CHAPTER 6

CREDIT AND DEBT

Reflect on the five groups of 20 individuals that received different amounts of income described at the outset of Chapter 2. They control different sums of money from each other, which provide them with different amounts of access to various resources. The amounts of wealth that people experience may shape their outlooks on life and their reasoning about life contexts. Some of these 100 people have plenty of money to acquire things they want or participate in events that they wish. On the other hand, some of the others have very little money as compared to things and events they want to acquire or attend; so realistically speaking they do not have the money for doing so. In the next two chapters we will consider the costs and benefits of borrowing and lending money. This chapter considers borrowing and learning from the point of view of the debtor. Chapter 7 presents the topic from the point of view of the creditor. The absence of the abundance of money is not something that is great or terrible. Rather, it is how people think of themselves that affects how they view money and the way they use it.

The wealth disparity among the 20 individuals presents a couple of problems. In terms of personal self-worth, people may have more favorable or unfavorable views of themselves (or of you) because of the amount of wealth they control. This is unfortunate because people are people, regardless of the amounts that they control. In terms of net financial worth, the disparity in the amount of wealth that they control prompts them to feel superior or inferior because the money under their control shapes their views of their social position. The differences in the amounts of money cause a sense of control among the affluent with regard to access to material resources. Thus, for example, one perspective of affluence may justify control of vast resources through the notion of merit and extend this rationale to limit access to resources by those of less privileged status. These individuals may view life as guided by principles of financial worth. They attribute financial accumulation to personal choices and their financial liabilities to environmental factors. The people holding the largest sums may claim that they somehow earned their funds through some common traits that they may possess. Those having similar amounts may reason that some external factor prompted their disadvantaged situation.

People with compassionate senses of personal self-worth value themselves for who they are. Their sense of worth does not depend on money, but rather, it relates to valuing the stories that define themselves. Developing a compassionate view of self allows individuals to become open to the different stories of others and to care about their life stories.

This chapter concerns credit and debt. In previous chapters we distinguished between personal self-worth and net worth. This distinction also relates to credit and debt. Before we discuss these concepts further, it important to consider how spending decisions relate to borrowing decisions and perceived needs for credit and debt. Whether or not one has a strong sense of personal self-worth, one may manage money in ways to minimize the need for credit and debt. Personal self-worth involves a sense of personal value. It does not depend on the amount of money that one controls. The key consideration when it comes to credit and debt involves whether one (1) needs the item that causes the need for credit or debt, (2) needs the item immediately or later, and (3) considers all sources of funding before pursuing credit. We will consider these issues a bit further, keeping in mind that the fundamental basis for making decisions involves whether one truly needs the item causing the pursuit of credit and the encounter with debt.

For now, we will present some basic concepts and provide a simple example to introduce the topics and offer questions to give opportunity for deeper reflection. After this introductory material, we offer instructional content that explains the reasons for credit, explain its processes, and describe its forms.

We begin with the dollar. A dollar is a rectangular sheet of paper or a coin. Not much to get excited about. It has shape, it has texture, and it has some degree of visual appeal. It even has a smell. It is simply a thing. Yet the dollar bill also has transferability. The dollar bill represents something of interest because everyone recognizes it as something that can be traded for goods and/or a service. So, a person who has one dollar bill can go just about anywhere and acquire something for personal use. We will say it is a cookie dough ice cream cone on a summer day. The dollar, itself, is something exchanged for a good or service.

Now, your friend has ten, one dollar bills. Jodie loves ices cream, so much that Jodie has saved a lot of money and has $10 ready to spend. Lucky Jodie! But wait, Jodie knows there are hungry children in the neighborhood who want ice cream, but have no money to buy it. Jodie has money that children can use and will let them use the money. The condition is that the children should they pay Jodie back, plus pay Jodie extra money in additional to what they borrowed.

So, for example, Lee wants an ice cream cone, mint chocolate chip. Jodie gives Lee a dollar for the ice cream cone, with a promise that Lee will pay Jodie the dollar plus a dime back in a week, to pay Jodie for the cost of not having the money for that period of time. Because Lee does not have money for the ice cream, Lee has to temporarily use money from Jodie for the purchase.

You may begin to wonder about this situation. Why charge the extra dime (which represents interest on the loan)? Why ask for repayment at all? So you should ask these questions. We will review from earlier chapters and consider this situation in terms of financial and personal self-worth.

Remember that we defined personal self-worth as what you think of yourself in absence of other objects or people. It does not relate to the things outside of yourself.

Your sense of who you are does not depend on the amount of money you have, the person whom you are dating, or the music to which you listen. It is based upon an appreciation of you. Financial worth represents the total value of things that you control: your debts, your bicycle, the money in your bank accounts, the souvenir that you purchased on your family vacation.

We will return to Jodie and Lee before we have a puddle of melted ice cream with which to deal. If we are discussing development of financial worth, Jodie's charging of interest represents an example similar to what occurs when financial institutions lend people money for different reasons, such as to purchase cars or houses.

If we are discussing the development of personal self-worth, at least two considerations arise as to how the parties involved with the transaction may amend their thinking to foster a more compassionate environment. First, Lee could realize that purchasing the ice cream does not affect personal self-worth and could delay the purchase. Lee's reasoning would be that personal self-worth does not relate to the ice-cream and locate a substitute. Second, another possibility is that Jodie could recognize that an additional dollar does not increase one's personal self-worth and could simply give Lee the dollar as a gift without expectation of repayment.

We offer another way to distinguish between personal self-worth and financial worth. Financial worth represents the total of objects that you control. The financial worth of another person involves the total value of objects that a person controls. Personal self-worth involves your valuing of yourself, such that you do not represent the object of another. Nor does the other person represent an object for you. You are not a tool for someone else's social benefit, nor are they a tool for yours. When considering credit and debt, we defined it as the use of someone else's resources with the understanding that the money borrowed will be repaid.

You might consider that credit represents a tool that allows you to spend money to possess items that you could not otherwise obtain. For example, if you want to purchase a car and don't have the funds in hand or in your bank accounts, you need to find someone who will loan the money to you with the promise that you will pay him or her money later. A question that relates to your personal self-worth might be whether the item for which you seek credit really reinforces the inner sense of who you are? The answer to the question may very well be "No"! It may be possible to address your transportation needs without purchasing a car, or without purchasing a car that requires you to pursue credit. Consider why this may be.

In terms of financial worth, ponder the long-term effect of accepting credit to purchase an item that loses value (depreciates) with time. Because new cars tend to depreciate more quickly during their first couple of years of use, you should be cautious that your payment schedule on related credit ensures that the value of the car stays greater than the balance on the loan.

It may be worth your while to delay the purchase of the car. With this option, you find alternative transportation means until you have sufficient funds to pay for a significant portion of the purchase price, such that any credit comes with the

assurance that you have some margin of equity within the vehicle. Equity refers to the amount of money that you would receive if you sold the car and paid off any debt for its purchase.

Finally, with regard to considering all funding sources, most people recognize the importance of comparison shopping to find the most financially favorable arrangement, such as the lowest interest rates. This principle makes common sense to increasing financial worth. If you borrow money at a lower rate, all things held the same, the loan costs less, and you as the borrower always benefit if the loan costs less money. Of course, you could benefit more if you do not need to make the loan.

