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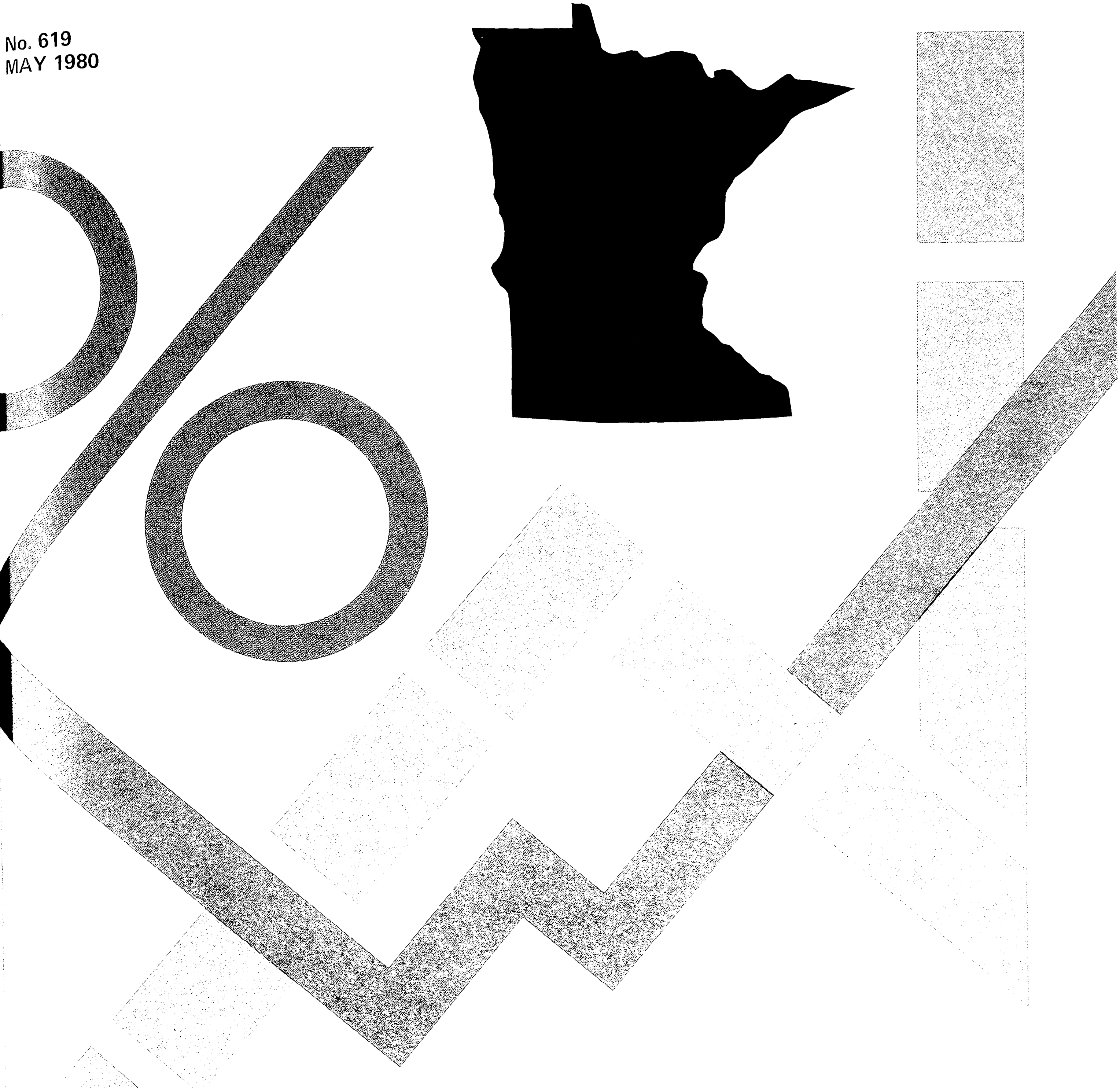


