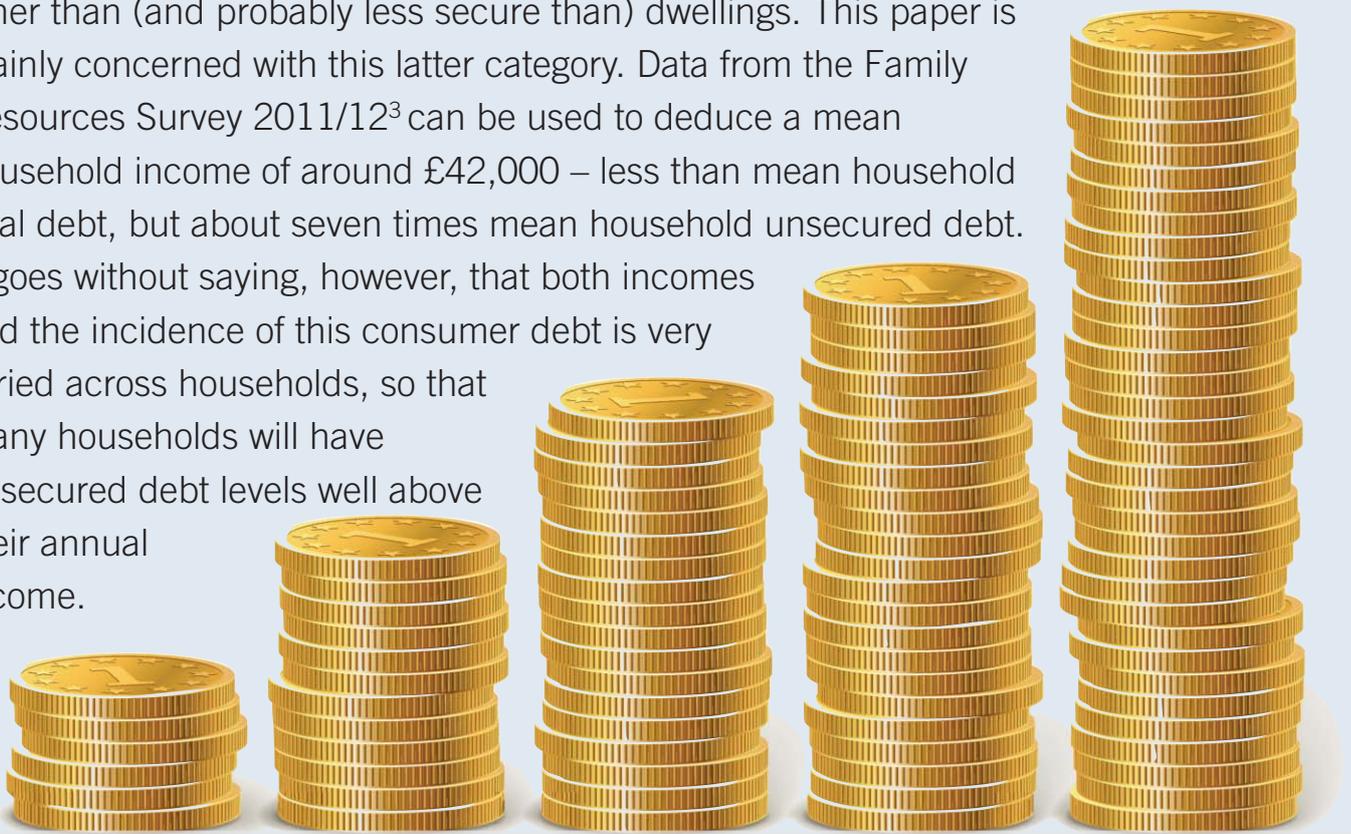


Behaviour Change: Personal Debt

This paper is concerned with debt held by individuals. This topic has rarely been out of the news since the financial crisis broke in autumn 2007, and in fact was being widely discussed before that. In terms of standard government accountancy definitions, the United Kingdom is a highly indebted society: at December 2013, total lending to individuals stood at £1.44 trillion,¹ which, given 26.4 million households,² implies £54,545 per household. Of this, £1.28 trillion was secured on dwellings (therefore mostly house mortgages), leaving a mean of £5,992 per household of ‘consumer credit’, or debt that was either unsecured or secured against something other than (and probably less secure than) dwellings. This paper is mainly concerned with this latter category. Data from the Family Resources Survey 2011/12³ can be used to deduce a mean household income of around £42,000 – less than mean household total debt, but about seven times mean household unsecured debt. It goes without saying, however, that both incomes and the incidence of this consumer debt is very varied across households, so that many households will have unsecured debt levels well above their annual income.



The Challenge

So, a lot of people owe a lot of money. That need not be a problem, if everything is under control, but the sheer size of the numbers involved implies that even in completely ‘normal’ times macroeconomically, at least some people would have problems with debts. But at least since 2007, the times have not been normal macroeconomically; and for at least 40 years before that, since credit cards first became widely available in the UK, commentators, practitioners and researchers have been expressing concern about rising levels of debt problems among UK consumers.

In the second quarter of 2013–14, Consumers Advice, as the main broad spectrum advice agency in the UK, handled 395,000 debt-related issues for 122,000 clients, 28 per cent of all the issues it dealt with.⁴ Step Change, a specialist debt advice charity, reports that 40 per cent of users of payday loans – the most easily available but most expensive kind of credit, with APR interest rates in the thousands of percent – used them to pay for daily necessities such as food and travel to work, and 25 per cent used them to pay off other credit.⁵

Other stakeholders concerned about debt levels include creditor organisations such as utility companies, and the courts service whose systems are overloaded with large numbers of cases concerned with consumer debt. Government departments have recognised over-indebtedness as a serious social problem.^{6,7,8} It is clear that substantial numbers of people have substantial problems with debt, and are responding to them in substantially dysfunctional ways.

