

Good Debt vs. Bad Debt

When the four letter word debt is mentioned, it is usually with tightened jaw and shortness of breath. December is often synonymous with the word and January's bills reflect the overspending.

The amount of consumer debt in this country is ever-increasing, readily available and easy to obtain. Do card issuers seek customers that can and will pay their bills in full each month? Of course not! Today's card issuers relish the opportunity to loan money to those that will only pay the minimum amount each month while charging a whopping interest rate.

To be money smart you must be able to differentiate between good debt and bad debt. If you make a loan (using a credit card is a loan) to purchase something and it immediately loses value, it is a bad debt. When credit card bills are not paid in full each month and interest is charged on the remaining balance, the item you purchased continues to lose value, and the amount you paid for it continues to increase.

Good debt creates value. A student loan, real estate loans, home mortgages and business loans are examples of good debt.

Now back to the issue of reducing consumer debt. If you take a home equity loan because you have 18 percent or more interest rate on credit cards and your new loan is a 6 percent loan that is tax-deductible, then that it becomes good credit.

Keeping the debt-to-income ratio, carrying balances on credit cards could potentially have a negative impact on your credit rating. It is recommended that personal debt should not exceed 36 percent of your total income.

Is auto debt a good debt or a bad debt? While most people need an automobile, the cost of an auto is usually more than one can pay in a lump sum. Unless you luck up and purchase a car way below the retail prices it is bad debt, but necessary to meet the needs of working, etc. Don't make the bad debt even worse by purchasing more car than needed.

As mentioned earlier, the best type of debt is debt that builds wealth over a long time, such as a mortgage. For many years homes were purchased at a reasonable amount and with some improvements and time, the home increased in value. For those not quite as fortunate, homes were bought at a premium and when forced to sell, the economy did not support the prices and families lost money on what should have been a good investment.

So the bottom line is use credit to purchase items that have good odds of making you money rather than costing you money.

Bankrate.com: The Top 10 Causes of Debt

1. Reduced income/same expenses
2. Divorce
3. Poor money management

4. Underemployment
5. Gambling
6. Medical expenses
7. Saving too little or not at all
8. No money-communication skills
9. Banking on a windfall
10. Financial literacy