South Dakota State University
Open PRAIRIE: Open Public Research Access Institutional Repository and Information Exchange

Extension Extra | SDSU Extension

7-1-2003

Consequences of Living On the Credit Card

Liz Gorham
South Dakota State University

Debra Pankow
South Dakota State University

Follow this and additional works at: http://openprairie.sdstate.edu/extension_extra

Recommended Citation
Gorham, Liz and Pankow, Debra, "Consequences of Living On the Credit Card" (2003). *Extension Extra.* Paper 464.
http://openprairie.sdstate.edu/extension_extra/464

This Other is brought to you for free and open access by the SDSU Extension at Open PRAIRIE: Open Public Research Access Institutional Repository and Information Exchange. It has been accepted for inclusion in Extension Extra by an authorized administrator of Open PRAIRIE: Open Public Research Access Institutional Repository and Information Exchange. For more information, please contact michael.biondo@sdstate.edu.

COOPERATIVE EXTENSION SERVICE
SDSU

Extension Extra

ExEx 14082
July 2003
Family & Consumer Sciences

COLLEGE OF AGRICULTURE & BIOLOGICAL SCIENCES / SOUTH DAKOTA STATE UNIVERSITY / USDA

Consequences of Living On the Credit Card

Liz Gorham, Ph.D, AFC, SDSU Extension family resource management specialist
Debra Pankow, Ph.D., NDSU Extension family economics specialist

We live in uncertain times, and stressful situations can catch us financially off guard. High medical bills without sufficient health insurance, loss of employment, a poor year of farming or ranching, a divorce, natural disasters, deployment in the military, or higher than expected college costs can force us into debt.

We're not alone. Household debt across the country increased more than 9% in 2002. This was the largest rate of increase since 1989, according to Federal Reserve Chairman Alan Greenspan.

South Dakota per-capita income is among the lowest in the nation ($25,993 in 2000), and South Dakotans had the nation's third-highest household debt in 2002 at $9,667 (behind only Alaska and Vermont residents), according to RAM Research Group Ltd.

The nation's lowest debt level ($3,000) in 2002 was shared by residents of North Dakota, Kentucky, and Alabama. Yet North Dakota personal bankruptcies have risen from 363 in 1980 to 873 in 1990 and 1,952 in 2002. The trend is similar in South Dakota: 397 personal bankruptcies in 1980, 104 in 1990, and 2,539 in 2002. (See national trends chart on page 2.)

When we become strapped for cash, what do many of us do? Reach for the credit card.

One place the credit card is popular is the college campus. Most new college graduates brought home a lot more than a diploma and worn textbooks this spring. Their debt load in federally guaranteed education loans alone averaged $17,000, according to a recent study by the State Public Interest Research Groups (PIRG) Higher Education Project. That's double the debt that students carried eight years ago and does not include other types of loans.

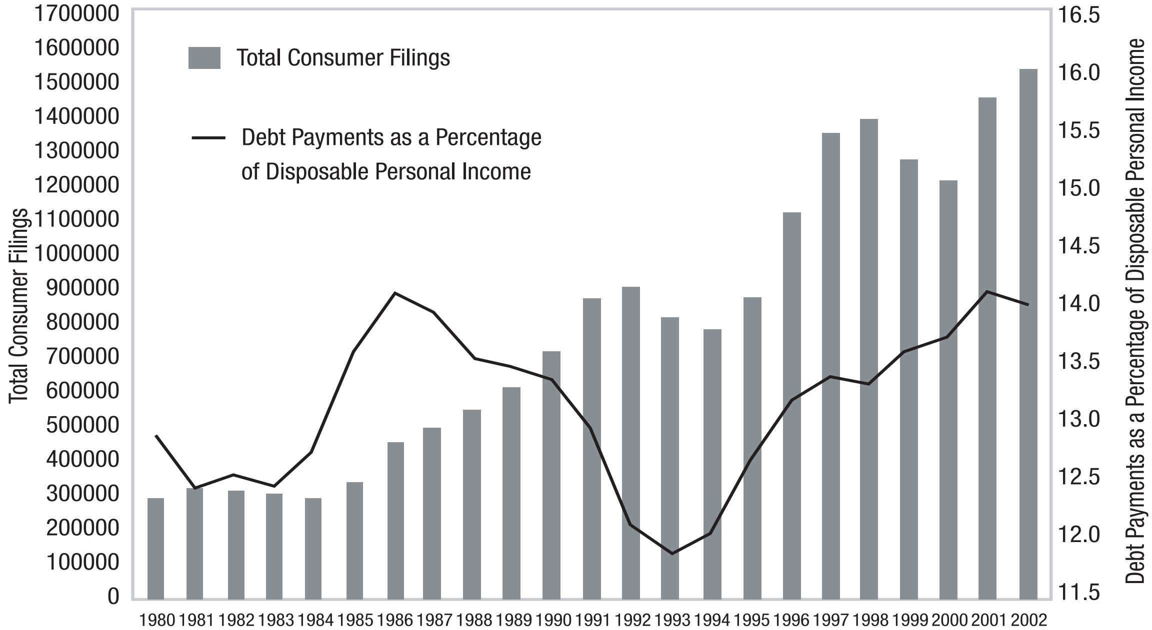
What's more, 41% of graduating college seniors also carry an average credit-card balance of more than $3,000 (Consumer Reports, July 2002). Three out of four college students have at least one credit card, according to a survey by student-loan agency Nellie Mae. The average balance on cards carried by the typical undergraduate totaled $2,748 (Consumer Reports, July 2001).

