Play Your Cards Right
It's Easy to Get Credit.
The Hard Part Is Using It Wisely.

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Credit cards. They seem like the easiest form of money: You just hand over that card and buy whatever you want.

Getting your first credit card is pretty easy, too. During the first few weeks of college, representatives from a raft of banks will clamor to sign you up for a card with a $500 limit or more. Or when you approach the counter at your favorite store with an armload of clothes, the clerk may offer you a store credit card and a 10% discount to boot.

"It's tempting because it sounds so easy," says Susan Craine, of NYPIRG, a consumer-advocacy group. "But anything that sounds easy with a credit-card company has a catch somewhere."

Those catches can be very costly. Make a payment after the due date and you'll get socked with a fee of $25 or more, plus interest charges on what you owe. Spend more than your assigned limit and you'll pay another fee. And spend more than you can afford to repay in two or three months and you may find yourself paying off old purchases until your hair goes gray.

That said, there are benefits to having a credit card and learning how to make the best use of it. A credit card gives you financial flexibility in a pinch and can help you establish a record of paying your bills on time, which will be important later when you want to buy a house or a car. Here are some basics to ensure your first credit card doesn't become your first financial nightmare:

Think of every purchase as a loan from a bank. Some people see credit purchases as buying with other people's money. But actually, when you use a credit card, you are simply borrowing money that has to be paid back.

True, if you pay your bill in full and on time, you won't pay any extra fees. (Credit-card companies will still make money, since merchants must pay 1% to 5% fees on all credit-card purchases.) But if you don't pay your full bill, next month you'll pay hefty interest, also known as finance charges, for the right to use that money.

Check the interest rate before signing up for a card. Credit cards are the most expensive kind of debt, more costly than car and home loans. That's because they aren't backed by an asset like a car or home-just by your good intentions.

A first-time credit card can carry an annual interest rate of up to 20%, or $1 in interest a year for every $5 in purchases. That can add up if you spend just a few hundred dollars a year and take your time paying it back. You should be able to get a far lower rate if you shop around. But few students pay attention. A survey of 18- to 24-year-old credit-card holders by Myvesta.org, a nonprofit consumer education group, found that 64% didn't know the interest rate on their cards.

After getting a card, experts say, you should check your bill for the APR, or annual percentage rate. Some banks offer initial teaser rates that climb after a few months. Others will raise your rate, with little or no warning, if you make a late payment or even if you miss payments on another debt.

The "minimum payment" on your bill may as well be a typo. Most credit cards require you to pay a minimum of $10 or $15 each month, or 2% to 2.5% of the amount you owe, whichever is larger. That
minimum is usually prominently displayed; you may have to actually search the bill to find out the full amount you owe.

Credit-card companies aren't being gracious. The less you pay each month, the more interest you will pay later on the borrowed balance. According to a survey late last year by Myvesta.org, the average college student had about $1,200 in credit-card debt. If the card carried an 18% interest rate and required a minimum payment of 2.5% each month, the initial minimum payment would be just $30. But if you paid only the minimum each month—and you never charged another dime—it could take up to 14 years to pay off the bill. In the meantime, you might also pay more than $1,400 in interest.

"Do you really want to be paying for that trip to the beach when you're 40 years old?" asks Jim Tehan, a Myvesta.org spokesman.

If you can't pay the entire bill, pay as much as you can afford each month to keep the debt under control.

An increase in your credit limit doesn't mean you're better off. After you successfully pay your bill for a few months, the credit-card company may reward you with a higher credit limit. Think of this limit as a very rich cake—don't eat the whole thing unless you can afford the consequences.

Perks on store credit cards may have a hidden cost. Many stores may offer a discount of up to 15% on your first purchase if you open a credit-card account. That can be tempting. Gap, for instance, offers discounts for purchases made with its Gap card one day a month and additional discounts and coupons depending on how much you spend.

This year, the retailer is rolling out a credit card that can be used at all three of its brands: Gap, Old Navy and Banana Republic. But since the card carries an annual interest rate of 19.8% (still relatively low for a retailer) you can run up big interest charges if you pay only a small part of your debt each month, quickly erasing the value of your perks.

Why do retailers push their cards so hard? In short, loyalty. Gap says its cardholders visit its stores about twice as often as other customers and spend about twice as much.