MINNESOTA AGRICULTURAL ECONOMIST

Agricultural Extension Service
University of Minnesota

Credit Card Use Among Rural and Urban Minnesota Households: A National Context

Jean Kinsey

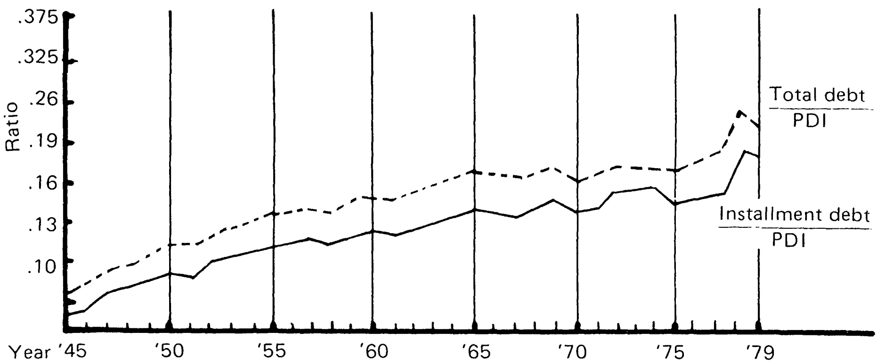
Credit cards are important in the consumption patterns of households because they provide convenience while shopping and traveling and a ready source of cash when necessary. Nationwide surveys showed that in 1977 the typical American family had five different credit cards. Three-fourths of the card holders used their cards in the month prior to the survey and charged an average of $240. About one-half of all households had at least one credit card.[1] In Minnesota in 1977 about 72 percent of all households had at least one credit card, most likely a retail store card.

National and statewide household surveys were conducted in 1977 to determine the number of credit card accounts held by households with a variety of socioeconomic characteristics. There were questions about attitudes on the use of credit and the awareness of credit costs. After a discussion of general trends in the use of consumer credit in the United States, this issue of the *Minnesota Agricultural Economist* proceeds in Section I to compare the results of the national and Minnesota consumer credit surveys and to highlight differences in consumer credit use in rural and urban areas. Section II reveals that some consumers were willing to pay more for credit than the law allows. These consumers often did not know the maximum allowable interest rate or could not translate the interest rate into an accurate dollar finance charge.

General Trends

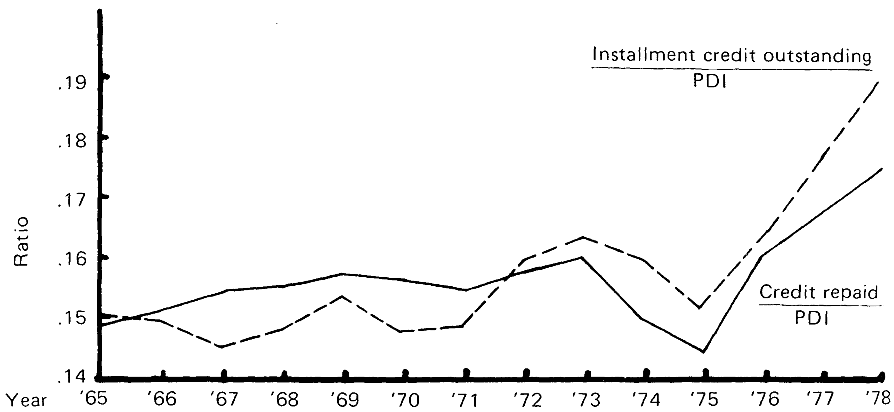
Continued high levels of consumer spending have helped to forestall a long anticipated and much predicted recession in the late 1970s and early 1980. Despite a dramatic increase in the price of necessities such as food, transportation, and housing, American consumers have insisted on maintaining their standard of consumption which has not only cushioned recessionary trends but has fostered continued inflation. This level of consumption has been financed by a decline in savings (down from 7.4 percent in 1975 to 3.3 percent of personal income by the end of 1979) and an increased use of consumer credit. Installment credit, including revolving charge accounts, increased over 18 percent per year in each of the last three years. Installment and noninstallment consumer credit outstanding, as a percent of personal disposable income (PDI), increased to 26.9 percent in 1978 and then declined slightly in 1979 to 22.8 percent.[2] Figure 1 illustrates the trend in the ratios of total consumer debt and installment debt outstanding to PDI since 1945.

