of \$1,500–\$3,500 reflect attorney and filing costs only — they do not include the full economic cost of a 10-year credit impairment, higher future borrowing rates, insurance and rental screening consequences, or reduced financial flexibility. The total economic impact of Chapter 7 is substantially higher than the direct fee figure. Debt settlement outcomes (~50% average principal write-down on enrolled balance; gross fees ~22% of enrolled balance) and the bankruptcy and debt-management comparisons draw on Dobbie (2021), a Harvard Kennedy School analysis of ~450,000 debt-settlement enrollees commissioned by the American Fair Credit Council; that study observes only enrollees and cannot establish the causal effect of settlement.

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Resolution Path	Illustrative Total Cost*	Key Advantages	Key Drawbacks	Best Suited For
Minimum payments (status quo)	~\$96,000+	Avoids default; no court process	Extremely high total cost; debt drags for 10+ years	Short cash squeeze
Credit counseling / debt management plan	~\$37,500–\$42,500*	Reduces interest (often to ~6%); structured plan; no court process	Repays 100% of principal (interest reduced, not principal); \$25–\$125/mo fees; 48–60 mo; covers only participating credit-card debt — excludes medical and most student loans; elevated non-completion	Manageable debt at high APR; income to repay full principal
Debt settlement (current law, assumes 22% federal tax rate bracket)	~\$25,000–\$31,000	Reduces principal; 2–4 yr resolution	Fees ~20–25%; credit impact; tax liability on forgiven debt	Moderate unsecured debt
Debt settlement (with tax relief legislation or full insolvency exclusion)	~\$22,000–\$27,000	Same as above, no taxable income on forgiven amount	Fees ~20–25%; credit impact	Moderate unsecured debt
Chapter 13 bankruptcy	~\$14,000–\$18,000*	Legal stay; structured plan; keep assets	3–5 yr plan; credit impact 7 yrs; ongoing court oversight	Income stability; assets to protect
Chapter 7 bankruptcy	~\$1,500–\$3,500 (direct fees only)*	Most debt discharged; fast (~4–6 months)	FULL COST includes: 10-yr credit damage, higher borrowing costs, insurance/rental screening, limited financial flexibility	Severe insolvency



Source: Modeled outcomes. Minimum-payment total assumes the most common issuer formula — the greater of \$35 or 1% of the balance plus interest — at 27% APR (~30-year payoff). Debt settlement reflects Dobbie (2021).

A Critical Note on Bankruptcy's Long-Term Impacts

Chapter 7 bankruptcy may appear dramatically cheaper in direct fee comparisons — typically \$1,500–\$3,500 in attorney and filing costs. This comparison is misleading. The full economic cost of bankruptcy includes a 10-year negative credit record, materially higher future borrowing rates, adverse outcomes in rental and insurance screening, and significant constraints on financial flexibility. Chapter 7 shifts cost from immediate repayment into long-term economic constraints that are real but less visible in simple comparisons.

Chapter 13 bankruptcy, by contrast, involves a structured repayment plan over three to five years and may better fit households with stable income, secured debt, or assets they seek to preserve. Understanding these distinctions matters: the right choice depends on income stability, asset position, creditor mix, and the household's ability to tolerate short-term credit deterioration.

To make the distinction concrete: a Chapter 7 discharge typically eliminates roughly 90 to 100 percent of eligible unsecured debt, but it is available only to filers who pass a means test tied to state median income, so higher-earning households are frequently ineligible. Chapter 13 — the consumer reorganization chapter (Chapter 11 is used primarily by businesses) — instead repays a portion of unsecured debt through a three-to-five-year, court-supervised plan, with roughly 60 to 70 percent of unsecured balances ultimately discharged. This is why bankruptcy can appear inexpensive in a side-by-side cost chart: the

chart captures only filing and attorney fees, not the means-test eligibility limits or the multi-year credit and access consequences described above. Readers should weigh who qualifies for each path, not just its headline cost.

A Note on Credit Counseling Program Structure

Credit counseling services and debt management plans are debt-resolution pathways available to households with credit-card-concentrated debt. The initial counseling session is often free, agencies are usually organized as nonprofits, and a debt management plan may lower interest rates or extend payment timelines while requiring repayment of 100 percent of principal over a fixed term.

Many credit counselors market their services as a “nonprofit” alternative to debt relief programs. This does not mean that credit counseling is a no-cost option for enrollees to reduce their debt.

