Lesson 14 Credit: Your Best Friend or Your Worst Enemy?
Lesson Description

The students do an exercise that shows how credit can be their worst enemy. They learn how quickly credit-card balances can grow and how long it can take to pay off a credit-card debt. They also learn that credit can be their best friend. Working in small groups, they consider seven scenarios and decide in each case whether it would be wise for the people involved to use credit. They discuss their conclusions and develop a list of criteria suitable for use in making decisions about credit.

Unwise use of credit can lead people to spend more money than they can afford to pay back, reducing their ability to make purchases or save money in the future. Many borrowers fall behind in their credit payments, jeopardizing their capacity to borrow in the future, and some wind up declaring bankruptcy. When it is well used, however, credit can provide many benefits. People can use credit to deal with emergency situations or to purchase valuable assets such as an automobile, a home or an education. It is in the students’ interest, therefore, to learn to analyze the costs and benefits of using credit.

Concepts

• Choice
• Costs and benefits
• Credit
• Debt
• Interest
• Revolving credit

Objectives

Students will:

1. Calculate interest payments, minimum balances and the cost of credit.
2. Develop and apply criteria for determining when the use of credit is appropriate.

Time Required

45 minutes

Materials

• A transparency of Visual 1
• A copy of Activities 1, 2 and 3 for each student

Procedure

1. Tell the students that in this lesson they will look at the good and the bad sides of credit. They will learn how to decide when it is and is not a good idea to use credit. To get started, ask the students to define credit. Credit is the ability to obtain goods or services before paying for them, based on a promise to pay later. Thus, each time a person uses credit, he or she is in effect borrowing money.

2. Tell the students that one particular variety of credit is called revolving credit. Ask them if they know what revolving credit is.

It is credit that is available up to a limit and automatically renewed as debts are paid off or paid down. People who use revolving credit often make partial payments on their unpaid balances at regular intervals. For example, credit-card accounts offer revolving credit to credit-card users, many of whom make partial payment on their balance each month.

3. Distribute a copy of Activity 1 and Activity 2 (the accompanying worksheet) to each student. Tell the students to read Activity 1 and then complete Activity 2; also tell them to use their answers on the worksheet to fill in the blanks of Activity 1. (Students may calculate their answers individually or in groups. With younger students, you may want to make a transparency of Activity 1 and handle the worksheet as a whole-class activity. Note: Many credit cards now charge considerably less than 18 percent interest; but as Justin is quite young and this is his first credit card, 18 percent is not an unrealistic figure in his case.)

4. Display Visual 1 and review the answers to Activity 2. Answers to Activity 2: January Purchases $235.00, Minimum Payment $11.75, Unpaid Balance $223.25; February Purchases $157.00, Previous Balance $223.25, Finance Charge $3.35, Total Owed $383.60, Minimum Payment $19.18, Unpaid Balance $364.42; March Purchases $270.00, Previous Balance $364.42, Finance Charge $5.47, Total Owed $639.89, Minimum Payment $31.99, Unpaid Balance $607.90; April Purchases $490.00, Previous Balance $607.90, Finance Charge $9.12, Total Owed $1,107.02, Minimum Payment $55.35, Unpaid Balance $1,051.67. Answers to Activity 1: $235, $11.75, $223.25; $383.60, $19.18; $639.89, $31.99; $1,107.02. The answer to the last question (“How long do you think it would take him to pay what he owes?”) is given in Procedure 5.
5. Write the following terms on the board at widely spaced intervals: 6 months, 12 months, 18 months, 24 months, 30 months. Tell the students to go to the board and stand next to the term that they believe best approximates the amount of time it would take Justin to pay off his credit-card balance if he did not make any more charges and paid the minimum balance each month. When the students have lined up, tell them that it would take 23 months for Justin to pay off his credit-card balance if he paid $55 each month. Remind them that interest is charged each month on the unpaid balance — even if no further purchases are made using the card. Tell the students that the total amount Justin will have to pay back is $1,226.88. Justin made total purchases of $1,051.67. The remaining $175.21 is the cost of credit.

6. Explain that credit can cause problems. People with high monthly payments often find that they cannot afford to buy things that they want to buy now, and cannot afford to save any money, because so much of their income is going to pay for past purchases. Sometimes people fall behind and fail to make monthly payments on their unpaid balances; this leads to financial penalties that add to their debt. Some people accumulate so many debts that they declare bankruptcy, which severely limits their capacity to borrow in the future. Still, when it is wisely used, credit can be a good friend.

7. Ask the students to consider this situation: “It is midnight and your car breaks down on [some local highway]. You are far from home. You use your cell phone to call an emergency auto-repair service. The service representative tells you that a service visit will cost $50, plus the cost of any parts and labor that are necessary to get you driving again. You have $7.57 in your pocket. Should you use a credit card?” Most students will probably agree that this would be a wise use of credit.

