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Should You Use Credit?[1]

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It is tragic to see the number of young people, who with the thrill of setting up a household, charge all of the nice things that took their parents years to obtain. They buy the merchandise with good intentions of paying for it, but they fail to take into consideration unexpected emergencies that can arise and take their money.

Changes in your family situation, such as unemployment or physical disability, can cause a reduction in personal or family income. As a result, your accounts can become past-due. Companies to whom you owe money start requesting payments, and you don't have the money. Frustration sets in, which frequently causes personal and family problems, simply because no one took the time to explain the functions of credit, and the pitfalls of using it unwisely.

Evidence shows young married couples who have knowledge of money management have a happier home life. Those who receive some schooling on handling credit will be faced with fewer delinquencies and bankruptcies.

What is Credit?

Credit allows you to obtain goods and services or money *now* in exchange for your promise to pay *later*. Credit is the present use of future income. Credit means using products and services before you pay for them. It is a buy-now-pay-later offer. You use credit when you charge it, finance it, buy on time, use an installment plan or put it on the credit card.

Every time you turn on your lights or use the telephone, you are using what is called *service credit*. Service credit is extended by your family doctor and others who send out statements at the end of the month for their services. When you use a credit card to fill your car's tank with gasoline or for hotel and motel service, you are also enjoying the convenience of service credit.

The term *consumer credit* refers to the use of credit by individuals or families for personal goods. Consumers in all age groups, income levels and occupations use consumer credit. You can use credit for large expenses, such as an education, a car, furniture, clothing or equipment. You might use this type of charge account credit for convenience in shopping. Most families who buy durable goods,

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such as automobiles, furniture and appliances, spread payments over a period of time using *installment credit*.

Credit, when carefully used, helps to make life more comfortable and enjoyable. However, when it is misused, credit can cause severe financial problems. You should add up the cost of credit and consider everything you have to give up to use it.

Using credit releases available cash for other purposes. Obviously, postponing payment for goods and services charged permits families to have a greater share of their current income available in cash. The day is probably approaching when all purchases can be computerized and made through credit arrangements; however, today's economy still requires cash for a variety of goods and services.

Cash or Credit?

Whether to pay cash or to buy on credit is a choice you may have to make each time you buy a good or service. The main family financial problem today is over-indebtedness according to a survey conducted by the Family Service Association of America. Because credit is fairly easy to get, it is difficult for some individuals and families to control their spending and stay within their income. Use self-discipline when deciding if a good or service is going to be purchased, and also when considering whether to use cash or credit.

What is a Reasonable Amount of Debt?

Many people try to carry too much debt. Both high and low income families have this problem. A high income suburban family can get over its head in debt just as easily as any working person's family.

There are several rough guides for determining what is a safe or reasonable amount of debt for you. One is to limit installment debts to 10 to 15 percent of your annual take-home pay, excluding your mortgage payment. If the annual take-home pay is $16,000, then the outstanding debt limit should be between $1600 and $2400.

You can determine whether you have over-extended yourself by answering these questions:

1. Are you committed to installment payments for more than a year?
2. Are you presently making payments totalling more than 20 percent of your disposable income?

A limit of how much debt a family can handle is hard to determine because each particular family situation is different. A large family with an average income cannot carry payments as high as a small family can. The purpose for using credit also has a bearing on how much debt is reasonable to assume.

How Do You Get Credit?

When you apply for credit, you are asking the lender to judge your ability to pay the debt. Your ability to pay will depend upon your income, where you live, which bank you use and what other credit accounts you have. If you have used credit in the past, your credit file, or credit history will be checked through a credit bureau. This file will tell what your reputation is for repaying your debts. A good credit reputation is very important to you as a consumer.

Your credit reputation is based on three factors:

1. *Capacity* — your ability to pay.
2. *Character* — your willingness to pay.
3. *Collateral* — your assets.

What is a Credit Bureau?

Credit bureaus are private firms that keep track of your past payment records and your present financial situation. This information is used by those considering giving you additional credit or a job to determine your credit reputation. The most important factor is your past record for paying debts. Lenders assume that if you have always paid on time in the past, you are likely to continue to do so.

Your credit history file follows you if you move to another city. Adverse information, such as unpaid bills, must be deleted after seven years. Information

of a bankruptcy must deleted after 10 years. Stores, banks and mortgage lenders can obtain access to your credit file if they are members of the credit bureau, or if they pay a fee to use the information for granting credit. Your credit file is also available to your present employer for such purposes as your promotion, reassignment or retention, as well as being available to a prospective employer. Your poor credit record could not only keep you from obtaining credit, but also from getting a job or promotion.