Figure 1. Trends in aggregate consumer debt ratios in the United States, 1945-1979



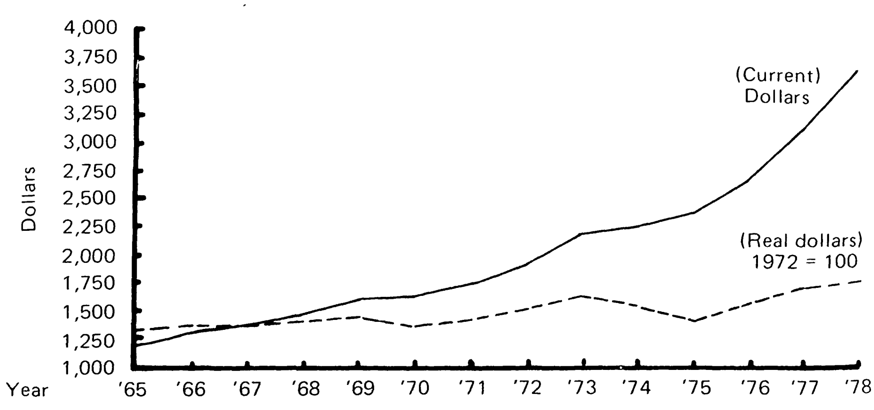
Source: U.S. Board of Governors, Federal Reserve System, *Federal Reserve Bulletins,* 1945-1980.

Figure 2. Ratio of consumer credit repaid to personal disposable income and installment credit outstanding to personal disposable income, 1965-1978



Source: U.S. Board of Governors, Federal Reserve System, *Federal Reserve Bulletins,* 1945-1980.

Figure 3. Installment credit outstanding per household in the United States, 1965-1978



Sources: U.S. Board of Governors, Federal Reserve System, *Federal Reserve Bulletins,* 1945-1980.
U.S. Department of Commerce, Bureau of the Census, "Population Estimates and Projections," *Current Population Reports,* Series P-25, No. 807, July 1979.

[1] University of Michigan, *Institute for Social Research Newsletter,* Winter 1980.

In 1978, 17.5 percent of personal disposable income was used to repay consumer debt. Although this percent fluctuates over time, figure 2 indicates with the solid line, a noticeable increase in the portion of personal disposable income being used to repay consumer debt. A deepening of consumer debt is indicated as the ratio of consumer debt outstanding to PDI rises above the ratio of consumer debt repaid to PDI. Figure 2 shows that consumers have carried more unpaid installment debt since 1972 than in prior years. The indebtedness per American household appears in figure 3. It has risen steadily from $1,235 per household in 1965 to $3,627 per household in 1978. In real terms (constant dollars) this installment debt per household increased by $466: a 37 percent increase over 13 years.

Revolving charge account debt is a growing portion of installment debt. The annual percentage increase in revolving credit card debt has been greater than the percentage increase in overall installment debt for every year between 1974 and 1977, indicating that consumers have been substituting credit card debt for other types of debt. Furthermore, credit cards issued by banks such as Visa and MasterCard have been capturing an increasing share of the revolving credit card business. The share of outstanding revolving debt owed to commercial banks was 46 percent in 1977 and 53 percent in 1979.

SECTION I

Rural and Urban Credit Card Use

National surveys have not typically distinguished between rural and urban credit card users, but a survey conducted by the Federal Reserve Board in 1977 showed that 33.3 percent of farmers and farm managers use credit cards; 15.5 percent used bank credit cards, and 23.9 percent used retail store credit cards.[3] A smaller percent of farmers, than those involved in any other occupation, used credit cards.

A 1977 survey of Minnesota households showed that 46 percent of farmers and 60 percent of rural, nonfarm residents had at least one store credit card; 9 percent of farmers and 17 percent of rural, nonfarm residents had a bank credit card. About 72 percent of all Minnesota households had at least one credit card compared to 50 percent of households across the nation. Urban residents in Minnesota were twice as likely, however, to have credit cards as rural nonfarm residents and three times as likely to have credit cards as farm residents.

Minnesota Credit Survey

In summer 1977 questionnaires were mailed to a random sample of 2,400 Minnesota households. Anonymous responses came from 1,330 persons to questions about use of credit cards, attitudes toward credit and credit practices, problems encountered in obtaining or using credit cards, perception of credit costs, and individual socioeconomic characteristics. The sample represented a cross section of households in Minnesota except that sample households tended to have higher incomes and higher education levels than that of the general population. This bias is not uncommon in mailed surveys since these are the people who are more likely to respond to survey questionnaires.