Prepared by **Professor Stephen Lea** on behalf of the Behaviour Change Advisory Group.

The Psychology

In terms of fundamental theory, debt is one variety of *inter-temporal choice*, that is to say, the person deciding whether or not to take a loan is choosing between outcomes that will be delivered at different points in time. This is the area of choice where observed human behaviour deviates most dramatically from the predictions of the kind of theory that dominated economics in the 20th century. By the standards of economic rationality, humans are appallingly bad at inter-temporal choice.^{9,10,11,12} This is true not only in quantitative terms (people often make choices as though they could secure interest rates on their savings of hundreds of percent), but also qualitatively (people show reversals of preference that should never occur according to conventional economics).^{11,13} Unsurprisingly, therefore, this is one of the areas where more modern, interdisciplinary, empirically driven approaches, whether under the name of economic psychology, behavioural economics, or experimental economics, have been most successful in presenting an alternative account of economic behaviour.

In terms of fundamental observations, however, the most important point to make is that people do not define debt in the same way as accountants do. Like many other ordinary-language concepts (including economic concepts such as money¹⁴), debt as it is understood by ordinary consumers is ill-defined. Different kinds of financial arrangements, all of which are unambiguously debts in the technical sense, are understood as being debt to different degrees, some of them perhaps as not being debt at all.¹⁵ Furthermore, the flexibility in the definition of debt allows people to use definitions that are to a degree self-serving. Being in debt is generally regarded as an undesirable state, and accordingly people frequently define debts that they hold as not being debt at all. In this situation, it is useful to make a distinction between three different consumer understandings:¹⁶ 'credit' (an arrangement between a willing lender and a willing borrower, where the agreement is being fully honoured on both sides); 'debt' (a situation where a payment of some sort that should have been paid has not been); and 'crisis debt' (a situation where the consumer has debts that cannot be repaid at all, or can only be repaid with disproportionate hardship, given his or her income and wealth).

