Debt and distress: Evaluating the psychological cost of credit

Sarah Brown *, Karl Taylor, Stephen Wheatley Price

Department of Economics, University of Leicester, University Road, Leicester LEI 7RH, UK

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Abstract

In this paper we explore the association between debt and psychological well-being amongst heads of households using the British Household Panel Survey. Our principle finding is that those household heads who have outstanding (non-mortgage) credit, and who have higher amounts of such debt, are significantly less likely to report complete psychological well-being. The average increase in the psychological distress is greater when outstanding credit is measured at the individual, as opposed to household, level. No such significant association is found in the case of mortgage debt. Our results highlight the psychological cost associated with the consumer credit culture in Britain.

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* Corresponding author. Tel.: +44 116 2522827; fax: +44 116 2522908.
E-mail address: sb118@le.ac.uk (S. Brown).
‘My other piece of advice, Copperfield,’ said Mr. Micawber, ‘you know.
Annual income twenty pounds, annual expenditure nineteen and six, result
happiness. Annual income twenty pounds, annual expenditure twenty pounds
ought and six, result misery.’

(David Copperfield, Chap. 12, by Charles Dickens)

1. Introduction

There was a consumer credit explosion in the UK between 1994 and 2004. This
accompanied the sustained economic boom during this period and followed on from
the gradual relaxation of credit constraints in the late 1980s and early 1990s. The in-
creased availability of unsecured credit is clear from the massive rise in the number
of different credit cards available (over 1300 in the UK, in 2000) and the broadening
of the range of financial institutions offering unsecured loans. From once being pri-
marily the preserve of the major banks, loans can also now be readily obtained from
building societies, UK and overseas-based finance companies and, even, supermar-
kets. In addition, the advent of telephone and internet-banking, and the availability
of credit at the point of purchase, has increased the accessibility of consumer credit
and the speed with which loan contracts are made.

Fig. 1 illustrates the dramatic escalation in the total value of outstanding con-
sumer credit in the UK, between 1982 and 2002 (measured in 1995 pounds sterling
and excluding mortgage debt). Less than 1% of this change can be explained by the
5% growth in the size of the UK population during this period. Most of the increase
has arisen from the rise in the value of loans arranged directly (e.g. personal loans) or
indirectly (e.g. hire purchase agreements) with financial institutions (the Other cate-
gory). A growing proportion of outstanding consumer credit has been obtained
through the use of credit cards. As a percentage of GDP, the amount of unsecured
borrowing accumulated by individuals and households doubled, between 1993 and
2002, to 16%. By the end of 2004 the total amount of outstanding (non-mortgage)
credit was over £185 billion (in current prices), an average of more than £4800 for
every adult of working age in the UK.

Monetary policymakers have become concerned about the extent of personal
indebtedness, its sustainability and impact on aggregate economic performance
(e.g. Bank of England, 2004, pp. 9–10). However, there is also considerable concern
from social welfare lobbyists, amongst others, about the associated increase in the
number of individuals and families with problematic levels of personal debt. For
example, members of the National Association of Citizens Advice Bureau in the
UK dealt with approximately one million new personal debt enquiries during 2002
(NACAB, 2003). Over two-thirds of these contacts were associated with consumer
credit arising from bank loans, credit and store cards (whose interest rates are typ-
ically two or three times those of the banks), catalogue debts and hire purchase
agreements. Many of their clients were also in arrears with regard to housing rent,
council tax and utilities bills. Additionally, they report a 47% increase in the number
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