In fact, these nonprofits are funded through monthly fees paid by program participants. In many programs, creditor "fair share" contributions are tied to amounts repaid through the plan, and state credit-services statutes generally require disclosure of creditor compensation. (Federal Trade Commission).

Scenarios: Matching Households to Resolution Paths

Scenario A: Moderate Income, Manageable Cash Flow → Debt Settlement Candidate

Profile: ~\$18,000 in credit card debt, limited savings, stable but modest income. Monthly cash flow can support a defined contribution to a structured settlement over 2–4 years.

Outcome: Principal reduction without court filing. Short-term cost is credit deterioration and potential tax complexity. Medium-term benefit is a clear path to resolution. Under tax reform that excludes forgiven debt from income, eliminating tax liability on forgiven debt would meaningfully improve net outcomes for this profile.

Scenario B: Severe Insolvency, Collection Pressure → Bankruptcy Candidate

Profile: Multiple accounts already charged off, irregular income, active collection pressure, no realistic capacity to fund settlement contributions.

Outcome: A legal stay and potential debt discharge can stop a downward spiral that informal negotiation cannot. Despite severe credit impact, Chapter 7 may provide the only viable reset. The full economic cost — years of credit impairment, higher future rates — must be weighed honestly against the alternative of continued collection escalation.

Scenario C: Student Debt-Dominant Profile → Administrative or Policy Solution Required

Profile: Financial distress driven primarily by student loans, which are generally difficult to discharge in bankruptcy.

Outcome: Traditional unsecured debt settlement does not reach the core problem. This borrower needs an administrative repayment pathway, income-driven repayment adjustment, or targeted policy solution. Applying standard debt resolution logic to student-debt-driven distress leads to misdiagnosis.

Scenario D: Housing-Burdened but Current → Upstream Intervention Needed

Profile: A renter household that is current on all debt but severely housing-cost burdened — spending 40–50% of gross income on rent. Appears healthy in conventional credit metrics.

Outcome: One income shock away from serious delinquency. For this household, rental stabilization, utility assistance, or wage support is more appropriate than debt restructuring. Conventional debt resolution tools address symptoms, not cause.

The Tax Treatment Problem

Under current federal rules, canceled debt is generally treated as taxable income unless an exclusion applies — such as bankruptcy or documented insolvency. Many households who enter settlement are functionally insolvent, but documenting the exclusion is complex, and the risk of a tax bill reduces the real value of the settlement (IRS, 2025).

To illustrate: a household carrying \$30,000–\$37,000 in unsecured debt that settles at 50 cents on the dollar and pays fees of roughly 22 percent of the enrolled balance faces a total out-of-pocket cost of approximately \$22,000–\$27,000. Under current law, if no exclusion applies, the forgiven principal—\$15,000–\$18,500—is treated as taxable income. At a 22 percent marginal tax rate, that adds an estimated \$3,300–\$4,070 in federal tax liability, bringing the effective total cost to roughly \$25,000–\$31,000, while still realizing a net savings on the household's debt. A household that qualifies for the insolvency exclusion under IRC Section 108 and correctly files Form 982 may owe nothing on that forgiven amount—but the documentation burden is real, and the exclusion is not automatic.

Recent legislative proposals would address this directly by expanding the discharge-of-indebtedness exclusion under IRC Section 108(a)(1)(E) for individual taxpayers, effective for debt forgiven after December 31, 2026. If a consumer's debt is forgiven because repayment is not economically feasible, treating that forgiveness as taxable income undermines the recovery pathway.

VII. Regional Inequality in Financial Stress

The consumer financial health crisis is national in scope but uneven in its regional expression. The same nominal wage or debt balance can imply very different stress levels depending on housing costs, labor-market composition, transportation needs, insurance costs, and the availability of local safety nets.

In high-cost coastal metros — particularly in California — the primary challenge is affordability. Housing absorbs a very large share of income, and even comparatively high nominal earnings may not create durable stability. Basic self-sufficiency for a single adult in San Jose requires a wage far above prevailing statutory minimums, and housing is the largest line item in the budget.

In Midwestern metros such as Milwaukee and Chicago, the challenge is different but no less serious. Housing costs may be lower, but wage levels can also be weaker, upward mobility may be more limited, and transportation needs may be higher when public transit cannot substitute for vehicle ownership.

The Sunbelt presents a third profile. Rapid population growth, rising insurance costs, infrastructure strain, and housing shortages have produced affordability pressures in markets once regarded as lower-cost alternatives — particularly in Florida, Texas, Arizona, and parts of the Southeast.