In this briefing we are primarily concerned with crisis debt, but the other categories are relevant because for some people they are stages on the way to crisis debt.

The evidence: What can psychology offer?

Psychological research on debt has concentrated on three questions:

- How do people get into debt?
- What are the psychological impacts of being in debt?
- And how do people get out of debt?

How do people get into debt?

Perhaps the use of plastic money (credit and debit cards) makes it harder for people to keep track of their expenditure than when they are using cash. The decline in the use of cash (in the US, from over 30 per cent of all consumer transactions in 1974 to 20 per cent in 2000)¹⁷ has

certainly coincided with a rise in unsecured consumer debt, and there is a little evidence that using plastic leads to greater willingness to pay.¹⁸ However, the increase in the availability of plastic applies across the board, and not all consumers fall into debt. What distinguishes those who do?

Several routes into debt have been studied. They include above average use of plastic money, especially credit cards, especially among students, and especially when they are aggressively marketed;^{19,20} a lack of financial mentoring from parents;^{21,22} unrealistic social emulation;²³ inappropriate entry into self-employment;²⁴ personality factors;²⁵ and various kinds of financial attitudes, including impulsiveness;^{26,27} positive risk preference;²⁸ over-optimism;²⁹ materialism;³⁰ and specific attitudes to debt and credit.^{31,32} Situational factors such as illness or accident, the breakdown of a marriage or other relationship, the loss of a job, or the need to take on caring responsibilities, have often been found to trigger debt.^{33,23} When people consider a credit arrangement, they tend to judge its affordability in terms of the repayment amounts,³⁵ or, in the case of credit cards, by the minimum required repayment,³⁴ even though when they have the opportunity, they judge desirability more in terms of total cost of credit.^{34,37} Focusing on recurrent cost means that if circumstances change an affordable credit arrangement can become an unmanageable debt.¹⁵

Although these studies show that a variety of institutional and psychological factors affect whether or not a household will fall into debt, wherever economic factors have been considered, these have been found to be by a long way the most substantial correlates of debt.^{15,38,39,40} It must be recognised that research into all three of the questions posed in this section depends on the participation of people who are or have been in debt problems, and because debt is a distressing and stigmatised situation, participation rates are often low and may be selective. There may be a category of well-off debtors, who could pay their debts but choose not to,⁴¹ but if these people exist, they also choose not to participate in research. Debtors who respond to researchers are overwhelmingly poor: they have low incomes and high essential outgoings, usually because of children. 'Essential' is of course a flexible category, and some of what is considered by parents as essential expenditure on children might not appear necessary to outsiders. The motivation to prevent children being seen by others, or by themselves, as less well off than the norm for their peer group is very strong.⁴²

To some extent the answer to how people get into debt is through being in debt already. People who have serious debt to one creditor, for example a utility company, usually owe money to many similar creditors.^{38,43} In a debt crisis, people often borrow from very expensive sources, such as payday lenders or door-to-door moneylenders who operate on the borders of legality, and this can cause a small debt to spiral into a much larger one.⁴² This point also brings to light another important cause of debt: being young. When young people (especially young men) first take financial responsibility for their lives, whether as students or as young adults moving out of the parental home for other reasons, they often make mistakes, including using credit unwisely.³² If, like many students, they come from prosperous families, or move on to good jobs, the consequences can be dealt with. If they come from disadvantaged families and cannot find work, an initial small debt may never be wiped out, and may grow to become a crisis debt even though the person has been living within his or her means ever since that initial error.^{15,42,44}

What are the psychological impacts of being in debt?