Imagine that you want to purchase the item to impress your friends. You argue that this purchase represents a method for improving your personal self-worth. Your thought represents a common fallacy of reasoning. Personal self-worth represents an inner quality independent of others. Purchasing a vehicle to impress others represents a process of objectification. It makes the purchaser an object of admiration for association with the purchased good or service. It makes the audience the basis for objectification. The purpose of the purchase is to please the audience, rather than develop oneself. In other words, the situation represents one of control. The financial decision relates to efforts to please or impress others, rather than value one-self.

In terms of personal self-worth, one should consider how the decision informs choices that respect others as one would him or herself, such that we are not objects of others' control. One should consider the extent to which the lender extending the credit pursues compassionate relationships with the community that it serves. For example, whether the lender has a presence in the low-income portions of the community or makes credit available to members of minority cultures or underrepresented groups. The lending institution supports community savings efforts by offering accounts with affordable minimum balance requirements and fee structures. Officials of the institution are visible in low-income communities learning about financial needs and concerns.

Financial decisions involve elements of care or stewardship. Loan interest represents one of the largest sources of income for a lending institution. A critically compassionate approach to credit and debt requires the pursuit of business relationships with lenders who reinforce the concept of personal self-worth within you. A manner of doing so involves interpreting the extent to which they reinforce the concept of personal self-worth in others. A financial institution that pursues relationships in low-income communities has a powerful sense of personal self-worth among its prospective customers and values their financial needs. A financial institution with local ownership that values executive community involvement may also reinforce a sense of personal self-worth. Obtaining credit from such institutions, even if the interest rates may be a little more expensive than the competition establishes a healthy relationship that may reinforce your sense of personal self-worth and relationship with the neighborhood. In regards to credit and debt, personal self-worth involves respect for oneself such that one can engage in financial processes that respect you for who you are, rather than for your financial capability.

Discussion Questions

- When was a time when you may have borrowed something or received credit or debt? What was the item or service that prompted the debt? What were your responsibilities and obligations towards the creditor? To what extent would you consider going through the same process again?
- What is your sense of personal self-worth when you owe something to another? What is your sense of personal self-worth when someone owes you something? What are the bases for your feelings? How may your feelings change when you consider the reasons for the other party's position?
- Think back to the distribution of resources to the 100 persons. How does the manner by which those resources were distributed relate to the needs for lending and borrowing? How might it affect reasoning with regard to those who possess the money? What about those who need the money?

CREDIT AS A TOOL

A healthy purchase decision involves three steps. The first determines whether one needs the item considered. If the item is needed, the second step considers the best manner by which one purchases the item(s). Ideally, when we need something, we have a reserve of funds available to buy what is needed. The third step contemplates the social consequences associated with making a transaction.

Credit is a basic financial tool to acquire goods and services for which a person does not have or does not want to use cash. Borrowing money to buy something usually costs more than paying cash because creditors charge money for credit (interest). Interest is the price the borrower pays for using someone else's money. The lender determines the interest rate for a loan. A borrower needs to acquire additional money to pay the interest on money borrowed. Interest paid to the lender is the cost for the use of the money. This fact leads us to the idea that the charging of interest to loan money rewards people who have money and punishes those who do not have money.

When people use credit, they receive something of value now and agree to repay the lender over time, or at some date in the future, with interest. The lender expects that the borrower will have a plan and the resources to repay the loan.

To illustrate these ideas on a basic level, we will revisit the ice cream scene with Lee and Jodie. Jodie is tempting Lee to borrow money to purchase the ice cream. Consider this chapter as viewing the possibilities from Lee's perspective. Lee wants ice cream and for a very good reason! We will consider Lee's alternatives.

First, Lee can give in to temptation. This would be convenient. The ice cream is there and Jamie has a dollar ready for the taking, with a small price tacked on to the repayment.

Second, Lee can say "No" to Jamie, run home and take a dollar from the piggy bank. This is less convenient and provides the ice cream. This choice takes more time,

and therefore is less convenient, yet Lee gets ice cream and avoids the credit, as well as the possible interest which means he will owe more money than he borrowed.

Third, Lee can say "No" to Jamie and pursue a water fountain or even ask the ice-cream vendor for a small cup of water. This may be socially awkward, but it is financially savvy and represents the correct answer. Why so?

The ice cream represents a tool for cooling oneself during the summer. It tastes great and can be filling (especially with a waffle cone). However, a cool drink of water costs less or practically nothing. What about all your friends having ice cream? Let them. Why do you have to eat what your friends eat? It is okay to be different. Personal self-worth does not depend on doing the same thing as others. Indeed, when it comes to money, the opposite often represents the situation. Many people do not make good financial decisions because they do not like the inconvenience. Ask yourself which of the three above situations best develops Lee's sense of personal self-worth.

Think back to or reread the previous chapters that related to money management and their coverage of the price of convenience. When we take short cuts with our money, it costs more than when we take time to fully consider the situation and respond deliberately.

Imagine that you are Lee. All of your friends decided they wanted ice cream! Good for them, let them enjoy it. Jamie had money and lent it to them. Thank you Jamie! But now, consider that each person has a loan plus interest to repay. Do all those borrowers have the money or will they get money to repay Jamie? Jamie has the potential to get money back from everyone plus the interest. Yet Jamie may have difficult choices when it comes to those who cannot or will not pay Jamie back.

You decided on water. You do not have a debt. You do not have to worry about owing Jamie money, so you can use your own money for different purposes. You also retained your sense of personal self-worth because you resisted an opportunity to be influenced by Jamie's effort to be financially manipulative. It was inconvenient to say "No" to ice cream; however, you do not have a debt and you did not spend your own money.

Everyone else acted impulsively to purchase ice cream. They have debt. You said "no" because you knew that ice cream was simply a tool to cool you down. Water did just that and was healthier for you as well. You can have fun drinking water just as you can when eating ice cream. You experienced some inconvenience; yet you acted wisely; however, you did not follow the crowd.

Consider this situation from a perspective of control. Commercially produced ice cream may contain many additives and sweeteners designed to appeal to your sense of taste. Your perceived need to purchase the ice-cream may relate to conditioning of your taste preference through repeated exposure to these chemicals and sweeteners. Advertisements in media influenced your thinking in a way that makes you consider ice-cream as the fun way to cool down on a summer's day. Previous chapters identified marketing as a strategy to convince consumers to purchase something.

Commercially produced ice cream represents one such product. Food is not the basis for a good social experience, people are the basis.

We will review. By saying "No" to Jamie, you avoided (1) being subject to Jamie's control of you and your money and (2) having your tastes controlled by the manufacturer.

So, why do most people not make good financial decisions? They make decisions because they decide impulsively, without thinking. Consider your budget from the last chapter and how those decisions are made at a desk in a calm manner. Now think about the ice cream purchase and the impulse associated with the choice. Imagine Jamie saying "Come on! Have some ice cream! I'll give you money and you can pay me back later." You are under pressure to make a financial choice that may not have been part of your budget or spending plan.

How might Jamie answer if you say "No"? If Jamie accepts your answer of no, you may appreciate Jamie for respecting your answer. However, it is possible that Jamie may not respect your answer. Jamie may tease or taught you. Jamie may say other things to make you feel bad for turning down the offer. In this case, you know you made the correct decision because Jamie is trying to control your choice. Jamie is attempting to manipulate you into a decision that you do not want to make. Very often, people who contact you to give you a good deal are not acting in your best financial interest. They are acting in their financial interests. Jamie is offering to give you money for fun (ice cream) but there's a cost. A week after the event, Jamie has you repay plus some interest. The others have the memories of ice cream and some may continue to have debt.