As housing costs consume a larger share of household income, many families have less cash available to cover everyday necessities such as groceries, utilities, transportation, and healthcare.

As a result, consumers often turn to credit cards to bridge the gap, causing high housing costs to contribute indirectly to growing unsecured debt burdens.

For policy design, regional variation means that one-size-fits-all interventions will underperform. National wage, credit, and tax policy matter, but local housing supply, transit access, zoning, insurance regulation, and labor-market conditions shape whether households can convert earnings into lasting stability.

VIII. Emerging Risk: Artificial Intelligence and Labor Market Disruption

AI is not simply a productivity driver. Without institutional adaptation, it becomes a force multiplier of household financial instability.

Artificial intelligence and automation are likely to reshape the labor market in ways that directly affect household financial stability. Previous waves of automation often concentrated pressure on lower-skill routine jobs or manufacturing occupations. Current AI systems are increasingly capable of augmenting or displacing administrative, analytical, professional-services, customer-service, coding, and middle-income knowledge work.

This introduces a new and broader form of risk: income volatility across a far wider segment of the workforce. In a household sector already characterized by limited savings buffers, high fixed costs, and reliance on credit, even temporary income disruption can accelerate families into the financial stress cycle described throughout this paper.

The Transmission Mechanism

AI may increase productivity and lower the cost of some goods and services. It may also create new categories of employment. But these benefits are unlikely to be evenly

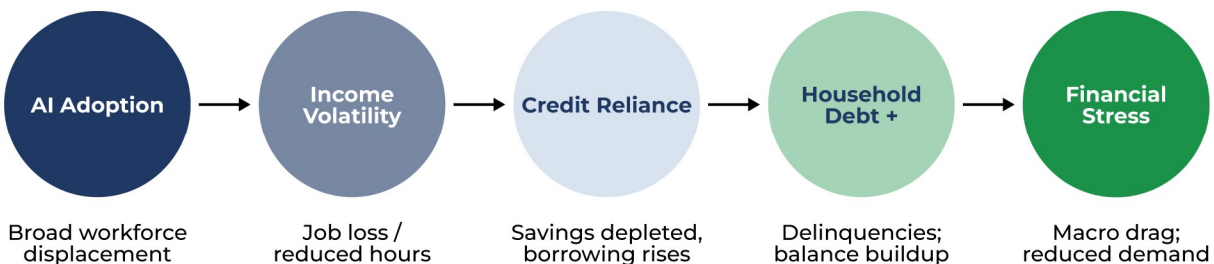
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distributed or immediately realized at the household level. The transmission mechanism runs as follows:

- AI adoption displaces or restructures roles across a broader range of income levels than previous automation waves
- Affected workers experience income volatility — temporary gaps, reduced hours, or permanent displacement
- Households with thin savings buffers turn to credit to bridge income gaps, increasing debt balances
- Rising debt-to-income ratios and delinquencies translate into reduced consumer demand and macroeconomic drag
- Without complementary policies — workforce transition support, portable benefits, income stabilization — the net effect is amplified household fragility

In that sense, AI does not merely affect employment; it directly influences household balance sheets by increasing the probability that income disruptions translate into debt accumulation. Without institutional adaptation that keeps pace with technological deployment, AI's productivity gains will be concentrated while its instability effects are broadly distributed.

Figure 9. AI as a force multiplier of household financial stress



Source: Author synthesis based on Acemoglu & Restrepo (2020).

Policy Implication

AI-transition policy — workforce retraining support, portable benefits, income stabilization mechanisms, and modernized consumer protections — must be designed proactively, before displacement translates into new debt dependence.

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Policy Implication

Once households enter the financial stress cycle, the options become more costly and the outcomes more constrained.

IX. Policy Implications and Structural Reforms

The evidence assembled in this paper points to a simple conclusion: piecemeal consumer-finance fixes cannot, by themselves, solve a problem rooted in the interaction of wages, prices, and leverage. An effective response must operate simultaneously on income formation, household expenses, credit design, and debt resolution systems.

Among the resolution tools available today, debt settlement is an established, federally regulated option that can produce substantial reductions in enrolled debt balances. As with any resolution strategy, outcomes vary based on a household's circumstances and participation, making proper matching to the most appropriate option critical.