8. Divide the class into groups of three or four students and hand out a copy of Activity 3 to each student. Give the groups 15 minutes to discuss the scenarios and decide whether the use of credit is a good idea in each case.

• Ana should take out the student loan. The additional training will increase her income and allow her to repay the loan.

• For Dave Larson, using credit to buy the stamp now may be a good idea, since the stamp may become more valuable in the future. On the other hand, Dave can’t be certain how much the stamp will gain in value. The decision here could go either way.

• Caroline Potter should use credit to buy a more dependable car. She might lose her income completely if she cannot get to work regularly and on time. Her current repair bills are large.

• Jake Purdy might increase his income by buying the new car — if it actually is true that the new car would impress his customers. That is uncertain. But it is certainly that payments on the new car would be high, and Jake’s salary is not high. Jake should keep his old car and explore other, less costly ways to please his customers — by providing better service, for example.

• Felicia Washington should buy the cheaper dress and pay cash rather than borrow.

• Mike Chiang is paying only the minimum balance on each of his credit-card accounts, and he has to work a part-time job to make those payments. How will he be able to make the higher payments that will result from his trip? This is an easy call: don’t do it, Mike!

• Bill Baker’s case for using credit is clear. If Bill puts the mattress and box spring on his credit card and pays $50 each month, and if his credit-card account charges 18 percent annual interest, Bill will pay off the charge in six months, and his total cost of credit will be $12.24 — much less than the additional $100 he would wind up paying if he waited until he had enough money saved to pay cash. How back will feel better, too. And by borrowing and paying back his loan promptly, Bill will improve his credit score — perhaps enabling him to qualify for a credit card with a lower interest rate.

Closure

Ask the class to develop criteria for determining when it is appropriate to use credit. List their criteria on the board. Possibilities include using credit to make an investment in your future, as Ana Rodriguez and Caroline Potter did; to meet an emergency situation, such as the car breakdown in the example; to buy something that will cost more later, as long as the cost of credit does not exceed the savings on the item you purchase; or to acquire something of great value that you may not be able to obtain at a later date.
Assessment

Multiple-Choice Questions

1. A disadvantage of a revolving credit account is that
   a. it is illegal.
   b. it is very difficult for borrowers to qualify for such an account.
   c. the balance must be paid off every month.
   d. balances can rise quickly if only the minimum payment is made each month.

2. Making purchases on credit
   a. is never a good idea.
   b. is a good idea if the benefits to the purchaser are greater than the costs.
   c. decreases the cost of the purchase to the borrower.
   d. is a good idea if the purchaser has so many credit payments that he or she is unable to live comfortably.

3. If you have a credit card charging 12 percent annual interest, the total amount you owe each month is
   a. the unpaid balance on your credit card plus 1 percent interest on the previous balance.
   b. the unpaid balance on your credit card plus 12 percent interest on the previous balance.
   c. 1 percent interest on the unpaid balance.
   d. 12 percent interest on the unpaid balance.

4. Which of the following is the best use of credit?
   a. You can’t buy everything you want on your current income.
   b. You can take advantage of a sale price that is lower than the normal cost of the item plus your cost of credit.
   c. You have a credit card with a low interest rate.
   d. You want to purchase something now instead of having to wait to use it.

Essay Questions

1. What are the advantages and disadvantages of using credit?
   **Advantages:** Credit is useful in an emergency, can be used to acquire valuable assets and allows consumers to take advantage of opportunities such as sales.
   **Disadvantages:** Credit increases the cost of purchases, reduces the capacity of borrowers to make future purchases and may cause individuals to borrow more than they can afford to pay back — perhaps leading to personal bankruptcy.

2. Define revolving credit and discuss its advantages and disadvantages.
   Revolving credit is credit that is available up to a limit and automatically renewed as debts are paid off or paid down by partial payments. Revolving credit enables consumers to pay for their purchases over a period of time rather than immediately. But interest continues to accrue on unpaid balances; and, since many people make only the minimum payment each month, revolving credit may come at a high cost.
# Lesson 14 Visual 1

**Answers to Worksheet for Justin Jabowski**

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<th>Purchases</th>
<th>Minimum payment</th>
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LESSON 14 ACTIVITY 1

JUSTIN JABOWSKI AND HIS MAGICAL MONEY MACHINE

Justin Jabowski is a high school junior with a part-time job. In January he acquired his first credit card. His credit-card account charges an annual interest rate of 18 percent. This means that every month Justin pays a finance charge of 1.5 percent (that’s 18 percent ÷ 12 months) on his unpaid balance. And every month Justin must make a minimum payment of 5 percent of the unpaid balance.

In January Justin used his credit card to buy two shirts and a pair of pants, at a total price of $160. He also charged a new pair of shoes on his card, at a price of $75. When his first credit-card bill arrived in February, Justin owed __________. Since his account provides for a 30-day grace period, Justin did not owe any finance charges immediately. Justin has heard that it is a good idea to pay the entire bill each month and thus avoid finance charges; but he was a little short of cash in February, so he mailed in only the minimum payment of __________. His unpaid balance on the card was __________.