Debt is associated with high levels of anxiety,⁴⁵ stress⁴⁶ and general psychological distress,^{47,48} as well as physical ill-health.^{49,50} It specifically increases the risk of clinical levels of depression,⁵¹ and this effect is independent of the poverty with which it is often associated, and which is also a risk factor for depression.⁵² It is a frequent precursor of suicide, attempted suicide, and suicidal ideation.⁵³ In addition to these general effects, it appears to cause changes in more specifically economic attitudes and behaviour. People with long-term debts become highly skilled at managing the little money they have available,⁵⁴ but they often do so in ways that are dysfunctional in the longer term (and certainly not in accord with their creditors' preferences): they pay off small debts completely rather than paying something off larger debts bearing higher interest;⁵⁵ they operate on very short time horizons in which the debt that falls due in a week's time has little leverage compared with a child's need for lunch money today; they frequently deliberately ignore or destroy communications from creditors – a characteristically depressive response to a problem; and they make use of, and often have positive attitudes towards, extremely expensive credit sources such as payday and doorstep lenders.^{15,42,44} Perhaps associated with these short time horizons is a tendency towards more tolerant attitudes towards debt.^{38,39} This can be seen most starkly among students in higher education, who show the characteristic intolerant attitude to debt before entering university, but a more accepting attitude a few months later, when they have been obliged to enter into formal debt arrangements to fund their studies, and have often taken on other kinds of debt as well, for example through credit cards.^{56,57}

How do people get out of debt?

Some of the 'poor debtor' group discussed above clearly have little prospect of getting out of debt at all. However, longitudinal studies do show that a substantial proportion of those reporting debts in one year report being debt-free within a year,⁵⁸ even among quite poor debtors.⁵⁹ This emphasises the point made at the beginning of this briefing, that not all debt is socially problematic: lending and borrowing are part of our economic system; they can give people flexibility in managing their affairs, and many people engage in them without ill-effect.

What, though, of those who do not simply rot out of debt? Some are helped out. This is frequently the case with students; tolerant families or first employers may see to it that it is brought under control. For some, the much dreaded crisis of a county court summons may in fact bring help, because the court imposes a repayment timetable that is more realistic than creditors are demanding. Advisory agencies such as Citizens Advice or StepChange may be able to help negotiate a realistic settlement, or guide people into bankruptcy, an Individual Voluntary Arrangement with their creditors, or a Debt Relief Order (or their equivalents in Scotland); counselling of this sort has been found to improve outcomes for serious debtors.⁶⁰ Without such help, the almost universal advice of 'get in touch with your creditors' is regarded by most debtors as useless,^{42,44} and schemes to encourage debtors to do this have not yet been shown to benefit either debtors or creditors.⁴⁰

Recommendations

Consumer credit is a necessary function in a modern economy, and used appropriately it allows flexibility and enhances consumer choice. But it has risks. What actions could be taken to discourage inappropriate use, and reduce the number of casualties?

- (a) **Improve education:** The wide variance between optimal and actual intertemporal choices means that there is some scope for consumer education. Trying to make this, as such, part of a formal school curriculum is likely to be both difficult and useless, but including calculations about debt and credit within ordinary maths education might be possible.
- (b) **Improve restricted access:** Inhibit the marketing of credit to younger people. Requiring people to show that they can manage small amounts of credit before they are allowed to take on larger commitments might well be effective. Taking credit should be treated like driving a car – something you have to demonstrate competence for before you are allowed to do it without restrictions.
- (c) **Improve credit awareness:** A major cause of debt problems is people's lack of awareness of (or refusal to face) the total of their credit obligations and the nature of their credit histories. A simple way of raising awareness would be to require credit rating agencies to notify the data subject of any change in their credit rating or recorded credit history, thus drawing people's attention to the total of their debt situation. This would be predicted to reduce indebtedness in the same way that regular use of a weighing machine helps reduce obesity.
- (d) **Improve access to impartial debt advice:** The current advice to people with debt problems, to contact their creditors with urgency, is dysfunctional. Unless forced to by an effective advice agency or the courts, creditors do not take proper account of their debtors' other liabilities (which are usually considerable) and thus make unrealistic and unsustainable demands – further discouraging debtors from maintaining dialogue. Debtors should only be encouraged to contact creditors when they have the support of a competent advisor.