Priority Reform Areas

1. RECONNECT PAY AND PRODUCTIVITY

Policies that increase labor market competition, reduce concentration-related labor frictions, expand worker mobility, and support productivity-linked compensation are central to reconnecting output growth with household living standards. The post-1970s divergence between productivity and pay is not merely a labor-market statistic; it is the upstream source of many downstream debt problems.

2. ADDRESS HOUSING COSTS DIRECTLY

Housing supply reform, zoning modernization, production of smaller and lower-cost units, and targeted subsidy redesign are essential. Without progress on shelter affordability, wage gains will continue to leak into rent and mortgage burdens.

3. REFORM CREDIT MARKET INCENTIVES

Greater transparency in all-in pricing, earlier hardship modifications, and tighter scrutiny of fee-based revenue models would help reduce the extent to which lenders profit from borrower fragility. Revolving credit and installment loans are necessary parts of the consumer finance system, but their most punitive features should not be the default mechanism by which households absorb ordinary volatility.

4. ENCOURAGE DEBT RELIEF PATHWAYS

Tax treatment of forgiven debt should better distinguish hardship resolution from ordinary income realization. Encourage transparent, low-friction, economically coherent pathways out of unsustainable debt such as expanded access to federally regulated debt settlement.

5. TREAT CONSUMER FINANCIAL HEALTH AS A MACRO INDICATOR

Household balance-sheet fragility affects spending, labor mobility, family formation, small-business formation, and credit-market stability. Debt service burdens, delinquency transitions, housing cost burdens, and living wage gaps belong on the country's broader financial-stability dashboard.

6. PREPARE FOR AI-RELATED INCOME VOLATILITY

Workforce retraining support, portable benefits, income stabilization mechanisms, and modernized consumer protections — must be designed proactively, before displacement translates into new debt dependence. Once households enter the financial stress cycle, the options become more costly and the outcomes more constrained.

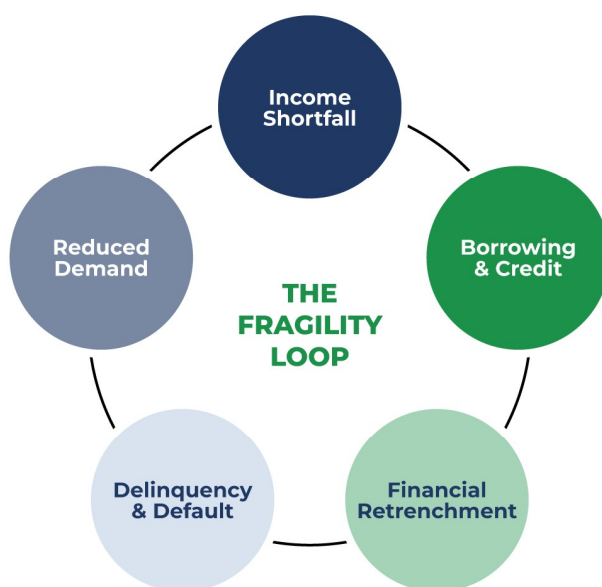
The window for proactive policy is before the wave, not after it.

X. Conclusion

The deterioration of consumer financial health in the United States cannot be explained by consumer choices alone, nor by any one product category, nor by any single inflation episode. It is the result of an economic structure in which the typical household has been asked to absorb rising costs with income growth that has lagged the economy's productive capacity for decades. Debt has filled the gap — but debt cannot permanently substitute for broad-based income growth.

That reality is visible in every major indicator examined here: the long-run productivity-pay divergence, the elevated stock of household liabilities, the renewed rise in debt service burdens, the persistence of revolving-credit distress, the mismatch between living wages and legal wage floors, and the regional concentration of affordability pressures. These are not isolated data points. They are parts of a single story.

Figure 10. The consumer financial fragility loop



Source: Author synthesis. Illustrative framework — not a statistical estimate.

A financially healthy consumer sector is not merely a social good. It is a precondition for durable growth, stable credit markets, and broad-based economic legitimacy. Restoring it should be treated as a national economic priority.

Appendix A. Metric and Data Notes

The debt measures used in this paper come from two overlapping but nonidentical frameworks. The New York Fed Consumer Credit Panel/Equifax series reflects debts appearing on consumer credit reports and is useful for balances by product type, originations, and delinquency transitions. The Financial Accounts measure of household liabilities is broader and ties more directly to macro balance-sheet analysis.

The debt service ratio should be interpreted as a required payment burden rather than a complete measure of financial pressure. It does not fully capture rent, insurance, childcare, utilities, or irregular medical expenses that crowd out debt service.