Good debt ... and bad debt

How much debt is too much? Financial counselors normally recommend that no more than a maximum of 20% of family take-home income (mortgage not included) be committed to consumer debt. Limiting consumer debt to 15% of family income may prevent problems for families at risk of large, unforeseen expenses, such as medical emergencies when there is little or no medical expense coverage.

Credit cards account for a large portion of family debt. Bank credit cards are extremely efficient payment tools. They offer consumers more flexibility than other types of credit. Consumers choose what to buy, when to borrow,

Influence of Total Consumer Debt on Bankruptcy Filings Trends by Year 1980–2002.



and whether to pay off the card balance in full or in installments.

Thanks to strong competition in the industry, consumers have a wide variety of bankcards to choose from. Credit cards are readily available to those with a good credit history. But how many credit cards does a person need? Many retail establishments do not accept every credit card, so most consumers should try to limit their credit card use to one or two cards issued by a major company. Visa, MasterCard, American Express, and Discover are the four most often used.

Lenders look at the potential debt (the credit card limit) rather than just the amount charged to a credit card when determining whether or not you are a good credit risk. There is also a risk associated with losing the cards due to carelessness or theft. When the card is used illegally by a thief, the person to whom the card is issued is liable for purchases made up to $50 **per card**. Your responsibility as a credit card holder is to report the loss or theft of your card within three business days to the company; doing so may result in waiver of this fee.

Using credit wisely

There are a few guidelines to limit costs should you be forced to turn to the credit card:

• Shop carefully to find the lender offering the best terms on the credit card. Make it a point to understand the terms of the contract you are signing. The law requires that this information be found in a boxed format somewhere in the contract:

- Look for a low **APR** (annual percentage rate); 14% to 16% is an average rate. A “low introductory rate” is usually lower, and may even be 0%, but it will rise, usually after 6 months, to the higher specified rate.

- A **fixed rate** credit card is best when interest rates are low. When interest rates are high, the “variable or flexible rate” credit card might be the better choice. Under a fixed rate, future debt payments can be calculated with accuracy; with a variable or flexible rate, your debt payments will be recalculated every time the rate changes.

- Be sure the card has a **grace period** of 20 or 25 days. This is the period in which you can pay off all purchases in full without paying interest. If there is no grace period, you have incurred an “instant loan” with interest charges even if you pay the monthly balance in full.

- A card with no **annual fee** is preferred. Many card companies do not ever charge an annual fee. Others delay the charge until after the first year of use. Cards with annual fees usually provide additional benefits—such as flyer miles, points for merchandise, hotel or rental car upgrades—that you may not need.

- The **calculation method** that will cost you the least is the average daily balance method. It is best not to get a card utilizing the two-cycle average daily balance method; it requires you to pay more interest.

- **Cash advances** on your credit card are not advised. Usually a higher rate of interest is charged when you take a cash advance.

- Charging activity that puts you over the established credit limit will mean that you pay the **over the credit limit fee**. Do not use the credit limit as a target for your monthly spending. You can ask for a lower limit to encourage you to lower your credit card use.

- Avoid **late payment fees**. These will be noted on your credit report and may go against you in applying for a loan.

• You are entitled to a written statement of all terms and conditions of any credit transaction you enter, and to know in dollars exactly what you are paying whenever using a credit card.

• Set a total amount you can afford for credit card use at the beginning of the month and stick to it. Do not commit yourself to monthly credit payments that exceed the amount you are certain you can repay.

• Shop as carefully when you use credit as when you use cash.

• Seek to transfer existing card debt to a lower interest rate card. The “low introductory rate” usually rises after 6 months, so start looking for the next rate as soon as the transfer is made, or try to convince the company that sponsors your current card that you either need a lower rate or you will transfer your balance to a competitor’s card. Be aware that there may be a fee charged to make any change or transfer.

• Rules regulating the credit card agreement can change. Written notification of changes needs only to be sent to each cardholder prior to the new rule taking effect.

• Pay bills promptly to keep finance charges as low as possible.

• Pay at least the monthly minimum required amount on time. Remember that when you do not pay off the balance in full on time, you will be charged interest for any new purchases along with the unpaid balance. While it is best to pay the full amount owed each month, that may not always be possible. Pay more than the minimum amount whenever possible but pay at least the minimum amount.