Analysis of the responses revealed that the distribution of credit cards among Minnesota households with different socioeconomic characteristics was not vastly different from the rest of the nation. Members of households with higher levels of income and education, heads of households between ages 30 and 60 or those in urban areas were more likely to have and use credit cards than were those with low levels of income and education, above 60 or under 30, or living in rural areas. Table 1 illustrates the estimated probability of holding credit cards for various levels of household income, age, and occupation of the head of the household. The probability of having credit cards was over 95 percent for households with incomes over $25,000 per year compared to 49 percent for those with incomes under $5,000 per year. The estimated number of credit cards a household would hold also increased directly with income. These ranged from one card for low income households to eight cards for upper income households. Professional-technical and white collar workers behaved very much like the 40- to 49-year-old age group and those earning $20,000 to $24,999 per year in terms of credit card holdings. They all has about an 88 percent probability of having credit cards and were estimated to carry about five cards. A larger percentage of Minnesota households (compared to the rest of the nation) had at least one store card (72 percent vs. 54.3 percent) and a larger Minnesota percentage had a gasoline card (53 percent vs. 34.3 percent). Examining only those households with credit cards, however, it was discovered that Minnesotans were less likely than were residents of other states to hold a large number of cards. For example, 50 percent of Minnesotans who had credit cards had one to four cards and 36 percent had five to nine cards compared to residents of Washington, New York, and California where almost 50 percent of the card holders had five to nine cards. The differences were more dramatic when looking specifically at bank cards or gasoline cards. The percentage of Minnesotans who carried two or more of these cards was less than half of the percentage in other states (table 2).

The picture which emerges is that retail store cards were widely distributed among urban Minnesota households. Many customers considered to be high risk (low incomes, young, unskilled) had retail store cards but were unlikely to have bank or gasoline cards. Apparently retail stores in Minnesota were more willing to extend credit cards to high risk customers than were banks or gasoline companies. One explanation, assuming this, may be that retail stores can readily affect small price increases on a large inventory to cover credit losses. Banks have more limited direct methods of offsetting credit losses. Also, retail stores issue their own credit cards to increase sales and build customer loyalty: benefits which are less likely to accrue to banks issuing credit cards.

The relatively small percentage of Minnesota households which had bank credit cards in 1977 can be explained largely by a lack of local supply and the few retail establishments that accepted bank cards. Prior to 1976 only two banks in the state issued bank

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[2] PDI is gross income for all U.S. earners *minus* contributions for social security and personal tax and non-tax payments to governmental units.

[3] Thomas A. Durkin and Gregory E. Elliehausen, *1977 Consumer Credit Survey*, Washington, D.C., Board of Governors of the Federal Reserve System, December 1978, p. 84.

Table 1. Estimated probability of holding credit cards, predicted number of credit cards held per household for Minnesota households in 1977

Description of household	Expected number of cards	Probability of holding credit cards
Income		
< 5000	1.13	.49
5,000-9,999	2.29	.68
10,000-14,999	2.96	.80
15,000-19,999	4.13	.85
20,000-24,999	4.79	.87
25,000-29,999	6.22	.96
≥ 30,000	8.06	.95
Age of householder		
< 21	0.96	.46
21-29	2.63	.76
30-39	4.15	.86
40-49	5.35	.88
50-61	4.68	.85
≥ 62	3.13	.70
Occupation of householder		
Professional/technical	5.20	.90
White-collar*	5.24	.88
Craft/skilled†	2.99	.76
Operatives/unskilled	2.36	.69
No regular employment‡	2.83	.67

Source: Minnesota Survey—1977

*Includes managers, supervisors, clerical, and sales.

†Includes foremen, service workers.

‡Includes students, retired persons, housewives.