Living wage calculations are not poverty thresholds. They estimate the hourly earnings needed to cover a basic-needs budget in each geography and family configuration — making them more relevant than poverty guidelines when the policy question is whether a full-time worker can achieve self-sufficiency without persistent borrowing.

Appendix B. Metropolitan Cost Profiles

Metro Area	Living Wage (1 adult)	Minimum Wage Benchmark	Annual Housing Cost (1 adult)	Gap: Living Wage vs. Min. Wage
San Jose, CA	\$37.93	\$16.90	\$31,440	124%
San Francisco-Oakland, CA	\$33.71	\$16.90	\$27,462	99%
Chicago, IL	\$25.80	\$15.00	\$17,251	72%
Milwaukee, WI	\$22.02	\$7.25	\$12,387	204%

Source: MIT Living Wage Calculator metro pages, February 15, 2026 update.

Appendix C. Comparative Features of Major Distress Pathways

Resolution Path	Illustrative Total Cost*	Key Advantages	Key Drawbacks	Best Suited For
Minimum payments (status quo)	~\$96,000+	Avoids default; no court process	Extremely high total cost; debt drags for 10+ years	Short cash squeeze
Credit counseling / debt management plan	~\$37,500–\$42,500*	Reduces interest (often to ~6%); structured plan; no court process	Repays 100% of principal (interest reduced, not principal); \$25–\$125/mo fees; 48–60 mo; covers only participating credit-card debt — excludes medical and most student loans; elevated non-completion	Manageable debt at high APR; income to repay full principal
Debt settlement (current law, assumes 22% federal tax rate bracket)	~\$25,000–\$31,000	Reduces principal; 2–4 yr resolution	Fees ~20–25%; credit impact; tax liability on forgiven debt	Moderate unsecured debt
Debt settlement (with tax relief legislation or full insolvency exclusion)	~\$22,000–\$27,000	Same as above, no taxable income on forgiven amount	Fees ~20–25%; credit impact	Moderate unsecured debt
Chapter 13 bankruptcy	~\$14,000–\$18,000*	Legal stay; structured plan; keep assets	3–5 yr plan; credit impact 7 yrs; ongoing court oversight	Income stability; assets to protect
Chapter 7 bankruptcy	~\$1,500–\$3,500	Most debt discharged;	FULL COST includes: 10-yr credit damage, higher borrowing costs,	Severe insolvency

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Resolution Path	Illustrative Total Cost*	Key Advantages	Key Drawbacks	Best Suited For
	(direct fees only)*	fast (~4–6 months)	insurance/rental screening, limited financial flexibility	

* Assumes \$30,000–\$37,000 in unsecured debt at 27–30% APR. Minimum-payment totals assume the most common issuer formula — the greater of \$35 or 1% of the balance plus that month's interest and fees — at 27% APR, under which a \$30,000 balance takes roughly 30 years to repay; totals rise with the balance and at higher APRs (about \$128,000 on \$37,000 at 30%). Figures illustrate the structural cost of minimum-payment dependence; in practice accounts typically default or charge off well before payoff. Settlement reflects typical 40–60% principal repayment plus fees.

Chapter 7 direct fees of \$1,500–\$3,500 reflect attorney and filing costs only — they do not include the full economic cost of a 10-year credit impairment, higher future borrowing rates, insurance and rental screening consequences, or reduced financial flexibility. The total economic impact of Chapter 7 is substantially higher than the direct fee figure. Debt settlement outcomes (~50% average principal write-down on enrolled balance; gross fees ~22% of enrolled balance) and the bankruptcy and debt-management comparisons draw on Dobbie (2021), a Harvard Kennedy School analysis of ~450,000 debt-settlement enrollees commissioned by the American Fair Credit Council; that study observes only enrollees and cannot establish the causal effect of settlement.

Appendix D. Glossary of Key Terms

Productivity-pay gap	The divergence between growth in economy-wide productivity and growth in compensation for typical workers.
Debt service ratio	Required household debt payments as a percentage of disposable personal income.
Living wage	The hourly earnings required to meet basic needs in a given geography and family configuration.
Debt layering	The process of rolling unpaid prior balances into new borrowing, as in negative-equity auto loans.
Cancellation of debt income	Forgiven debt that may be treated as taxable income unless an exclusion applies.
Financial fragility loop	The sequence of income shortfall, borrowing, retrenchment, delinquency, and reduced demand.

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