Credit Cents

Credit: Is It a Tool or a Trap?

Used wisely, credit can be a valuable tool. By helping you accumulate assets, it can contribute to your financial future. Used poorly or abused, credit can be a trap. It can tie up future income and leave you with too many debts.

When you receive credit, you promise to repay the amount you borrowed, plus interest and other finance charges. Interest is the fee you pay for using another's money over time. It's an expense to the borrower but income to the lender. Your finance charges may also cover various debt-related services and insurance.

Types of credit

There are four types of credit:

- **Sales or installment credit** lets you buy goods. Car dealers, department stores, and furniture shops—among others—offer it.
- **Loans** of cash are usually available through a bank, credit union, or finance company. You typically use them to meet unexpected expenses, make major purchases, or pay off other debts.
- **Credit cards** allow you to have goods or services - and even cash—immediately. They're generally offered through banks but are also available from businesses and other types of financial institutions.
- **Service credit** is extended by doctors and utility companies.

Using credit: Advantages & disadvantages

It's important to understand the obligation you accept when you receive credit and take on debt. Knowing how much credit you can afford on a monthly basis and recognizing the "real" cost of buying on time are vital to your financial well-being. Credit is not "free" money. It is a commitment to repay the amount borrowed, plus interest and other fees.

Used appropriately, credit can give you financial advantages. Having and using credit has even become a necessary convenience: if you're going to rent a car or reserve an airline ticket or hotel room, you'll need a credit card.

The advantages of using credit are:

- You can build a solid credit history with the record of payments you create.
- You can get goods and services before you pay for them.
- You can make large purchases without waiting.
- You can meet emergency needs or get emergency cash.
- You don't need to carry large amounts of cash.

But using credit also has disadvantages:

- Credit usually costs money. You'll generally pay extra for the item you're buying because of the interest and finance charges.
- You're spending future income. You're living on money you expect to have down the road.
- If you lose your job or get sick and don't make the future income you expect, your inability to repay your debts will damage your credit rating.
- You may overspend. It's easy to lose track of how much you've spent when the bills don't come for a month.
- You may be tempted to buy on impulse because it doesn't feel like you're spending "real" money.
- You run the risk of ending up in a downward spiral of debt and even in bankruptcy.

Before you decide to use credit, ask yourself:

- Do I really need this item or can it wait until I have saved for it?
- What are the extra costs of buying this item on credit?
- Is having this item now worth those extra costs?
- Can I make the monthly payment as scheduled?
- To use credit now, what will I give up in the future?
- Will I be able to handle an emergency if one comes up?

Remember that when you use credit, you're agreeing to pay back the money you owe, plus finance charges. You're also agreeing to make each of your scheduled payments on time.

Figure out how much you can afford to repay each month. To avoid paying interest and other fees, pay your monthly bills in full. But if that's not possible, try to make more than the minimum payment.

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