Think about the current music artist to which you enjoy listening on your MP3 player. You learn that the artist is on a world tour and that the local concert will provide you with the final opportunity to see the person perform live. Think carefully about this situation. The "special" tour represents a ploy to convince you to buy the ticket. Does going to the concert improve your personal self-worth? It might; social experiences inform us about who we are. The answer depends on your relationship to friends, the concert and the artist. If you enjoy the music and respectfully interact in safe manners with your friends, you are secure in your personal sense of self-worth. If you become obsessed with the artist and the music or you depend on your friends to enjoy the opportunity, there may be some concern. Is going to the concert fun? It may very well be. Should you borrow money temporarily for the concert if you don't have it? Not a chance. The artist or the artist's promoter is manipulating your thinking to lead you to believe that you will experience a better life because of the attending the concert.

The first principle of credit and debt relates to choices with regard to money management. The least expensive manner to pay for a good or service is to pay with cash. Credit and debt occur when one uses another's money to acquire goods and services. They are potentially more expensive than cash because of additional fees and charges that may result from their incurrence.

At the same time, the basic principle of credit and debt applies whether you need the item or service purchased. You should consider the difference between your personal and financial worth. When you can say “no” to goods and services, such as ice cream and concerts, you have a strong sense of personal self-worth. When in control of your money, you make decisions based on your needs; when pressured into buying something, he or she becomes manipulated by the good or service that is available. The former instance represents a matter of control; the second is not.

A compassionate approach to financial literacy involves roots in personal self-worth founded upon who you are. When one talks about control in the above sense, he or she talks about having the compassion for yourself such that (1) you can resist the consumer purchases that present you as an object for others’ societal gains, (2) you enter into social relationships that are based on your personal self-worth, not necessary financial gain, (3) you stay within yourself such that you do not impose yourself or control the lives of others for your own personal agenda. In other words, a critically compassionate approach involves the compassion for yourself such that you recognize the controlling nature of economic environments, while controlling yourself such that you resist imposing yourself on others. The following story illustrates such a compassionate approach.

> One summer afternoon, on my way home, after a ball game, I stopped in for a cola. I was tired and thirsty, and looked forward to a cold refreshing drink. By now, Mr. B’s was like an extension of our family’s pantry. We always talked and shared each other’s interests. Mr. B. was busy doing something in the back when I came into the store.
>
> “Mr. B, how ya doin?”
>
> He heard my voice and responded: “Hi-ya, Cookie, what’ll it be today?”
>
> I stood in front of the cooler. “Just a cold cola to go.”
>
> Without coming from the back, he said “Help yourself, Cookie, I trust you.”
>
> I opened the cooler and brought out the ice-cold bottle. As I fished in my pockets,
>
> I realized I didn’t have any money. I went back behind the counter, and replaced the bottle in the cooler. By this time, Mr. B. came out of the back room into the store and saw me return the soda.
>
> “I thought you wanted a cola.”
>
> “I did, but forgot my money.”
>
> Mr. B. opened the cooler and brought out the chilled bottle of cola. “Here Cookie, you look like you could use this.” Before I could speak, he continued. “Pay the next time you come in,” he said. “I trust you.”

> A few days later, I stopped in and paid him the money, and thanked him.
>
> Then Mr. B handed me back the coins. "Thank you, Cookie, for keeping your word.
>
> You keep this — for when you get thirsty. This one's on me."
>
> (Koch, 1991) [1]

In the preceding story, Mr. B built Cookie's trust through generosity and kindness. Rather than telling Cookie to put back the drink that he could not purchase, Mr. B. expressed compassion for Cookie by providing him with a drink to quench his thirst. He allowed Cookie the opportunity to decide whether to honor that kindness by paying the money back. Mr. B had the sense of personal self-worth such he could let go of the drink that he gave Cookie.

The opposite of trust is manipulation, a concept founded in conditionality and control. It occurs from the perpetrators' limited sense of compassionately founded personal self-worth. He or she manipulates others to find value in him or herself.

CREDIT AND DEBT PROCESSES

This section clarifies the meanings of credit and debt. When we think of a credit, we think of acknowledging something someone has accomplished. For example, you receive credit for turning in a class assignment or in sports a person receives credit for a significant play. We trust the record that something has been done.

Consider the concept of trust. Trust represents that belief, understanding, or awareness among a group of people that members will do what is expected. For example, when you grew up, hopefully you trusted that your parents or older siblings would get you to school on time in the mornings. You knew that you could count on them to do what was expected. You trusted that your family would have a safe place for you to live. Trust means a sense of security that those on whom you depend will do what is expected.

In a previous chapter, it was acknowledged that some families present trust as something to be earned. We feel sad for these settings because they confuse trust with manipulation. Trust represents a concept founded in giving and care. One does not earn trust. One experiences trust.

When a person has a concept of worth that does not depend upon control or possession of other things, you can be reasonably certain that the person is caring and compassionate. Why? The person accepts him or herself for who she or he is. He or she accepts responsibility for his or her actions because he or she is comfortable with him or herself. He or she feels safe when expressing vulnerability because he or she recognizes the acceptability of making mistakes. Mistakes are part of human nature.

When a person has a concept of personal self-worth that depends on control, that person may have difficulty viewing others or acting in a caring and compassionate

way. Why? The person has some elements of personal insecurity that require him or her to control situations to fit his or her point of view. This person has difficulty accepting responsibility for his or her conduct, concealing mistakes and blaming others for his or her problems. This person believes conditionally. In other words, he or she will accept a situation if there is some indicator or condition that informs him or her that trusting represents a safe decision. This person considers advantage as something to be earned because he or she lacks an inner confidence and feels the need for some leverage to control the situation.

In an environment of control and anger, trust represents something earned by one who has experienced environments of fear and intimidation. The person has been conditioned through punishments and rewards to respond to and respect the authority of another who controls access to various resources. To this person, trust represents a conditional phenomenon based on a weak sense of self developed through aggressive and intimidating treatment by others.

For one who has experienced environments of care, compassion, and respect, trust represents something given. The person engages in conversations and acts of acceptance. The person developed a sense of inner security because s/he has received care without condition. The person has the ability to regulate or discipline him or herself without promises of punishment and rewards because they are irrelevant to his or her sense personal self-worth. Financial credit involves an environment of manipulation, rather than trust. Those who control financial resources set conditions for obtaining credit in ways that advantage their social position.

A credit is a financial relationship where one person or party gives money to another with the expectation that the money will be repaid over a certain period. The creditor believes that the borrower will pay the money back under the terms established by the creditor and agreed to by the debtor. How often have you told a creditor that you do not agree with terms of a credit arrangement? Interest is charged as a cost for borrowing the money. Think of this as if the borrower were temporarily buying money from the lender. Do you need to buy $100 and pay it back in a year? Someone who has the money will sell it to you. The cost is six dollars, or 6 percent, for every 100 dollars that you buy. Interest represents the cost of borrowing the money. Lenders generally tell consumer borrowers the price for their credits. An interest rate is the price of using someone else's money expressed as an annual percentage of the loan principal.

In the view of lenders, borrowers who repay loans as promised demonstrate that they are worthy of getting future credit. A reputation for not repaying a loan as promised can result in higher interest charges on future loans. There are a variety of planned and unplanned reasons why borrowers may not repay loans. They range from irresponsibility, to relocation, to loss of job, illness, and others.

