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Debt and distress: Evaluating the psychological cost of credit

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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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> '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 increased 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 primarily the preserve of the major banks, loans can also now be readily obtained from building societies, UK and overseas-based finance companies and, even, supermarkets. 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 consumer 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 category). 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 typically 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