In February Justin treated himself and his girlfriend to an evening out at a rock concert. He charged two concert tickets for $50 each, plus a handling fee of $3 per ticket. He enjoyed the performing group’s music so much that he bought three of their CDs at $17 each, using his credit card. When his bill for March arrived, Justin owed __________ for the new charges, his previous balance and the finance charge on the previous balance. He was a little short of cash at the time, so he made only the minimum payment of __________.

In March, Justin had a great opportunity to go skiing with his friend Travis. Travis’s parents had rented a ski condo. They planned to make the trip by driving; by joining them, Justin was able to get free lodging, transportation and breakfasts. But lunches and dinners for the three-day outing cost him $150 (he treated Travis and his parents to lunch one day), and ski-lift tickets for three days came to $120. Justin’s total credit-card bill at the beginning of April was __________ for the new charges, the previous balance and the finance charge on the previous balance. By then Justin had become alarmed at the size of his credit-card bill; but he was still a little short on cash, so he made only the minimum payment of __________.

After he mailed off his April payment, Justin resolved firmly to stop charging things on his card until he could get his entire balance paid off. Unfortunately, his car broke down the next day, and the repair bill came to $490. He needed the car to get to work and to school, so he charged the repairs. His total credit-card balance in May was __________.

Taken aback by his growing balance, Justin swore not charge another dime until he paid it off entirely. He decided to pay $55 a month for as long as it would take to pay it off.

If Justin held to his resolution and made payments of $55 each month, how long do you think it would take him to pay what he owes?
### LESSON 14 ACTIVITY 2

**WORKSHEET FOR JUSTIN JABOWSKI**

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**Lesson 14 Activity 3**

**Should You Borrow?**

*Ana Rodriguez* graduated from high school last year with a good grade-point average. She works as a receptionist at a physical-therapy clinic, making $8.50 an hour. She would like to become a physical therapist. The work appeals to her, and salaries for physical therapists are excellent. Within a few years of finishing her training, she could earn more than $50,000 a year. But Ana’s parents cannot afford to pay for the training Ana would need to complete. Ana has investigated student loans, but she knows she would have to pay back anything she might borrow over a 10-year period. Should Ana take out a student loan?

*Dave Larson* is an avid stamp collector. For a long time he has wanted to own a Bolivian Double Eagle stamp. This stamp is very hard to find, and Dave believes it will gain value in the future. Dave learns that his favorite stamp store has a Bolivian Double Eagle for sale, priced at $200. Dave doesn’t have that much money in savings, but he is afraid that if he doesn’t buy the stamp now, someone else will. Should he use his credit card to buy the stamp?

*Caroline Potter* is a single mother with two small children. She commutes 15 miles to work five days a week, driving an old car that has developed several problems. Caroline has been late to work twice in the last month because of car problems, and each of the problems has saddled her with a large repair bill. Should Caroline buy a better used car, even though she will have to borrow money and take on monthly car payments?

*Jake Purdy* just got a great job working as a salesman. His salary isn’t high, but he can earn excellent commissions if he makes a lot of sales. Jake has a reliable car, but he has his eye on an expensive new model that would make a better impression on his customers (and also on his dates), he thinks. Car payments for the new model would be high, but Jake feels that he can make enough in sales commissions to cover the cost. Should he take out a loan and buy the new car?

*Felicia Washington* is the homecoming queen at her high school. She is going to the homecoming dance with the best-looking guy in the senior class. She goes shopping for a new dress to wear to the dance. She finds one nice dress for $79—an amount she could pay in cash. However, she also finds a spectacular dress priced at $169. She could buy this dress with her credit card. Sure, it’s a lot of money, Felicia thinks, but she owes it to her friends and her date to look dazzling for the big event. Should Felicia put the spectacular dress on her credit card?

*Mike Chiang* is a community-college student. He has three credit cards, all charged close to the limit. Mike managed to make the minimum payments each month, thanks to his part-time job at Pizzas-R-Us. Mike really, really wants to go with his friends on a spring-break trip to Padre Island, Texas, but he doesn’t see how he can afford to do it. Then he receives a friendly letter from one of his credit-card companies. “Dear Mr. Chiang,” it begins, “Since you are one of our most valued customers and always make your payments on time, we are raising your credit limit by $2,000.” Mike is thrilled! Now he can go to Padre Island with his friends. Should he do it, charging his expenses to his card?

*Bill Baker* needs a new mattress and box spring. He’s still sleeping on the same set he used as a kid, and his back is killing him. He has started putting away $50 a month for a new mattress and box-spring set that costs $400. Then the set he wants goes on sale, for a limited time only. The sale price is $300. Should Bill put the mattress and box-spring set on his credit card now, or should he wait until he can save $400 to buy it?