

Cash's comeback overdue

Sam M. Ditzion

The age of easy consumer credit made for good times, with the guy next door showing off the new 52-inch plasma TV in his living room but struggling to pay the mortgage. But the party is over. And cash is making a comeback.

For years, consumer payment preference trends have steadily shifted away from cash and checks toward electronic alternatives, like credit and debit. Most notably, a perfect storm of ultra-convenience, attractive rewards, aggressive marketing, and old-fashioned greed flooded the vast majority of Americans with credit cards.

Now, as the consumer credit market continues to deteriorate, millions of people across the country are starting to migrate away from credit cards – either voluntarily or involuntarily – and go back to the novel philosophy of only spending money they actually have in the bank. That means cash, debit, or check. Sure, some consumers rely on credit cards for the sake of convenience and pay their balances in full each month. But, the vast majority of cardholders borrow some, if not most, of the money they charge. After all, credit card issuers make the bulk of their profits from interest income, finance charges, and late fees.

Many consumers have already maxed out their credit cards, and millions more will max-out in an attempt to stay afloat as the recession deepens and pink slips pile up. Furthermore, in an 11th hour attempt to mitigate risk, banks are aggressively tightening lending standards and notifying

millions of customers that their existing credit card limits have been substantially reduced. This phenomenon is all too familiar to sub-prime and prime borrowers alike.

For millions of Americans, credit will simply no longer be an option – at least for a few years. It will be back to the basics: living within one's means. Green is the new platinum.

Contrary to popular belief, cash is not obsolete. Even though the mix of electronic transactions has rapidly increased in recent years, cash still represents the dominant payment mechanism in the United States. In fact, over the past five years, the value of cash in circulation in the United States has actually grown at an average annual rate of approximately 4.22 percent. This rate of growth is low and essentially flat after accounting for inflation and population growth, but cash is still king.

The debit card, which offers the ability to draw from a checking account with the convenience of a credit card, will also benefit enormously from the consumer credit crisis. But some consumers still have concerns about fraud and liability. Furthermore, frequent debit cards swipers can fall prey to many of the same problematic spending behaviors associated with credit cards, such as spontaneous purchases and the sense that plastic isn't "real" money.

In fact, more and more people simply do not trust themselves with any type of plastic, credit or debit cards, and are removing them from their wallets altogether. Some families are starting to budget by withdrawing a finite

amount of cash from the ATM each week to pay for all of that week's expenses. Other families are reverting to the Depression-era monthly envelope system, placing cash in envelopes labeled rent, groceries, clothing, and so on. When it's gone it's gone.

Many readers may find these approaches rudimentary, but like it or not, a cash-only budgeting system might be the only thing that actually works for many Americans. In fact, nearly nine percent of families in the United States do not even have any kind of bank account and make all of their purchases in cash.

Many small businesses also prefer cash as a way to avoid hefty transaction fees. And cash drives the ever prolific under-the-table and underground economies. Without a paper trail, the opportunities for underreporting are endless.

We can expect a few painful years ahead. The sad truth is that many Americans were never taught the simple but critical lesson of only buying what you can truly afford.

But this crisis may very well present a golden opportunity. When the dust settles, millions of Americans will be smarter and savvier when it comes to their personal finances. Widespread financial irresponsibility got our country into this mess. Going back to basics will get us out of it.

Sam M. Ditzion is the CEO of Boston-based consulting firm Tremont Capital Group and an expert in the payments industry.