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Most people are paying off their credit card debt all wrong — are you?

By **Christopher Ingraham** January 2

There's a surefire way to pay off your credit card debt to maximize the money you keep in your pockets and minimize how much you have to pay to your credit card company.

Say you have two or more cards that you carry a balance on and you have a set amount of cash each month you can use to pay down all your cards. If you want to ensure you pay the smallest amount of interest, thus eliminating your debt the fastest, you have to do just two things: First, pay the minimum amount on each card. Second, dedicate all of your remaining money to the card with the highest interest rate.

Easy, right? As it turns out, the overwhelming majority of people are not paying their cards off that way.

In a [new study out of England](#), researchers analyzed repayment behavior among 1.4 million individual credit card holders, focusing on people with multiple credit cards with revolving balances (those people who don't pay off their balance every month). This sets up a situation in which individuals have to choose how to allocate their debt payments: Do they split payments between cards based on interest rates, or debt balance, or by some other factor?

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The nice thing about this scenario, from an economic perspective, is “optimal” behavior is clearly and unambiguously defined: “it is optimal for these individuals to make the minimum payment on both cards, repay as much as possible on the high interest rate card, and only allocate further payments to the low interest rate card if they are able to pay off the high interest rate card in full,” the researchers write.

When they dug into the data, the researchers discovered cardholders were doing something else.

While debtors should have been allocating close to 100 percent of their excess payments (over the minimum amount) to the highest APR card, instead they were devoting “only 51.5% of their excess payments to the high APR card, behavior that is virtually indistinguishable from the completely nonresponsive baseline.” It did not look like people were considering interest rates at all, in other words. Only 10 percent of the individuals in the study were devoting all their excess payment to the high-interest card.

This pattern held true regardless of the number of cards a person had. People were simply splitting their payments up between cards more or less evenly, regardless of the interest rate. As a result, many were losing hundreds of dollars or more to interest payments annually.

The average two-card household, for instance, was wasting the equivalent of \$90 a year on unnecessary interest payments because of how they split up their payments. For the average five-card household the waste added up to \$327 a year. The more debt they had, the more money they wasted: the top 10 percent of debt-holders with five or more cards were each throwing away over \$1,000 a year, simply by allocating their payments poorly.

If debtors weren't following the standard advice about high-interest balances, were they doing something else instead? Many financial experts, for instance, recommend paying off the smallest balances first, to nab an easy win and set up the discipline and motivation necessary to tackle the bigger balances. Maybe cardholders were doing something like this?

After running the actual distribution of payments against the distribution you'd expect to find for various payment models, the researchers found the model that best explained cardholders' behavior was something called “balance-matching”: “individuals match the share of repayments on each card to the share of balances on each card,” the researchers write.

Say a person owes \$10,000 on one card and \$5,000 on another and they have a total of \$1,500 to put toward both cards in a given month. Chances are they'll pay down \$1,000 on the larger card and \$500 on the smaller one, regardless of interest rates or any other concerns.

The researchers suspect they do this because balances are one of the first things we think of when we think about our credit cards — they are displayed prominently at the top of our monthly statements, often in big, bold print.

“The balance-matching heuristic naturally arises from the salient display of balances on credit card statements and the broad tendency for humans (and other species) to use 'matching' heuristics in decision-making,” the authors explain. “Individuals might make payments in relation to [these] saliently displayed balances (instead of less saliently displayed interest rates).”

Instead of following the experts, in other words, people just follow the big numbers on their statements.

One caveat is the data used in this study came from the United Kingdom, so American cardholders' behavior may be different. The authors note another recent study found similar behavior among cardholders in Mexico, suggesting non-optimal debt repayment may transcend country borders.

In the United States, more than 70 percent of households have at least one credit card, and as of 2016 44 percent of American families held some amount of revolving credit card debt. The U.K. study suggests many of these families are making hundreds or even thousands of dollars in unnecessary interest payments each year.

 **142 Comments**

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