References

- ¹ Bank of England Statistical Release (2014). *Money and credit: December 2013*. London: Bank of England.
- ² Office for National Statistics (2013). *Statistical Bulletin: Families and Households, 2013*. Author.
- ³ Department for Work and Pensions (2013). *Family Resources Survey 2011/12*. Retrieved 9 March 2014 from www.gov.uk/government/publications/family-resources-survey-201112.
- ⁴ Citizens Advice (2013). *Advice trends, 2013/14 Quarter 2*. London: Author.
- ⁵ StepChange Money Aware (2013). *How do I get out of payday loans? Find out in 5 steps*. Accessed 22 February 2014 from <http://moneyaware.co.uk/2013/07/how-do-i-get-out-of-payday-loans/>.
- ⁶ Department for Business Enterprise and Regulatory Reform (2007). *Tackling over-indebtedness: Annual Report 2007*. London: Author.
- ⁷ Department for Business Innovation and Skills (2010). *Over-indebtedness in Britain: First follow-up report*. London: Author.
- ⁸ Department for Business Innovation and Skills (2010). *Over-indebtedness in Britain: Second follow-up report*. London: Author.
- ⁹ Fisher, I. (1930). *The theory of interest*. New York: Macmillan.
- ¹⁰ Friedman, M. (1963). Windfalls, the 'horizon', and related concepts in the permanent income hypothesis. In C.F. Christ et al. (Eds.), *Measurement in economics*. Stanford CA: Stanford University Press.
- ¹¹ Ainslie, G. (1975). Specious reward: A behavioral theory of impulsiveness and impulse control. *Psychological Bulletin*, 82, 463–496. doi:10.1037/h0076860.
- ¹² Ainslie, G. (1992). *Picoeconomics*. Cambridge: Cambridge University Press.
- ¹³ Berns, G.S., Laibson, D. & Loewenstein, G. (2007). Intertemporal choice – toward an integrative framework. *Trends in Cognitive Sciences*, 11, 482–488. doi:10.1016/j.tics.2007.08.011.
- ¹⁴ Snelders, H.M.J.J., Lea, S.E.G., Webley, P. & Hussein, G. (1992). The polymorphous concept of money. *Journal of Economic Psychology*, 13, 71–92.
- ¹⁵ Dearden, C., Goode, J., Whitfield, G. & Cox, L. (2010). *Credit and debt in low-income families*. York: Joseph Rowntree Foundation.
- ¹⁶ Lea, S.E.G. (1999). Credit, debt and problem debt. In P.E. Earl & S. Kemp (Eds.), *The Elgar companion to consumer research and economic psychology*, pp.139–143. Cheltenham: Edward Elgar.
- ¹⁷ Humphrey, D. B. (2004). Replacement of cash by cards in US consumer payments. *Journal of Economics and Business*, 56, 211–225. doi:10.1016/j.jeconbus.2003.09.001.
- ¹⁸ Prelec, D. & Simester, D. (2001). Always leave home without it: a further investigation of the credit-card effect on willingness to pay. *Marketing Letters*, 12, 5–12.
- ¹⁹ Hayhoe, C.R., Leach, L. & Turner, P.R. (1999). Discriminating the number of credit cards held by college students using credit and money attitudes. *Journal of Economic Psychology*, 20, 643–656.
- ²⁰ Norvilitis, J.M., Szablicki, P.B. & Wilson, S.D. (2003). Factors influencing levels of credit-card debt in college students. *Journal of Applied Social Psychology*, 33, 935–947.
- ²¹ Norvilitis, J.M. & MacLean, M.G. (2010). The role of parents in college students' financial behaviors and attitudes. *Journal of Economic Psychology*, 31, 55–63. doi:10.1016/j.joep.2009.10.003.
- ²² Webley, P. & Nyhus, E.K (2006). Parents' influence on children's future orientation and saving. *Journal of Economic Psychology*, 27, 140–164.
- ²³ Sullivan, T.A., Warren, E. & Westbrook, J.L. (1989). *As we forgive our debtors*. New York: Oxford University Press.
- ²⁴ Lehnert, K.F. (1977). Das psychologische Konkursprofil. *Psychologie und Praxis*, 21, 86–91.
- ²⁵ Donnelly, G., Iyer, R. & Howell, R.T. (2012). The Big Five personality traits, material values, and financial well-being of self-described money managers. *Journal of Economic Psychology*, 33, 1129–1142. doi:10.1016/j.joep.2012.08.001.
- ²⁶ Joireman, J., Kees, J. & Sprott, D. (2010). Concern with immediate consequences magnifies the impact of compulsive buying tendencies on college students' credit card debt. *Journal of Consumer Affairs*, 44, 155–178.
- ²⁷ Ottaviani, C. & Vandone, D. (2011). Impulsivity and household indebtedness: Evidence from real life. *Journal of Economic Psychology*, 32, 754–761. doi:10.1016/j.joep.2011.05.002.
- ²⁸ Brown, S., Garino, G. & Taylor, K. (2013). Household debt and attitudes toward risk. *Review of Income and Wealth*, 59, 283–304. doi:10.1111/j.1475-4991.2012.00506.x.
- ²⁹ Seaward, H.G.W., & Kemp, S. (2000). Optimism bias and student debt. *New Zealand Journal of Psychology*, 29, 17-9.
- ³⁰ Watson, J.J. (2003). The relationship of materialism to spending tendencies, saving and debt. *Journal of Economic Psychology*, 24, 723–729.
- ³¹ Chien, Y.W., & Devaney, S.A. (2001). The effects of credit attitude and socioeconomic factors on credit card and installment debt. *Journal of Consumer Affairs*, 35, 162–179.
- ³² Hayhoe, C.R., Leach, L.J., Turner, P.R., Bruin, M.J. & Lawrence, F.C. (2000). Differences in spending habits and credit use of college students. *Journal of Consumer Affairs*, 34, 113–133.