Table 2. Comparative credit card holdings. Percent of households with at least one retail credit card*

	Minnesota	Washington	New York	Texas	California
Interest rate	12%	12%	18%	18%	18%
Year of survey	1977	1974	1973	1971	1970
Retail cards			percent		
1-2	40	46	26	27	25
3-4	30	33	34	30	36
5 or more	30	21	40	43	39
Bank cards					
None	72	43	33	32	32
1	22	41	41	37	48
2 or more	6	16	26	31	20
T & E cards					
None	84	86	77	81	83
1	14	12	19	16	13
2 or more	2	2	4	3	4
Gas cards					
None	47	27	45	11	16
1	22	18	16	12	19
2	14	23	15	18	21
3 or more	17	32	24	59	44
Total cards					
1-4	50	36	30	n.a.	18
5-9	36	47	45	n.a.	49
10-14	11	14	20	n.a.	28
15 or more	4	3	5	n.a.	5

*Surveys similar to the one taken in Minnesota were conducted in four other states earlier in the 1970s. For details see Ray McAlister and Jean Kinsey, "Impact of Perceived Costs and Household Characteristics on Credit Cards Held," *Proceedings of Annual Conference of American Council on Consumer Interests,* San Antonio, Texas, April 1979, pp. 166-178.

credit cards: one in Minneapolis and one in St. Cloud. The two largest banking systems in the state, Northwestern National Banks and First National Banks, first issued bank credit cards in July 1976, after a court ruled that banks could charge an annual user fee ($15) for bank credit card accounts. This fee would ostensibly compensate banks for a relatively low interest rate ceiling (12 percent) which then prevailed in Minnesota. Legislation passed in Minnesota in 1979 allowed banks to drop the $15 annual fee and instead charge 18 percent interest. The law mandates that consumers must be given the option of paying the annual fee of 12 percent interest or the 18 percent interest rate. Consequently, bank credit cards issued in Minnesota are now less expensive for most consumers. (Unless consumers revolve their bank credit card accounts regularly and maintain very high balances, it is less expensive to pay the 18 percent interest than 12 percent interest plus a $15 annual fee. For those who pay their bills in full each month and never pay an interest charge, the 18 percent option is obviously cheaper.)

Bank credit cards have become more useful as they have gained acceptance in stores, and banks all over the state have begun handling them. The impact of a nationwide campaign to expand the number of people holding bank credit cards did not miss Minnesota. Part of this campaign involved name changes. Bankamerica Card is now called "Visa" and Master Charge has changed to "MasterCard." Another part of this campaign involves having major department stores adopt bank credit cards in addition to or as a substitute for its own store credit cards. By March 1, 1980, approximately 45 of 760 banks in Minnesota were issuing bank credit cards and another 271 were handling merchant's bank credit card accounts or receiving applications from consumers, while in early 1976 only two banks were doing these things.[4] One would expect that if Minnesota households were surveyed in summer 1980, a much larger percent, including households in rural areas, would have bank credit cards. An informal February 1980 survey indicated that rural residents were finding bank credit cards increasingly available and increasingly useful for travel and as identification when cashing checks away from home.

[4] By April 1, 1980, several banks temporarily stopped issuing new credit card accounts. This is an adjustment to federal regulations designed to increase the cost of lending which should decrease the supply of credit and consequently decrease consumer spending. The effects of this anti-inflation policy have yet to be determined.

In 1977, 60 percent of Minnesotans who had no store credit card lived in rural areas or towns with less than 5,000 population. There is little reason to think that this proportion has changed much in three years. Store credit cards have been less useful to farm and rural-nonfarm residents especially if they shopped at locally owned stores. If they chose to charge a purchase many local clothing or furniture stores or co-ops have offered 30 day charge accounts. Many of these accounts have been interest free and have not required a credit card. In cases where the seller and the buyer know each other personally and the volume of credit sales is small, credit cards have not been necessary.

Large chain department stores operating in smaller towns have offered credit cards, but there are some reasons why revolving credit accounts or even installment loans may not be a useful purchasing tool for some rural and farm households. One reason has to do with an irregular flow of income associated with some crop and livestock businesses. Another reason deals with substitute sources of credit available to farm operators.

Revolving or installment credit arrangements can be useful money management tools for households which receive annual incomes in small but steady payments. A portion of each paycheck can be used to pay a portion of an outstanding debt. In other words, outgo can be matched to income over time by the use of revolving or installment credit. It would be less convenient for households receiving incomes in large and sometimes irregular installments to be obligated for small, regular debt payments.

Many farmers have access to and use credit from their local banks or Production Credit Associations or Farmers Home Administration to help finance their farm operation. To the extent that funds used for a given farm household and farm operation are comingled, it is entirely possible that major purchases for a farm household are indirectly financed with farm credit. If this undocumented substitution of farm credit for consumer credit is occurring, it explains part of the difference between rural and urban use of consumer credit.

