

Stop Paying the Minimum.

Credit cards are there to put you in debt and keep you in debt. When they do it, they have one tool at their disposal that is more effective than all the others. It's called the minimum payment.

What's a Minimum Payment?

Your minimum payment is the absolute minimum that you must pay off each month to avoid defaulting on the debt. If you don't pay your minimum, they'll come after you – but don't make the mistake of thinking it's just fine to only ever pay that much.

Why are Minimums Bad?

They never used to be. Minimum payments used to be set at relatively high percentages, anywhere from 5% to 10%. This meant that you paid more, but your debt would get paid back faster.

Credit card lenders realised, though, that they could set the minimum payments lower, and collect a smaller amount of money each month for a much longer period of time. This would let them tell people that debts on their cards were 'affordable', while they raked in the cash over the long term, thanks to the power of compound interest.

Here's an Example.

Let's say you owed \$1000 at an interest rate of 12.7% per year (1% per month). Your minimum payment is 5% per month. Remember that your payment goes towards the interest first, and then the debt. In this example, \$10 out of the \$50 you paid would disappear as interest – but \$40 would still go towards paying off the debt, meaning that your debt the next month would be \$960.

What happens if you change the minimum payment to only 2%? Well, the difference is enormous. Sure, you're only paying an 'affordable' \$20 – but \$10 of it is still going on interest. That means that your \$20 has only paid back \$10 towards the debt, and you still owe \$990!

There are so many people who just look at the interest rates they're being charged, and don't understand the terrible difference it can make if you only ever pay the minimum payment. In our example (which is relatively typical), 50% of the payment was going on interest – meaning that paying the minimum gets you an effective 50% interest rate, even though your APR was only 12.7%. For higher interest rates, it only gets worse: there are cards out there where only making the minimum payments will actually cause you to owe more each month, not less!

So What Should You Do?

The answers aren't fun, but they are true. Firstly, look for a card with a high minimum payment – this is a good way to discipline yourself into paying off the debt faster.

Secondly, always pay more than the minimum if you can afford to. I know it feels like money for nothing, but isn't it better to pay it now and get it over with, instead of paying it for the rest of your life?

