

## 12.5: Credit

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### Learning Objectives

- Define and explain credit

### What is Credit?

When you make a purchase using money that you don't have, you are using credit. Credit is someone else's money that they have lent to you. Typically you use credit to buy something like a car, a house, or college expenses, "big-ticket items" that will benefit you for a long time. Instead of saving up and only then paying for them, credit allows you to buy now and pay for them over time. Sometimes people obtain credit in advance so that in the future when opportunities or needs arise they will be able to buy something. This is particularly common for businesses. Either way, when you use credit, you are borrowing money.

Credit comes in many forms, including loans, bonds, notes, or lines of credit (like home equity loans). All are essentially IOUs: that is, promises to repay with interest. Debt is accumulated credit, less what has been repaid. If you look at a credit card statement, each purchase you make using a credit card is a loan from the credit card company to you. Your balance on the credit card statement is your debt to the credit card company. Of course, your total debt is the sum of money you have borrowed from **all** your creditors, less what you have repaid. This would include credit card debt, car loans, educational loans, mortgages...everything you have borrowed and not paid back.

### Credit vs. Debit

Debit cards enable you to make purchases like credit cards do, but with one major difference. Debit cards are not credit! Rather, they draw on a bank account, so they are a form of money. When you buy something with a debit card, it is just as if (but more convenient than) going to the bank to make a withdrawal, and then spending the cash. Credit/debt is not a bad thing. It is a tool for buying things you can't afford to pay for all at once, and repaying the loan over a period of time. Most economic agents, that is, individuals or families, businesses and governments, borrow money/obtain credit at some point. The trick is to know what you're getting into and to use credit responsibly.

### Try It

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