Among the greatest differences between rural and urban residents, revealed by the 1977 Minnesota Credit Survey, were attitudes toward the use of consumer credit. One survey question asked whether the respondent thought consumer credit was a good or bad idea. In rural farm and nonfarm areas 21 percent thought it was a bad idea. In towns under 5,000 population 17 percent thought it was a bad idea compared to 11 percent in urban areas. Of those who reported belonging to a farm organization, 30 percent thought it was a bad idea compared to 15 percent of those who belonged to a labor union and 6 percent of those who belonged to a professional or business organization. Reasons for disliking or disapproving the use of consumer credit varied from moralistic admonitions, to fearing a lack of financial self-discipline on the part of oneself or one's neighbor, to the effect of excess credit on the economy. Whatever the reason expressed, rural economic patterns have been such that consumer revolving credit card accounts have not been necessary and are still less useful there than in metropolitan areas. Rural banks appear to be the primary source of credit for rural consumers. As bank-issued credit cards are promoted in rural areas and as rural residents find them more useful in their local communities and for travel, banks will command an even larger portion of the rural credit market.

SECTION II

Credit Card Costs

The 1980 Minnesota legislature passed a bill allowing retailers to charge up to 16 percent simple annual interest on charge accounts. This applies to charge accounts not paid off in 30 days at feed and seed stores as well as revolving credit card accounts at department stores. The old interest rate ceiling was 12 percent per year. As discussed earlier, this was recently raised to 18 percent for bank credit cards. In addition to raising the interest rate, the new law mandates that retailers allow "30 days free time" on all new purchases. This means that no interest can be charged on new purchases during the first billing period even if an unpaid balance exists. If the account is not paid in full before the second billing, these purchases will be subject to 1.33 percent interest per month.

In the 1977 Minnesota Credit Survey, householders were asked if they knew the legal maximum annual percentage rate (APR) of interest on retail credit card accounts and its equivalent dollar finance charge. Thirty-two percent of Minnesotans knew the APR was 12 percent while 41 percent of credit card *users* knew the correct APR. This was not very impressive because nationally 64.7 percent of retail credit card users and 71.3 percent of bank card users knew the APR.

The probability of Minnesotans knowing the APR increased with income level from 10 percent for those with incomes under $10,000 to 40 percent for those with incomes between $20,000 and $30,000 a year. Education beyond high school raised the probability of knowing the APR from 21 percent to over 42 percent. Rural or small town residents had a 21 percent chance of knowing the APR while 37 percent of city residents knew the APR. The probability varied little by age except that those over age 61 were about half as likely as others to know the APR. Those in professional or white collar occupations were more likely to know the APR. The following factors tended to increase a person's knowledge of the APR: the total number of credit cards held by the household, a positive attitude toward credit, higher levels of installment credit outstanding, and both a checking and savings account.

Being uninformed about the APR is a situation exacerbated by an inability to translate APR into a reasonably accurate dollar finance charge. Most people will take whatever APR they believe to be correct (say 12 percent) and treat it as an "add-on" rate when, in fact, the APR is calculated on a declining balance. To illustrate: when respondents were asked how many dollars it would cost to borrow $100 and repay it in 12 equal monthly payments at the interest rate in their state, most responded by multiplying $100 x .12 = $12.

Although 18 percent of Minnesota householders treated the APR as an "add-on" rate, surveys revealed 25 percent of Washington householders and 41 percent of Texas householders did the same. In Minnesota, 43 percent responded that they didn't know the dollar cost.

A quick and reasonably accurate way to estimate the dollar finance charge for this example would be to divide the amount borrowed in half (consumer has an average of $50 credit over the 12 months) and multiply $50 x .12 = $6. The actual dollar charge would vary between $5.50 and $6.50 depending on the timing of payments and purchases. A 16 percent APR on $100 repaid over 12 months provides an annual dollar charge of approximately $7.82. Only 7.4 percent of Minnesota householders estimated a reasonably accurate dollar charge. Among householders who knew the APR, however, the probability of estimating a correct dollar charge increased to over 21 percent (table 3).

One of the long standing objections to using credit is that merchandise ends up costing more because of finance charges. It was found, however, that the price householders believed they were paying for credit had no effect on the number of credit cards they held. In addition, it is not necessarily true that merchandise purchased with credit costs more. On most credit card accounts no interest has been charged during the first billing period after merchandise is purchased unless there is an unpaid balance. In that instance, some creditors have allowed "free time" for new purchases: some have not. Under the new Minnesota law, all merchants must allow 30 days interest free on all new purchases. If revolving charge account bills are paid in full each month, credit can be used without paying any finance charge at all.

In addition to asking Minnesotans whether they knew the legal maximum APR and the dollar finance charge the APR would generate for a hypothetical example, they were also asked what they thought was a "fair" dollar price to pay for $100 repaid in 12 equal monthly payments. Over three-fourths of the respondents thought something greater than $6.50 was a fair price. About 12 percent said the actual dollar charge corresponding to a 12 percent interest rate was fair. Of those who knew both the APR and the corresponding dollar charge, 52 percent said the actual dollar charge was fair. Over 80 percent of the respondents who did not know the APR and/or the actual dollar finance charge said more than $6.50 was a fair price to pay for $100

Table 3. Percent who knew the dollar finance charge, given they knew the annual percentage rate (APR)

Response		Knew APR: Yes	Knew APR: No	Overall percent
Estimated a reasonable dollar cost of $100 credit repaid in 12 equal monthly payments*	Yes	6.9 (21.4)†	.5 (.7)	7.4
	No	25.4 (78.6)	67.2 (99.3)	92.6
Overall percent		32.3 (100.0)	67.7 (100.0)	100.0

Source: Minnesota Survey—1977

*Reasonable Dollar Cost is defined here as anything between $5.50 and $6.50.

†Numbers in parentheses are the percent who estimated an accurate dollar charge *given* they knew (or did not know) the APR. 21.4 percent of those who knew the APR estimated a reasonably accurate dollar charge on the example given.

Table 4. Relationship between knowing annual percentage rate (APR), knowing actual dollar finance charge, and the dollar finance charge reported as fair

Response	Percent who knew APR		Percent who knew actual dollar charge		Percent who knew both APR and actual dollar charge		Overall percent
Dollar finance charge reported as fair*	Yes	No	Yes	No	Yes	No	
Less than $5.50	14.2†	11.4	29.6	11.0	28.3	11.1	12.3
$5.50-$6.50 (actual level of charge)	18.8	8.1	52.0	8.4	52.2	8.6	11.6
Greater than $6.50	67.0	80.4	18.4	80.7	19.6	80.3	76.1
Overall percent	32.3‡	67.7	7.4	92.6	6.9	93.1	

Source: Minnesota Survey—1977

*Fair Dollar Finance charge on $100 of credit repaid in 12 equal monthly payments.

†14.2 percent of those who knew the APR thought that less than $5.50 was a fair dollar charge.

‡32.3 percent of all Minnesota householders knew the APR and 67.7 percent did not.

Table 5. Range of perceived price by credit by income, age, and occupation group (Respondents estimate of cost of $100 of credit paid back in twelve equal monthly payments)

Description of household	Low price	Mean price	High price
Income			
<5000	$ 1.00	$ 9.97	$36.00
5,000-9,999	0.15	10.22	25.00
10,000-14,999	1.00	10.25	25.00
15,000-19,999	0.60	10.35	44.00
20,000-24,999	1.00	10.34	22.00
25,000-29,999	2.00	10.74	25.00
≥30,000	0.75	10.12	32.00
Age of householder			
<21	0.15	9.96	18.00
21-29	1.00	10.74	30.00
30-39	1.00	10.49	25.00
40-49	0.60	10.41	44.00
50-61	0.41	10.27	34.00
≥62	0.50	9.71	36.00
Occupation of householder			
Professional/technical	0.60	10.37	32.00
White-collar*	0.41	10.48	44.00
Craft/skilled†	0.15	10.30	24.00
Operatives/unskilled	1.00	10.40	25.00
No regular employment‡	0.50	9.83	36.00
Card holders	0.15	10.39	36.00
Noncard holders	0.50	9.95	44.00
Accurate price @ 12% interest = $6.00			

Source: Minnesota Survey—1977

*Includes managers, supervisors, clerical, and sales.

†Includes foremen, service workers.

