

How does debt grow the economy?

For some consumers good credit comes naturally. Paying bills on time and not getting into unaffordable debt is their second nature. But for many other consumers bad credit is a chronic problem that takes a lot of attention and care to cure.

Credit scores and credit history are very important in our current economical environment. The United States economy as well as many other western countries is based on the ability of individuals and businesses to get loans or in other words to have debt. By utilizing debt tools Through debt the business can grow and individuals can build wealth and assets.

If you are not sure how debt can help grow the economy and also help grow individual wealth maybe some examples would help. Lets first look at a business that would like to grow. In order to grow businesses need to invest. Investments is basically the building of assets and acquiring of resources that when used in the course of the business creates more revenues than their investment cost. In order to invest a business needs cash. A typical business can get cash in two ways. One is to use its own cash reserves. The other is to borrow money from a bank or other investors.

Businesses that are rich in cash can opt for the first option however most businesses would need to wait a significant amount of time to accumulate the cash they need to make the necessary investment in many times waiting too long and losing the potential market initiative. Borrowing money is a fast an efficient way for a business to make fast investment. By relying on the current business cash flows and credit history a bank or other investors would provide the business with the necessary cash to make the investment. The business would then invest and by doing so would create more jobs resources and assets. If successful the business would compensate the lenders by paying an interest on the loan and also sometimes providing the lender with some equity stake.

For individual creating wealth is usually associated with investing in some assets too. The most common asset is a home. Similar to the business if an individual would have to wait until he or she saved enough cash to buy a home they would most likely end up buying the home at their retirement age losing many years of potential home price appreciation. By taking a loan also known as a mortgage on their home individuals can buy a house at an early stage with the downside of paying an interest on the money they borrowed. The assumption behind such wealth building is that home appreciation averaged over the course of many years would be higher than the interest on the mortgage.

Debt however can also result in the opposite of growth and wealth. Irresponsible borrowing results in loan defaults or in other words in the inability to return the money to the lenders. In a normal situation some borrowers are expected to default. After all not all business investments succeed and not all individual purchases appreciate as expected. But in a normal situation the lenders make sure they have enough collateral to collect the debt or some of it in case of a default. In a normal state the defaults are also relatively low and thus overall most debt taken and invested is profitable. If too many loans default and there is too much money that lenders have to write off as a result of debt being not collectible the economy can actually shrink as those write offs delete a large number of assets from the economy in extreme cases more than the overall successful investments value.

About the Author

Marshall Wilson writes about Internet subjects. Find more on [debt](#)

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