- ³³ Stone, B. & Maury, R.V. (2006). Indicators of personal financial debt using a multi-disciplinary behavioral model. *Journal of Economic Psychology*, 27, 543–556. doi:10.1016/j.joep.2005.11.002.
- ³⁴ Ranyard, R. & Craig, G. (1995). Evaluating and budgeting with instalment credit: An interview study. *Journal of Economic Psychology*, 16, 449–467.
- ³⁵ Stewart, N. (2009). The cost of anchoring on credit-card minimum repayments. *Psychological Science*, 20, 39–41.
- ³⁶ Ranyard, R., Hinkley, L., Williamson, J. & McHugh, S. (2006). The role of mental accounting in consumer credit decision processes. *Journal of Economic Psychology*, 27, 571–588.
- ³⁷ McHugh, S., Ranyard, R. & Lewis, A. (2011). Understanding and knowledge of credit cost and duration: Effects on credit judgements and decisions. *Journal of Economic Psychology*, 32, 609–620. doi:10.1016/j.joep.2011.02.005.
- ³⁸ Lea, S.E.G., Webley, P. & Levine, R.M. (1993). The economic psychology of consumer debt. *Journal of Economic Psychology*, 14, 85–119.
- ³⁹ Lea, S.E.G., Webley, P. & Walker, C.M. (1995). Psychological factors in consumer debt: Money management, economic socialization, and credit use. *Journal of Economic Psychology*, 16, 681–701.
- ⁴⁰ Mewse, A.J., Lea, S.E.G. & Wrapson, W. (2010). First steps out of debt: Attitudes and social identity as predictors of contact by debtors with creditors. *Journal of Economic Psychology*, 31, 1021–1034. doi:10.1016/j.joep.2010.08.009.
- ⁴¹ Dominy, N. & Kempson, E. (2003). *Can't pay or won't pay? A review of creditor and debtor approaches to the non-payment of bills*. London: Department for Constitutional Affairs.
- ⁴² Walker, C.M. (1996). *The psychology of debt in the 1990s*. Unpublished PhD thesis: University of Exeter.
- ⁴³ Aznar, C. (2009). *A life in debt*. London: Citizens Advice.
- ⁴⁴ Wrapson, W., Mewse, A.J. & Lea, S.E.G. (2007). Social identity and attitudes in problem debt. In International Association for Research in Economic Psychology (Eds.), *Proceedings of the Symposium*. Ljubljana.
- ⁴⁵ Brown, S., Taylor, K. & Price, S.W. (2005). Debt and distress: evaluating the psychological cost of credit. *Journal of Economic Psychology*, 26, 642–663. doi:10.1016/j.joep.2005.01.002.
- ⁴⁶ Norvilitis, J.M., Merwin, M.M., Osberg, T.M., Roehling, P.V., Young, P. & K. (2006). Personality factors, money attitudes, financial knowledge, and credit-card debt in college students. *Journal of Applied Social Psychology*, 36, 1395–1413.