Credit is financial trust. What is debt? Debt is the amount of credit that a person has outstanding or needs to repay. So, for example, Slim Jim has a thin wallet and walks around town all the time. Jim wants to purchase a Weinermobile, just like Oscar Meyer drives. In an effort to catch up to Oscar, Jim goes to the Peoples Bank

of Snacktown and seeks a loan. The bank musters together its finest loan officers and decides to lend Jim $20,000 for the vehicle. Jim has a $20,000 credit with the bank. Jim also has an unpaid $20,000 debt. Time goes by. Jim relishes his new set of wheels and pays the debt down to $10,000. Now Jim has an unpaid debt of $10,000 that resulted from the $20,000 credit. Do you recognize the difference between credit and debt?

To review for clarity, credit is an agreement between borrower and lender. The lender trusts that the borrower will repay the money under the terms agreed upon. Debt is the amount owed the creditor for the ability to borrow the money. Interest is the cost of the money that the creditor has temporary sold to the borrower. That is quite a smorgasbord to digest. We will consider more examples before we leave this discussion.

Lana Lou loves linguini. Lana Lou loves linguini so much that she wants to share her passion with the community and earn a little money at the same time. Lana Lou uses her noodle and decides to open a restaurant. She conducts some research and decides she needs about $50,000 start-up costs to get the business going. She contacts her friend, Al Fredo, at the bank. Al discusses the matter with his head lending officer, Mary Nara, who views this opportunity as good for the bank and the community. Lana Lou graciously signs the $50,000, five year, credit agreement at 5% interest. The loan will be paid back in five annual payments of $10,000 plus interest. The business runs smoothly and she makes her first two payments. We will consider our vocabulary and how they apply to this situation.

What is the credit? The credit is for $50,000. Remember that the credit is the amount of trust agreed upon. What is the debt? Each year the debt reduces by $10,000. The first two years, Lana Lou makes her payments (total of $20,000). Taking the credit of $50,000 and subtracting the payments of $20,000 provides a debt balance of $30,000. What is the interest amount? Presuming that the interest is compounded annually, Lana Lou will owe about $1,500 this year, in addition to the full payment of $10,000 due on an agreed upon date as determined by the loan contract.

Here is an explanation of the difference between simple and compound interest. Remember the 100 people who received random amounts of money. Some have a lot of money and some have little money. People who need to borrow view the transaction differently from those who are able to lend. That rationale of those who lend the money is that interest compensates for the cost of not using the money elsewhere. In other words, they have a choice among borrowers to lend the money. Lower borrowing rates are charged to those whom the lenders identify as bringing less risk to the transaction. When people borrow money (credit) and pay the money back, plus extra money (interest), those who lend the money reason that interest compensates for the cost of not using of the money elsewhere.

The justification for interest (to pay the lender for the risk of lending the money and the opportunity cost of finding another use for it) represents one created by the

lender. The borrower cannot justify it. The borrower can only accept it. The borrower is over a barrel in a manner of speaking, and hopefully not from too many Slim Jims or too much pasta. Why? The lender, not the borrower, determines the terms for the credit contract. The borrower agrees to the terms set by the creditor.

Based on understandings of personal self-worth, the concept of interest lacks justification. It represents a mechanism for social control designed to maintain social order based on notions of privilege. The debtors' mechanism for reducing interest rates lies in reducing the demand for borrowing money. By lessening the need for credit, borrowers invite lenders to lower interest rates. A fully egalitarian environment provides for no interest and no need for repayment.

If we consider interest from a holistic view of the transaction, realizing that ownership of money relates largely to one's social origin and access to information, we notice that interest rewards people who have money and it punishes those who do not have money.

Indeed, one may claim that if the purpose of the loan relates to something other than increasing one's financial worth, then the loan may increase the financial differences between the lender and borrower. People who do not have money are forced to locate extra money to pay others who have money for the use of the money borrowed. People who have money receive more money for lending money to those who need more money than they have.

Research finds that children learn how to manage their money through the modeling experienced in their social networks (Gudmunson & Danes, 2011). If a person originates from a home environment that does not possess many financial resources and cannot resist calls to purchase things promised to make his or her life better, he or she will soon find him or herself controlled by obligations to repay debts to those who lent him or her money.

Sound financial management develops through (1) social modeling, (2) financial knowledge, and (3) compassionate-based personal self-worth. If a person has a strong sense of personal self-worth, rooted in a sense of compassion for himself or herself, he or she can resist the call of others to purchase goods and services that are outside his or her financial control.

Here's an example, Mike owns a lot of money because he comes from a family that already owns a lot of money. Chris has no money because he comes from a family that is poor. Chris borrows money from Mike and has to pay extra money as part of the repayment. In other words, Chris needs to find extra money in addition to the amount borrowed. Chris does not have money and is punished for borrowing because Mike wants more money for the privilege of having money to lend. The rich get richer and the poor get poorer, unless one, the other, or both can resist entering into the credit relationship. We will apply the concept of interest to another instance of borrowing to convey this idea.

What if we substituted a hammer for money? Chris does not have a hammer to nail shingles into a roof on his home. Chris borrows a hammer from Mike. When

Chris returns the hammer to Mike, does Mike deserve some extra nails because he lost the use of the hammer? No, nails are not part of the contract. Has the hammer lost any value in the transaction? No, it has not.

So, why does a creditor demand interest in payment on a loan? Consider all of the possible arguments for charging interest on the loan. To what extent do these arguments involve rationales that reinforce the sense of entitlement in the lender?

One argument claims that the lender needs compensation in the event that the borrower does not repay. Many borrowers repay their loans as promised. Some borrowers intentionally or unintentionally do not repay their loans. One may argue that this failure to repay does not absolve the true financial responsibility of the lender. While the debtor should acknowledge this responsibility, the lender should also possess an obligation to dialogue with the borrower and learn about potentially new circumstances that prevent the loan's repayment and cooperate with the borrower.

One may respond that the creditor does not have this obligation because both parties entered into the contract willingly and need to honor the commitment. However it is possible that the borrower felt desperate for money and pursued the credit because he or she did not have the sense of personal self-worth to consider alternative ways of managing their crisis. While they may have entered the contract willingly, conditions that affected their ability to pay may have changed during the credit period. Working with the debtor to repay or modify the loan represents a compassionate way of helping the obligator to experience financial success. It also builds good will with the community.

If the debtor acts in a deceptive or deceitful manner to misrepresent his or her circumstances, the creditor should consider the causes of the debtor's misrepresentation and whether the debtor possesses the will and resources to remedy the conditions that cause his or her dishonesty.

A creditor that possesses compassionate view of credit and debt recognizes the factors that may prevent repayment and works with the borrower to resolve the situation. Credit represents a matter of human values. When one focuses on money, rather than people, he or she lacks compassion for which people are. A creditor with a strong sense of personal self-worth may extend this compassion to others by forgiving or modifying the debt. From the lenders' perspective, interest is money that compensates for the risk of nonpayment. If the borrower has a history of not paying loans, the lender charges a higher interest rate. Because the lender wants some assurance of repayment in case the borrower defaults on the credit.

On the other hand, interest is a cost to the borrower. The borrower has a burden of having to find more money to repay a loan. If the borrower has a history of not paying loans, the higher interest rate deters or discourages borrowing money, even if the borrower has improved from earlier situations that caused the financial difficulties. A compassionate lender considers the borrower's perspective, contemplates the causes of the behavior and restructures the terms accordingly.

Discussion Questions

- What are some indications that tell you that someone is trustworthy? Explain the reasons that you give. How do the reasons that you give inform your sense of personal self-worth?
- Rate your agreement with the each of the following two statements from 1–5 with 1 being Strongly Disagree and 5 being Strongly Agree.

  1. Interest rewards people who have money and it punishes those who do not have money.
  2. Interest compensates creditors for the loss of their use of funds for other purposes.

  Explain the reasoning for your answers and then share and discuss ratings with your classmates.
  How does your background influence your ratings of each statement?
- Six months ago, Kim borrowed $35,000 from the local savings bank and has not made any of the monthly payments. The loan originally had a five year maturity. Kim has to pay an annual interest rate of 4% on the loan. What is the amount of Kim's credit? How much debt does Kim have? What amount of interest would be due today?
- Sam had difficulty repaying a loan to a bank because Sam was in an accident and could not work for a month. Sam recovered from the accident and expects to return to work in six weeks. In other words, Sam will have been absent from work a total of 10 weeks. Sam has contacted you, the lender, about the situation. How do you respond to Sam?

TYPES OF CREDIT

This section describes some of the forms of credit that you might encounter. It initially focuses on short term loans (credit cards, consumer loans) and long term loans (mortgages and education loans). The benefits of using credit to make daily purchases of food or clothing are short-lived and do not accumulate over time.

Consumers can choose from a variety of credit sources. The range of choices depends on the consumers' financial histories and their access to financial institutions. Lenders charge different interest rates based on the risk of nonpayment by borrowers. The higher the risk of nonpayment, the higher the interest rate charged. The lower the risk of nonpayment, the lower the interest rate charged. Higher interest rates can also prevent weak borrowers from escaping debt difficulties.

We will begin with a credit card as a tool for short-term borrowing. Credit cards were originally created in the 1930s as tools for business travelers to receive temporary credit for their expenses until their employers paid them for their travels (Weatherford, 1997). As society changed, financial institutions issued credit cards to non-travelers (1) to provide them with financial access to purchase additional goods and services (2) as a way of creating more interest income for the banks.

A bank or other financial institution may issue a credit card. One presents the card at the store when it is time to pay for the purchase. When one uses the card, the bank makes a payment to the business for the amount of the purchase. At the same time, one has a credit with the issuer of the card for the amount of the purchase. The debt must be paid by the end of the billing cycle or the lender will charge interest. The interest rate associated with the credit card varies by institution and can be very high. For example, during the summer of 2014, rates for automobile loans ranged from 3–5%, whereas credit cards ranged from 13–15% (http://www.bankrate.com). Further, the bank has the right to call in the balance of the credit card at any time.

A credit card purchase is a loan from the financial institution that issued the card. Credit card interest rates tend to be higher than rates for other loans, in part, because the lender does not have collateral for the loan.

Financial institutions may also charge significant fees related to a credit card and its use. According to the Federal Reserve (http://www.federalreserve.gov/creditcard/fees.html), credit card companies may charge fees for applications, account set-up, cash-advances, and balance transfers that exceed one's credit limit, and increasing credit limits. There are many expenses associated with impulsive borrowing to consider.

Borrowers who use credit cards for purchases and who do not pay the full balance when it is due pay higher costs for their purchases because interest is charged monthly. A credit card user can avoid interest charges by paying the entire balance within the grace period specified by the financial institution. Borrowers having unpaid balances on their credit cards are charged interest based on the average daily balance for the billing cycle. Consumers can save credit card interest by paying their credit card debt before the end of the billing cycle, presuming they do not make additional credit charges. The credit associated with a credit card is the maximum amount of spending for which you can use the card. For example, a $5,000 spending limit on a card represents a $5,000 credit. The debt is the unpaid balance on that card. For example, if one used the card to charge $1,500 worth of goods and has not made a payment, the debt is $1,500. The interest for a credit card is charged on the average daily balance unpaid on the credit card each month. This is a tricky way of calculating interest, but it is very important to understand.

Imagine that one has the unpaid balance of $1,500 on the credit card mentioned above. He or she wants to make a $500 payment to reduce the debt. Does one make the payment now as soon as one can? Or wait until receiving a billing statement from the financial institution and then sending the check?

Making this decision is a bit tricky. The answer is to avoid convenience and make the payment as soon as one can. The average daily balance basis for interest calculation requires this approach.

Consider the examples in Table 6.1 for three instances when we might make this payment. One example is for the 10th day of the month. The second example is for the 20th day of the month. The final example is for the last day of the month. Notice how the timing of the payment affects the amount of interest owed. The amount of

interest is calculated by multiplying the average daily balance by the interest rate, by the number of days in the billing cycle divided by 360 (ADB x i x (days/360)).

Table 6.1. Payment scenarios, credit card interest, average daily balance

	Day 10 Payment	*Day 20 Payment*	*Day 30 Payment*
Beginning Balance	$1,500	$1,500	$1,500
Days at $1,500	9	19	29
Days at $1,000	21	11	1
Average Daily Balance	$1,150	$1,317	$1,483
Interest @ 12%	11.50	13.17	14.83

When paying a credit card, there is a price for the convenience of delaying the payment. Accept the inconvenience of doing without and pay the credit card early.

We previously considered the benefits of doing things faster by doing things slower. How does this situation illustrate this adage? In this situation, what are you doing slower to accomplish faster? You are slowing your spending to build your financial worth faster by reducing your debt. You could spend the amount that you save on an ice cream cone. Would you choose to do so or make an additional payment on the credit card?

While the choice to spend is yours, remember that when you have debt, your creditors control your use of money. Your money is obligated to pay your debts first. By taking the time to reduce your debts, you increase your financial freedom, reducing your financial obligations to others.

You say that the creditors cannot control you. You will just exercise your financial right to pay the minimum credit card balance and continue your lifestyle. You are entitled to it.

Revisit our discussion of trust and manipulation. Your statement does not appear to represent one that affirms a compassionate sense of personal self-worth. Making excuses to conceal willingness or to avoid responsibility to repay your debts represents a form of manipulation.

Table 6.2. Characteristics of credit cards

Feature	*Notes*
Credit Amount	A spending limit established by the issuing bank
Debt Amount	The unpaid monthly balance associated with the card account.
Payment schedule	Any time before end of billing cycle, but generally within 30 days.
Interest	Very high rate if balance is not paid within 30 days.
Notes	Convenient to use. May provide difficulties without disciplined use and payment.

CONSUMER LOANS

Consumer loans help people purchase things for which they either do not have the savings to pay for or do not wish to use their savings. There are different types of consumer loans.

Cash loans represent one type in which the borrower may receive cash to any of a variety of consumer purposes, such as making a purchase, paying off debts, or other reasons. A purchase loan does not involve cash. Instead, the lender transfers funds directly to the seller.

Various financial institutions and businesses make consumer loans and may charge different rates of interest. The rates of interest depend on the costs of their funding sources and the risks of repayment by their borrowers. What creditors issue consumer loans? Cash loans come from a variety of sources, such as pawn shops, title loan stores, and general finance companies. While these businesses represent sources of cash, the interest rates that they charge are very high, much higher than those charged by larger banks and financial institutions. So, whereas credit cards charge 13–15% interest annually, pawn shops may charge between 5–25% per month (http://www.bankrate.com). Why might this situation occur? There is a price for convenience! In general, consumer loan outlets are sources of convenience lending. Cash loans are generally issued for small amounts, up to $5,000. Because cash is something that is easily spent and because those who are in decent financial health do not tend to experience difficulties, cash loans are generally associated with people who are at high risk of repayment.

Think about this statement. If a person needs cash to help pay-off monthly bills or a loan, then that person needs to reevaluate his or her income and expenses or even his or her lifestyle. It may also be that he or she does not have an income to meet obligations. Cash loans are often made to borrowers who would have difficulty getting credit from other sources. They represent forms of borrowing which are very expensive. Given our discussion of personal self-worth, what are the consequences to your personal self-worth of a personal consumer loan?

The usury rate is the highest interest rate that the law allows creditors to charge borrowers. The laws that define this rate vary by state; however they can be quite high. For example, the usury rate in one state is 50% for non-consumer loans (http://www.cardhub.com). Such laws are designed to protect consumers from being charged too much for their credit. Each state legislates and enforces its own usury law.

DISCUSSION POINT

As a class, research the usury laws that are in place for your state. Discuss answers to the following questions.

- What is/are the usury limit(s) stated?

- How complicated is the language within the law? How different is this from language that is more focused on explaining money lending or terms of financial agreements?
- What exceptions to the limit are present? Why do you think these limitations exist?
- How do usury rates compare with other loan rates? Why do these differences occur?

PURCHASE CONSUMER LOANS AND INSTALLMENT LOANS

By using credit to buy durable goods — such as cars, houses, and appliances— people are able to use the goods while paying for them. A durable good is a product that people can expect to last a long time.

Some durable goods, such as jewelry or collectible items, increase in value with age. Most durable goods decrease in value with age. Very often consumer loans are made for the purchase of a particular good, such as a car. With this type of loan, the lender sends a payment for the purchased item to the seller and the borrower pays the lender for the credit. This often happens with the purchase of a very expensive item, such as a car.

An installment loan occurs when the borrower repays a loan through a series of regular payments or scheduled installments. Such an arrangement is made because (1) the plan fits the borrower's budget or form of income and (2) the balance of the loan grows smaller as the value of the purchased item decreases. The installment aspect of the loan describes a payment schedule designed to repay the loan within a certain period of time (for example, 3 years) using amounts that are appropriate for the borrower's budget. A portion of each payment is assigned to interest and to principal. More of the early payments are allocated to interest. More interest is paid during the early portion of the payment schedule. Consumer loans may be secured, which means that the lender has a right to take some of your property (often the good being purchased) if you do not repay the loan.

Use a car loan as an example of a consumer loan for discussion. You agree to a $15,000 car loan to be paid over 48 months (four years) at 5 percent interest. Your monthly payment is $345.

Now, say that $345 is not in your monthly budget. The lender has a solution for you. You may pay the loan over 60 months (five years) and keep the interest rate the same. The monthly payment is now $284. Do you say "Yes"? The arrangement provides you with lower monthly payments that fit within your budget.

You and this textbook have been together long enough to know the answer. The answer is "No". Feel yourself calm as you hear the gentle n and o glide through your lips as you calm the emphatic lending officers. N-n-n-n-o-o-o-o, the lower monthly payment is not the way to g-o-o-o-o. We will compare the presented alternatives.

It seems that the lower monthly payment represents a good deal. You are borrowing the same amount, you have the same interest rate, you take longer to pay and you pay

less each month. It is a win-win situation! You are saving $61 per month. Think of the things you could do with $61 per month!

Table 6.3. Monthly payment loan comparison

	Loan Amount	*Rate*	*Months*	*Payment*
Option 1	$15,000	5%	48	$345
Option 2	$15,000	5%	60	$284
Difference				$61

"No so fast." says your slower, not faster, money friend. We will get some additional information and then decide. The table below shows the results of this information processing.

The extended loan with lower monthly payments may affect the monthly budget; however, the total cost of credit is $480 more than the 48 month loan. It is better to adjust your budget for the $61 and pursue the higher monthly payment. All other loan conditions the same, it is better to pursue a short loan term if you can afford the higher monthly payment.

Table 6.4. Detailed monthly loan comparison

	Loan Amount	*Rate*	*Months*	*Payment*	*Total Payments*	*Interest*
Option 1	$15,000	5%	48	$345	16,560	1,560
Option 2	$15,000	5%	60	$284	17,040	2,040
Difference				$61	480	480

LONG TERM LOANS

People can use credit to finance investments in education and housing. The benefits of using credit in this way are spread out over a time. Borrowers may view the long-term purposes of these loans as generating more money than the cost of interest associated with the loan. The large costs of acquiring the education or housing are spread out over time as well. The benefits that people expect from investments may not be as much as they realize and these situations may impair their abilities to repay their loans.

EDUCATION LOANS

People use education loans to pay for college tuition and room and board. They represent long term loans because the amounts take a long time to pay. Consider

that your college tuition may cost $5,000 per semester. You attend school for eight semesters (four years). Your total tuition amounts to $40,000. If you borrow the entire amount, you have a significant financial responsibility at the end of college.

When considering education loans, as with all loans, you should think about several matters. Consider (1) whether the potential earnings from a college education outweigh the expenses associated with the loan, (2) whether you really need to borrow the money. Aside from personal resources, there are many programs and organizations that offer grants and scholarships to assist with funding of your tuition. In addition, many universities offer student work programs. If you decide that you truly need to borrow, find out (3) who offers the money at the lowest cost and (4) how you would repay the money. The federal government has a number of college loan programs that offer funds at low interest rates. Your ability to repay the loan depends upon the amount you will earn and the length of the career that you pursue after college.

MORTGAGES

Mortgage loans are associated with borrowers who demonstrate stability in their manner of living. A mortgage will often be made for a very long time, often 30 years. Why? This situation arises for several reasons. First, houses are expensive and most people do not have the money to make a purchase of that amount. Second, people with stable lifestyles may stay in the same home for 30 years or more. Such people are good credit risks for the lender. Third, unlike consumer goods, such as cars and appliances, houses do not generally decrease in value unless they are in locations that experience much economic change.

One may view the mortgage as a long-term monthly payment loan for a home. The difference is that the monthly payments are much greater than those for your car loan. Given that situation, the principle of taking a higher payment for a shorter loan maturity makes much more sense in terms of saving interest. We will look at an example that compares a 30 year mortgage (often referred to as conventional) versus a 15 year loan. Use a $75,000 loan as an example.

Table 6.5. Mortgage payment comparisons

	Loan Amount	*Rate*	*Months*	*Payment*	*Total Payments*	*Interest*
Option 1	$75,000	4%	360	$358.06	128,902	53,902
Option 2	$75,000	4%	180	$554.77	99,859	24,859
Difference				$196.71	29,043	29,043

Pursuing the shorter loan maturity again saves interest. In just 15 years, one saves more than $29,000 by paying an extra $200 a month. For the next 15 years, one has funds available for other purposes that he or she would have previously applied to the loan.

Imagine that you already have a 30 year loan and feel badly and because you are stuck with the low payments. Cheer-up! If your loan contract does not have a prepayment penalty, you can simply send an extra principal payment with your regular payments so that the loan balance reduces faster. When it comes to mortgages, efforts to reduce the balance early in the loan payment experience will save money in the long-run.

Mortgage loans are generally good risks for lenders because they offer stable sources of interest income and the homes generally have stable values if they need to be sold to repay debt. Because of these conditions, mortgage loans are generally offered for comparatively low interest rates versus car loans. As of March, 2015, interest rates in the United States run counter to this idea with 30 year mortgages carrying rates of 3.90 percent and car loans running from 2.5–3 percent (http://www.bankrate.com). Why the difference? Mortgage loans generally involve low risk of default and stability of collateral for people who have long-term community commitments; in times when many people lose their jobs they cannot afford to pay their mortgages, banks charge higher rates to compensate for the risk.

Why would a bank not foreclose on a mortgage loan that is past due? Foreclosure simply means the bank completes a legal process to repossess the house and sell it to pay for the unpaid loan balance. If a lender decides to foreclose on a mortgage, it may incur many legal fees and expenses to take control of the property if the borrower is uncooperative. Because people can become emotionally attached to their homes, they resist moving to other locations, even if they do not make their loan payments.

The low rates associated with car loans may occur for different reasons such as automotive finance companies (those affiliated with car manufacturers) enticing people to purchase new cars. They compensate for the risk of payment default by making the rates available only to those borrowers with pristine credit histories. One reason that lenders may be more flexible with their lending rates for automobiles involves comparative ease of collecting the vehicle in the event that the borrower stops payment on the loan. The lender simply repossesses the vehicle and sells the vehicle to collect the balance of the loan. The costs of this process are much less than those for foreclosing on real estate.

One strategy to consider when shopping for a used vehicle would be to approach a local lender whom you trust about the availability of repossessed vehicles. The reason for this strategy lies in the lender's interest in selling the vehicle to pay a non-performing loan (a loan that is not earning interest for the lender.) The lender has first-hand information about the vehicle and may provide information about the extent to which the borrower may have cared for it. Of course, whenever you consider purchasing a used vehicle, be certain to have your trusted mechanic examine the car to ensure that it is safe for operation. The following table describes the types of loans just considered.

Table 6.6. Comparisons of interest rates and repayment risk for various loan types

	Interest Rates	*Risk of Repayment*
Cash Loans	High	High
Credit cards	High	High
Purchase (Installment) Loans	Moderate	Moderate
College Education Loans	Low	Low to Moderate
Mortgages	Low	Low to Moderate

CREDIT SOURCES

Despite the best efforts to manage your budget, you do not have the resources to purchase a car or home and need to obtain credit to do so. Where could you obtain credit? There are a number of different source available; however, before considering the different types of creditors, we will clarify that any financial entity: person, local store, institution, may be interpreted as a business that buys and sells money. [2] It buys money in the form of deposit accounts, loans, and owners' capital. It sells money at a higher interest rate through its loans and investments. The difference between interest received and interest paid contributes to the increase financial worth. Different lenders serve people who have different degrees of repayment risk.

People who are regarded as favorable risks tend to be served by depository institutions such as commercial banks, savings and loans, and credit unions. These sources generally offer credit at lower rates than other sources. The costs of the funds that they buy (deposit accounts) are generally lower than other sources; therefore they can afford to charge less for their loans than charged by other courses. At the same time, these lenders scrutinize their borrowers more than other lenders by researching past credit performances when deciding whether or not to extend them credit. By extending loans to the customers who have the strongest records of loan repayment, these banks can afford to keep their loan rates low.

Other lenders, such as commercial finance companies, charge very high interest rates for their loans. This situation occurs because these lenders pay higher amounts for their sources of funds. It also occurs because their borrowers represent high repayment risks and generally cannot obtain credit from depository institutions.

High interest rates make debt more difficult for borrowers to afford. Sometimes people are unable to pay their debts. These situations may occur through conditions under which the people cannot control. These situations may result in creditors' repossession of property or garnishment of their wages. The debtors may also attempt to renegotiate the debt or sell the collateral to pay it off.

You may be thinking that you want borrow from the depository institution and so you should think that. If you obtain credit, you should use the creditor that charges

the lowest possible interest rates possible. You should also ensure that your debt levels are manageable. How can you accomplish this?

First, develop a strong sense of personal self-worth. Remember that buying things does not make you a better person. Controlling your spending and managing your money responsibility are the first steps towards making you a stronger candidate for credit and debt if you need them.

Second, manage your money properly. Use a budget or spending plan to organize your expenses and monitor your funds.

Third, when you need to borrow, do so with a specific plan for repayment in mind. Examine your budget or spending plan and consider how to adjust it *before* you approach a creditor. Taking on the credit will require you to free-up money in your budget for debt repayment. If it is possible to delay your credit, consider paying yourself the debt payment into a savings account for a time and using cash from your reserves to make the purchase later.

Finally, we will clarify how credit and debt relate to personal self-worth. Remember that we defined personal self-worth in terms of your early relationships with others. Your personal self-worth originates from your valuing of who you are. This sense derives from an environment that unconditionally accepts you. Your personal self-worth does not depend on accumulation of money or objects.

Given this reality, why is knowledge of credit and debt relevant to personal self-worth? By understanding how systems of credit and debt work, you may better resist the strategies used by financial institutions to sell you loan products that threaten your personal self-worth. How may this be so?

If you define your personal self-worth in terms of the money that you control, poor decisions with regard to credit and debt may subject you to the control of financial institutions. By convincing you of the need to borrow money to afford a particular lifestyle, these businesses control your future use of money, and therefore your options of using financial resources in the manner you would choose and requiring payment of interest for their profit. By recognizing that your personal self-worth comes from within, you can confidently say “No” to potentially controlling credit and debt tools.

A critically compassionate approach to credit and debt recognizes that an obsession with financial net worth distracts from a healthy sense of personal self-worth. A compassionate view of yourself empowers you to compassionately interpret the system of financial control exercised through credit and debt practices that exploit you as a tool for profit. With this awareness, we invite you to divest yourself of dependency on credit and debt and invest in your personal self-worth.

NOTES

1. This story was originally quoted and referenced in the article Economic Influenced Perceptions and Their Implications for Early 21st Century Education published in the winter, 2003 issue of the journal *Educational Foundations*, on pages 41–54.
2. Thank you to Timothy P. Neeck, with the Federal Deposit Insurance Corporation, for this analogy.

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FINANCIAL LITERACY BENCHMARKS

4th Grade

Conventional Standards	*Compassionate Standards*
Credit is a basic financial tool.	Credit is a basic financial tool to acquire goods and services for which a person does not have or does not want to use cash.
Borrowing money to buy something usually costs more than paying cash because there is a fee for credit (interest).	Borrowing money to buy something usually costs more than paying cash because creditors charge money for credit (interest).
Interest is the price the borrower pays for using someone else's money.	Interest is the price the borrower pays for using someone else's money. The lender determines the interest rate for a loan. A borrower needs to acquire additional money to pay the interest on money borrowed.
	Interest paid to the lender is the cost for the use of the money. Interest rewards people who have money and punishes those who do not have money.
Responsible borrowers repay as promised, showing that they are worthy of getting credit in the future.	Many borrowers repay their loans as promised. Some borrowers intentionally or unintentionally do not repay their loans.
When people use credit, they receive something of value now and agree to repay the lender over time, or at some date in the future, with interest.	When people use credit, they receive something of value now and agree to repay the lender over time, or at some date in the future, with interest. The lender expects that the borrower will have a plan and the resources to repay the loan.
By using credit to buy durable goods—such as cars, houses, and appliances—people are able to use the goods while paying for them.	By using credit to buy durable goods—such as cars, houses, and appliances—people are able to use the goods while paying for them. Some durable goods decrease in value with age. Some durable goods increase in value with age.
Borrowers who repay loans as promised show that they are worthy of getting credit in the future. A reputation for not repaying a loan as promised can result in higher interest charges on future loans, if loans are available at all.	Borrowers who repay loans as promised show that they are worthy of getting credit in the future. A reputation for not repaying a loan as promised can result in higher interest charges on future loans. There are a variety of planned and unplanned reasons why borrowers may not repay loans.
	High interest rates make debt more difficult for borrowers to afford.
	The usury rate is the highest interest rate that the law allows creditors to charge borrowers.

8th Grade

Conventional Standards	*Compassionate Standards*
Comparing the costs and benefits of buying on credit is key to making a good purchase decision.	A good purchase decision involves first determining whether one needs the item considered. If the item is needed, the purchase should be made with cash.
People who apply for loans are told what the interest rate on the loan will be. An interest rate is the price of using someone else’s money expressed as an annual percentage of the loan principal.	Lenders generally tell consumer borrowers what the price of their credits will be. An interest rate is the price of using someone else’s money expressed as an annual percentage of the loan principal.
For any given loan amount and interest rate, the longer the loan period, the smaller the monthly payment and the larger the total cost of credit.	For any given loan amount and interest rate, the longer the loan period, the smaller the monthly payment and the larger the total cost of credit.
A credit card purchase is a loan from the financial institution that issued the card. Credit card interest rates tend to be higher than rates for other loans. In addition, financial institutions may charge significant fees related to a credit card and its use.	A credit card purchase is a loan from the financial institution that issued the card. Credit card interest rates tend to be higher than rates for other loans. In addition, financial institutions may charge significant fees related to a credit card and its use.
Borrowers who use credit cards for purchases and who do not pay the full balance when it is due pay much higher costs for their purchases because interest is charged monthly. A credit card user can avoid interest charges by paying the entire balance within the grace period specified by the financial institution.	Borrowers who use credit cards for purchases and who do not pay the full balance when it is due pay much higher costs for their purchases because interest is charged monthly. A credit card user can avoid interest charges by paying the entire balance within the grace period specified by the financial institution.
	Borrowers who have unpaid balances on their credit cards are charged interest based on the average daily balance for the billing cycle. Consumers can save credit card interest by paying their credit card debt before the end of the billing cycle, presuming they do not make additional credit charges.
Consumers can choose from a variety of credit sources.	Consumers can choose from a variety of credit sources. The range of choices depends on the consumers’ financial histories and their access to financial institutions.

(Continued)

Conventional Standards	*Compassionate Standards*
Various financial institutions and businesses make consumer loans and may charge different rates of interest.	Various financial institutions and businesses make consumer loans and may charge different rates of interest. The rates of interest depend on the costs of their funding sources and the risks of repayment by their borrowers.
Lenders charge different interest rates based on the risk of nonpayment by borrowers. The higher the risk of nonpayment, the higher the interest rate charged. The lower the risk of nonpayment, the lower the interest rate charged.	Lenders charge different interest rates based on the risk of nonpayment by borrowers. The higher the risk of nonpayment, the higher the interest rate charged. The lower the risk of nonpayment, the lower the interest rate charged. Higher interest rates can also prevent weak borrowers from escaping debt difficulties.
People can use credit to finance investments in education and housing. The benefits of using credit in this way are spread out over a period of time and may be large. The large costs of acquiring the education or housing are spread out over time as well. The benefits of using credit to make daily purchases of food or clothing are short-lived and do not accumulate over time.	People use credit to finance investments in education and housing. The benefits of using credit in this way are spread out over a period of time and may be large. The large costs of acquiring the education or housing are spread out over time as well. The benefits of using credit to make daily purchases of food or clothing are short-lived and do not accumulate over time. The benefits that people expect from investments may not be as much as they realize and these situations may impair future abilities to repay their loans.
Credit bureaus maintain credit reports, which record borrowers' histories of repaying loans.	Credit bureaus maintain credit reports, which record borrowers' histories of repaying loans. Financial institutions use these reports to interpret the risks of their credit applicants' repayment.
Sometimes people borrow more money than they can repay, which can have consequences such as repossession and garnishment.	Sometimes people are unable to pay their debts. These situations may occur through conditions under which the people cannot control. These situations may result in creditors' repossession of property or garnishment of their wages. The debtors may also attempt to renegotiate the debt or sell the collateral to pay it off.

ACTIVITIES

Activity 1

Locate a phonebook or a technological device with internet services and a map of your local community. In the business section of the phone listings, find and record the addresses for the offices of two or three banks, credit unions, and/or savings and loans. Plot the locations of these offices on the community map, using different codes for different types of branches (e.g., full-service branches, limited service branches, and ATM only).

After plotting these locations, find and record the addresses for offices of the commercial finance, pawnshop, and pay-day lending businesses. Plot these locations on the same community map, using different color codes than those used for the depository institutions. Answer the following questions:

- What patterns do you observe with regard to the income characteristics of the neighborhoods in which the various businesses are located? Why do you think these businesses choose to locate in the communities that they do? To what extent did the people in these communities make the choices to live in these neighborhoods? To what extent were people in these communities forced to live in these neighborhoods?
- To what extent do you think that the people in the community shape the businesses that are present? To what extent do the businesses that are present shape the nature of the community?

Activity 2

Lenders charge higher rates to those who have histories of not repaying their loans. Develop a list of reasons as to why you think people do not repay their loans. Share this list with your classmates and study the reasons that you developed. How many of these reasons relate to poor decision-making, difficult circumstances, poor images of worth, or a combination of factors? Based on your findings, propose some solutions for changing these conditions. You should provide an equal number of strategies for lenders and for obligors. In your proposals, consider things that both the businesses and the people of the community can do to improve the worth of the community.

Activity 3

There is a car that you want to purchase and you need to borrow $5,000. You have $150 per month budgeted for the purchase. You go to the bank and receive approval to borrow the money; however, you are provided four options for repayment, all involve an interest rate of 5%. Each option includes a prepayment penalty if you decide to pay the loan early.

- Decide which of the following options best suits your situation. Explain your answer.
  a. A one-year note for which you will pay the bank a one-time payment $5,025 in twelve-months.
  b. A two-year note with monthly payments of $219.36
  c. A three-year note with monthly payments of $149.85
  d. A four-year note with monthly payments of $115.15
- Consider that bank has decided to wave the prepayment penalty for the loan. What option is best for your situation?

Activity 4

Silly Sarah Spender loves sales. Sarah loves sales so much that she has a special credit card that she uses to buy things when she goes to them. Sadly, Sarah's credit card debt is more than a level with which Sarah is comfortable. Sarah has a credit card balance of $4,000 and needs to pay down the debt. She has $300 per month available. The card charges an interest rate of 10% on the average daily balance.

Sarah is struggling with how to pay down the credit card in the most efficient way, and has three options. Her statement is due on the 30th of each month and she is paid on the 15th of the month. She is considering three options. (1) Send the check for $300 as soon as she is paid (2) send the check to the bank when the credit card is due (3) send the bank a check for $100 every 10 days during the month to keep shrinking the daily balance. Which option should Sally choose? Provide the mathematical calculations to support your response.

Activity 5

Fred does not have a lot of money and works at hourly wage jobs performing manual labor such as washing dishes and bussing tables. Fred is riding the bus home one day and sees a classic car available with a local used-car dealer for only a couple of thousand dollars. Fred does not have that amount in savings; however, sees a sign at the car lot that says "We Tote the Note." In other words, the used car dealer will work with a consumer credit company to finance the loan to purchase the car.

Imagine you are Fred's friend. You two are hanging out, and Fred is raving about the car, how it would make life so much better, and how the car loan sounds like a bargain. What does Fred's information tell about his sense of personal self-worth? What does the information tell about his sense of financial worth? What advice would you offer Fred about the car?