‡Includes students, retired persons, housewives.

credit repaid over 12 months (table 4). A substantial lack of knowledge about the legal interest rates and the corresponding dollar cost of credit found a vast majority of Minnesota householders accepting as fair a dollar finance charge in excess of what they needed to pay or actually were paying given the legal interest rate ceiling in 1977.

The percentage reporting over $6.50 varied little by income group. The dollar charge reported as fair was unrelated to the age, education, or occupation of the head of the household. Those living in rural areas were as likely as those living in a city to overstate the "fair dollar charge."

An index of the perceived costs of credit was constructed from answers to the question about the actual legal dollar charge for $100 credit repaid in 12 equal monthly payments. Where no answer was given to that question, the reported fair dollar charge was substituted. This index provided some insight into what Minnesotans think credit costs. The perceived costs for the example given ranged from $44 to 15 cents which translates into APR's of 90 and 0.33 percent, respectively. The average *perceived cost* was $9.50 which corresponds to about an 18 percent APR. The range and the mean perceived price did not vary much over income, age, or occupational groups (table 5). Cardholders were no more realistic than noncardholders. On the average, Minnesotans perceived credit costs to be higher than they were and displayed a very wide range of beliefs about the costs of credit.

Summary

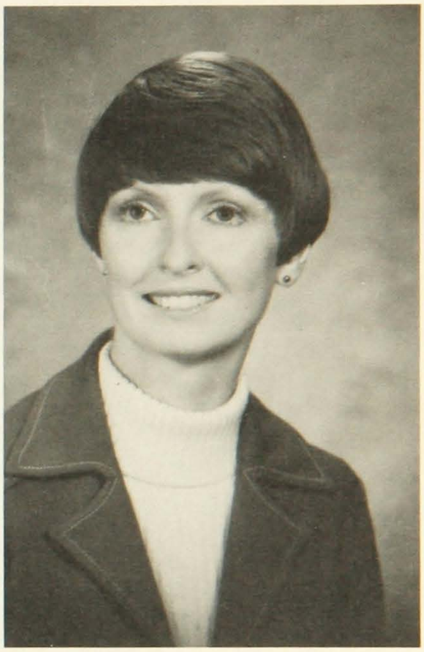
Numbers of credit cards held by households in Minnesota lagged behind households across the nation. On the average, the head of a Minnesota household had between three and four credit cards in 1977. However, a larger portion of Minnesota households than households across the nation had at least one retail credit card. When Minnesotans acquired credit cards, they were most likely to begin with one or two retail store cards, then acquire a gasoline card, then a bank card, and finally travel and entertainment cards.

Few Minnesotans are aware of the true costs of using credit card accounts. They tended to overestimate the cost in dollar terms. There appears to be a contradiction between what consumers are willing to pay for credit in terms of dollars and in terms of interest. Over 75 percent of the survey respondents said something greater than $6.50 was a fair price to pay for $100 credit repaid in 12 equal monthly payments when, in fact, the actual legal price at 12 percent interest was less than $6.50. Yet, most people were unwilling to pay a higher interest rate. There is confusion about how to translate interest rates into dollar finance charges.

Rural residents had fewer credit cards than urban residents and were more likely to say consumer credit was a bad idea. In fact, consumer revolving credit has been less useful in rural areas because of the personal nature and the economic structure of rural communities.

The use of credit cards is expected to continue to increase in rural and urban areas and consumers who know how to use credit cards as a financial management tool are the most likely to benefit. Informed consumers who plan and control their use of credit can generally use it to increase their well-being. Those who shun credit may be missing opportunities while the uninformed, prolific users of credit can easily find debt payments controlling their lives.

Those who control the credit supply, be it lenders or public officials, have a challenge and an obligation to provide accurate, understandable information about the costs of credit: its beneficial uses as well as its potential pitfalls. Educators can play a key role in producing better informed consumers and better household financial managers.



Jean Kinsey

Jean Kinsey is an assistant professor, consumption economics, Department of Agricultural and Applied Economics.

The Minnesota Credit Survey referred to in this publication was taken with the cooperation of Ray McAlister, professor, North Texas State University, Denton, Texas.

Please send any address changes to Nancy Van Hemert, 231 Classroom Office Building, 1994 Buford Ave., University of Minnesota, St. Paul, MN 55108.

Jerome W. Hammond. . . . . Editor

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