• Protect your credit rating by reporting to creditors immediately if you are unable to make a payment due to unexpected circumstances. You may be able to extend the repayment period and lower the monthly payment.

• Do not skip a payment without contacting the creditor. A disgruntled creditor will be all too ready to send your billing to a collections agency, and your credit rating will suffer.

• Keep a list of your credit card numbers and telephone numbers of each card issuer in a safe place and notify the card issuer immediately if your cards are lost or stolen.

• If you have a poor credit rating, you usually cannot get the lowest-rate cards. You can find lists of lower-rate cards in financial magazines, newspapers, and on web sites: http://www.bankrate.com; http://www.cardweb.com/ and others.

The consequences of overuse

Living on the credit card should only be a temporary measure. There are consequences of prolonged use:

• It will be difficult to get out of debt when paying only the monthly minimum required amount, and it increases the cost of using credit.

• You may have to endure a poor credit rating if you can't pay even the monthly minimum required amount.

• You may find difficulty in securing low-rate loans.

• It may terminate long-term relationships with one or more local creditors who may be personal friends.

• Your status in the local community as a responsible citizen who always pays his/her bills may suffer.

• The longer you use the card, the more discipline you will need to 'kick the habit' of over-use.

• You may have to declare bankruptcy. You may have to declare Chapter 13 (debt reorganization so you can pay creditors but keep your possessions) or Chapter 7 (unsecured loans are erased but assets are sold to pay secured debts).

• Bankruptcy remains on your credit report for 10 years and will affect subsequent loan opportunities. In addition, potential employers, insurers, and others may have access to this information on your credit report.

Getting out of debt ...

As quickly as possible, decrease your dependence on the credit card. You may need another job. Check with the closest One-Stop Career Center (http://www.state.sd.us/dol/sdjob/DIRECT.HTM or http://www.jobnd.com) and newspaper circulars for the availability of local jobs.

When you have more income or have cut back on expenses, begin paying more than the required monthly payment on your credit card.

Paying down your debt is a good investment for your financial security. To find out how many payments you have left and when you will be out of debt (by making the monthly minimum payment), get a free PowerPay analysis of your debts at your local county Extension office. If you prefer, contact your state family resource management/family economics specialist through the mail or by mail to do the calculations. Using information from the latest billing notice, send the following information for analysis:

- Name of each creditor.
- Outstanding balance on each debt.
- Monthly minimum payment for each debt.
- Annual percentage rate (APR) for each debt.

... And staying out of debt

Track your income and expenditures to understand how you might change spending habits or increase your income. If needed, get professional help to get out of debt.

Start an emergency fund—no matter the dollar amount. Get in the habit of saving. Keep the use of credit cards under control. Do not use a credit card except for basic needs; delay your "wants" (non-essentials for living) until you get back on your feet. Hold a meeting with family members to get everyone's support for keeping the use of credit cards to a minimum.

By taking the above suggestions seriously, you can have some control in uncertain times. Remember that living on credit cards for any reason should be considered temporary.

Resources

American Bankruptcy Institute, 2003 Statistics. Accessed at http://www.abiworld.org/stats/bystate.html on 6/23/03.

Olson, Corrine. March 24, 2002. South Dakotans dogged by debt. Argus Leader, Sioux Falls, S.D.

Consumer Reports. July 2001. Pushed off the financial cliff, p. 20-25.

Consumer Reports. July 2002. Graduated payments. State Public Interest Research Groups' (PIRGs) Higher Education Project. Accessedhttp://www.consumerreport.org/main/ detailv2.jsp?CONTENT%3C%3Ecnt_id=156981&FOLDER%3C%3Efolder_id=21135&bmUID=1055767273510 on 06/17/03.

Nellie Mae. February 13, 2002. Undergraduate students and credit cards: an analysis of usage rates and trends. Accessed at http://www.prnewswire.com/cgibin/stories.pl?ACCT=105&STORY=/www/story/02-13-2001/0001426743 on 06/17/03.

Remarks by Chairman Alan Greenspan. Financial education at the JumpStart Coalition's Annual Meeting, Washington, D.C. April 3, 2003. Accessed at http://www.federalreserve.gov/BoardDocs/speeches/2003/20030403/default.htm on 04/03/03.

COOPERATIVE EXTENSION SERVICE
SDSU

Issued in furtherance of Cooperative Extension work, Acts of May 8 and June 30, 1914, in cooperation with the USDA. Larry Tidemann, Director of Extension, Associate Dean, College of Agriculture & Biological Sciences, South Dakota State University, Brookings. SDSU is an Affirmative Action/Equal Opportunity Employer (Male/Female) and offers all benefits, services, and educational and employment opportunities without regard for ancestry, age, race, citizenship, color, creed, religion, gender, disability, national origin, sexual preference, or Vietnam Era veteran status.

ExEx 14082, July 2003. Access at http://agbiopubs.sdstate.edu/articles/ExEx14082.pdf