Information from your credit file can be given in the following circumstances:

- In response to a court order.
- If the consumer requests, in writing, that a report be made.
- If the person seeking information will use it for granting credit, collecting payments or reviewing your account.
- If the person seeking information will use it for employment purposes such as hiring, promotion, reassignment or retention.
- For an insurance policy application involving the consumer.

What Are Your Credit Information Rights?

The consumer has the right to bring suit against a credit reporting agency for willful or negligent non-compliance with this law, known as the *Fair Credit Reporting Act*. Any person who willfully obtains a credit report under false pretenses or furnishes such a report in violation of the law may be fined up to $5,000 or imprisoned for one year, or both.

The Fair Credit Reporting Act allows you to see what is in your file and to correct any mistake you find. It is a good idea to visit your credit bureau and find out what is in your file. If you find a mistake, the credit bureau will check the information. If you still do not agree with something in your file, you can give them a short letter (100 words or less) to explain the problem. This letter will become part of your credit file.

The *Equal Credit Opportunity Act* prohibits creditors from discriminating against applicants because of age, sex, race, religion, marital status, national origin, color or source of income. The Act gives a married woman the right to establish her own credit records based on jointly held accounts. As of 1977, creditors who provide information to credit bureaus on how you pay your bills must inform the bureaus of both names on accounts you share. The Act prohibits creditors from requesting that your spouse co-sign for individual, unsecured credit and thus, be liable for the debt. Also under the Act, a creditor cannot deny you credit because you have reached a certain age or have retired. However, a creditor can require a larger collateral, a larger down payment, or a shorter repayment period on a loan if you are an elderly person.

What Types and Sources of Credit Exist?

The various sources of credit include savings and loans associations, commercial banks, credit unions, insurance companies, financial companies and retail stores. The cost of credit differs among these sources, so you should compare the various costs.

In addition to various sources of credit, there are different types of credit. The major types are described here. It is important to learn what your long-term responsibilities will be before you select which source or type of credit to use.

Personal Loans

The personal loan is another widely used form of consumer credit. In its various forms, it may have aspects similar to both the charge account and the installment sales contract. The commercial bank is a source that people use most often. Banks are generally willing to loan larger amounts than many other financial institutions, and their interest rates are competitive.

Charge Accounts

You can get either a 30-, 60- or 90-day charge account in which you must pay the whole amount in a given time with no interest charged; or you can get a revolving charge account in which you may charge

up to a certain amount of money and pay a set minimum amount each month. For example, your limit might be $100 and you may have to pay at least $10 a month. These limits are determined by your income and your credit rating. The interest rate is usually about 18 percent per year.

Installment Sales

An installment sales contract usually applies to large items and involves repayment in stated amounts at specified times. A down-payment or trade-in is usually required. Furniture, large appliances and cars are often purchased this way. The yearly interest rate and finance charge are stated in the contract. You use the item while you are paying for it, but you do not really own it until all the payments are made.

You can finance your purchase or loan from the store, a bank, a credit union or a finance company.

Credit Cards

This is a contract between you and the credit card company. Once you have used a credit card, you have legally accepted the terms even though you have never signed a contract. Be sure you understand all the conditions of this contract before using the card.

If your card is lost or stolen, notify the company as soon as possible. You only have to pay $50 for the charges you did not make. The company cannot collect the $50 unless it has told you of this limit and sent you a postage-paid, return-addressed envelope for you to use in notifying them of your lost or stolen card. Companies are required by law to provide you with the envelope to notify them of the loss. Credit cards must bear some positive identification, such as your signature. You are not responsible for cards that have no identification, or for which you did not specifically ask.

After making a charge on your credit card, you have a *no-interest* period in which to pay the bill. This period begins on the day the bill was written, not on the day you receive the bill. If you do not pay before the due date, you must pay an extra finance charge. If your credit card has an interest rate of 1 1/2 percent per month, you are paying 18 percent interest per year.

What Are Your Responsibilities?

Consider your financial situation and ability to pay debts before you sign a credit agreement. Read the contract carefully before you sign it, and be aware of what the agreement requires you to do. Pay on time as designated in the contract. If for some reason you cannot make the payment on time, talk with your creditor. Pay the penalty noted in the contract for late payments, and accept any other consequences listed in the contract for not fulfilling the requirements. If you feel that the creditor has not explained the contract to you fully, report it in writing to the Federal Trade Commission in Washington, DC.