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Bank Credit Cards

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BANK CREDIT CARDS

In the last Newsletter, Mr. Smith discussed some of the characteristics of revolving credit systems which require individual transactions with each type of retail outlet. In this issue, he discusses the merits of bank credit card systems which allow customers to purchase many types of goods and services with payments made to only one party. - Editor.

Bank credit cards are almost universally acceptable, can be a source of short-term, interest-free credit, reduce the need for carrying cash thereby lessening the risk of robbery or loss, and the liability of the cardholder is low. However, when used to establish revolving credit or when handled recklessly, they can be prohibitively expensive.

In general, credit has been indispensable to the development and continued affluence of the U.S., but the recent invention of the bank credit card (or the "everything" card as it is sometimes called) can be exceedingly expensive. The purpose here is not to advocate the disuse of bank cards since they are important and useful, but to make the users of this form of credit aware of the costs. In your budget analysis, finance charges should be avoided where possible and minimized if their exclusion is not possible; therefore, your use of bank credit cards in particular and all credit cards in general should be scrutinized. In view of the phenomenal growth rate of bank cards and their wider use, the above caution is becoming more applicable to the average consumer.

Parenthetically, card holders purchase approximately 30 percent more merchandise on impulse and 20 percent more in general than those who pay cash.

In mid-1971 approximately two-thirds of all bank credit card accounts were being used as revolving credit and subjected to an 18 percent a year finance charge. At this time, the average balance per active account was $227. This means the average bank credit card holder is paying about $40.86 per year for $227 of credit. Since there were 17 million active accounts in mid-1971, bank card interest payments are indeed a big business; the total interest paid was $695 million for the year and this yields $1.863 million interest paid per day. From an economic standpoint, it would be better to negotiate a lower interest rate personal loan for your credit needs if at all possible. Is the convenience of a bank card revolving credit account worth the difference?

Assume you use a bank credit card (Master Charge or Bank-Americard) for purchases of $300 during the month. Depending upon the billing cycle, you will not have to pay for the purchases until up to about 60 days later. At the outside, an interest free loan of $300 has been received for 60 days. If cash instead of merchandise is obtained by using the credit card, however, interest charges begin immediately. Once you are billed by the bank card company, a grace period of 25 days is given before the bill is due.

Only about one-third of the card users pay in full during this grace period. What happens, then, if you elect to pay the $300 in installment payments as you are encouraged to do by the issuing agency? Your outstanding balance will be subject to an interest charge of 1-1/2 percent per month; this is the same as 18 percent per year.

Can you afford to pay 18 percent per year for a small sum of money? If all credit cards (oil companies, retail sales, travel and entertainment, etc.) are recklessly used, the problem is magnified into unmanageable proportions. While the 18 percent per year finance charge on a small revolving credit card account is not financially burdensome in the short-run, its high cost becomes evident when reviewed in a long-run context.

As an example, $227 revolving credit at 1-1/2 percent per month would cost about $820 over a 20-year period. That is, $820 is being paid to borrow $227 for 20 years. If this same $40.86 per year were saved and invested at only five percent per year simple interest, paid yearly, it would be worth approximately $1420 at the end of 20 years. It can be said the alternative to paying $820 of interest for $227 of credit is earning $1420: a difference (or true cost) of $2240.

Only one credit card account and a nominal amount have been used in the above example but if all revolving credit accounts and more realistic amounts are used, the finance charges associated with credit card "revolvers" becomes too large to ignore.

What happens if your bank credit card is lost or stolen and used by the thief or finder? Your maximum legal liability (in the absence of fraud and willful negligence) is set at $50 per account. This $50 maximum applies if, and only if, you have been provided with a self-addressed, stamped envelope and/or a toll free telephone number to call in case of loss or theft. The upshot of this maximum liability, legislated into law early in 1971, is that credit card insurance is no longer necessary. Check your home-owners' or renters' policy to see if you carry this excess baggage.

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