- ⁴⁷ Roberts, R., Golding, J., Towell, T., Reid, S., Woodford, S., Vetere, A. & Weinreb, I. (2000). Mental and physical health in students: the role of economic circumstances. *British Journal of Health Psychology*, 5, 289–297.
- ⁴⁸ Taylor, M.P., Pevalin, D.J. & Todd, J. (2007). The psychological costs of unsustainable housing commitments. *Psychological Medicine*, 37, 1027–1036.
- ⁴⁹ Nettleton, S. & Burrows, R. (1998). Mortgage debt, insecure home ownership and health: an exploratory analysis. *Sociology of Health & Illness*, 20, 731–753.
- ⁵⁰ Nettleton, S. & Burrows, R. (2000). When a capital investment becomes an emotional loss: The health consequences of the experience of mortgage possession in England. *Housing Studies*, 15, 463–479.
- ⁵¹ Richardson, T., Elliott, P. & Roberts, R. (2013). The relationship between personal unsecured debt and mental and physical health: A systematic review and meta-analysis. *Clinical Psychology Review*, 33, 1148–1162. doi:10.1016/j.cpr.2013.08.009.
- ⁵² Jenkins, R., Bhugra, D., Bebbington, P., Brugha, T., Farrell, M. et al. (2008). Debt, income and mental disorder in the general population. *Psychological Medicine*, 38, 1485–1493. doi:10.1017/S0033291707002516.
- ⁵³ Meltzer, H., Bebbington, P., Brugha, T., Jenkins, R., McManus, S. & Dennis, M.S. (2011). Personal debt and suicidal ideation. *Psychological Medicine*, 41, 771–778. doi:10.1017/S0033291710001261
- ⁵⁴ Walker, C.M. (1996). Financial management, coping and debt in households under financial strain. *Journal of Economic Psychology*, 17, 789–807.
- ⁵⁵ Amar, M., Ariely, D., Ayal, S., Cryder, C.E. & Rick, S.I. (2011). Winning the battle but losing the war: The psychology of debt management. *Journal of Marketing Research*, 48, S38–S50.
- ⁵⁶ Lea, S. E. G., Webley, P., & Bellamy, G. (2001). Student debt: expecting it, spending it and regretting it. In A. J. Scott, A. Lewis, & S.E.G. Lea (Eds.), *Student debt*, pp.37–47. Bristol: Policy Press.
- ⁵⁷ Haultain, S., Kemp, S. & Chernyshenko, O.S. (2010). The structure of attitudes to student debt. *Journal of Economic Psychology*, 31, 322–330. doi:10.1016/j.joep.2010.01.003.
- ⁵⁸ Webley, P. & Nyhus, E.K. (2001). Life-cycle and dispositional routes into problem debt. *British Journal of Psychology*, 92, 423–446.
- ⁵⁹ Kempson, E., McKay, S. & Willits, M. (2004). *Characteristics of households in debt and the nature of indebtedness*. Department for Work and Pensions Research Report no. 211.
- ