There are two important rules to remember in comparing credit card terms. First, always compare the rates based on APR rather than the nominal, or stated, rate. Second, read your credit agreement carefully to determine how finance charges are calculated. In general, the best deals will be on cards that calculate the finance charge using either the average daily balance with a grace period or the adjusted balance method, since these methods give you access to short-term free borrowing. If your credit card balances are gradually increasing, your highest monthly finance charge will come from the average daily balance without a grace period. Since your personal financial plan probably includes a debt reduction goal, it is important to note that consumers who are gradually reducing their outstanding credit card debt should avoid cards that use the previous balance method or the two-cycle method, since both place more weight on your previous balance, which will always be greater than your current balance as you continue to pay off the debt. A comparison worksheet is included in your Personal Financial Planner.

You’ve just received a credit card solicitation in the mail that offers you a 4 percent APR. Your current card, which has an outstanding balance of $5,000, has an APR of 14 percent.

1. What factors should you consider in making the decision to transfer your balance?
2. How much interest will you save the first month by switching cards, assuming you make no additional charges and both cards calculate interest based on the average daily balance?

The Advantages and Disadvantages of Credit Card Use

Earlier in this chapter, we noted that using consumer credit involves both advantages and disadvantages, both for individuals and for the economy. Although credit cards offer these same advantages, as well as some others discussed in this section, the high costs of interest and fees tend to outweigh the benefits of this form of borrowing, from the perspective of personal financial planning. In this section, we look at the additional advantages and disadvantages of credit card use. Exhibit 6-5 compares the costs and benefits of consumer credit in general, which includes consumer loans of various types, with the costs and benefits of credit cards. Debit cards offer many of the same advantages without the disadvantages of borrowing.

Advantages of Credit Cards

Like other forms of consumer credit, credit cards provide the opportunity to delay payment for purchases, the convenience and safety of not carrying cash, and a source of emergency funds. In addition, they may offer the following positive features.

Method of Identification. Although most people use their driver’s license for their primary means of identification, a credit card is a secondary method for verifying your identity. Some cards are now being imprinted with photos to make them more useful as an identification tool, as well as to reduce the risk of fraudulent card use.

Means of Record Keeping for Business Expenses. Credit cards provide a convenient way to organize business-related and tax-deductible expenses. Using a specific credit card for all reimbursable business expenses makes it easier to submit requests for payment to your employer. Similarly, if you have tax-deductible business expenses that need to be kept separate from household expenses, a credit card may offer an easy method of record keeping. American Express even provides an end-of-year summary that separates total annual expenditures into various categories, such as restaurants, hotels, and airfare.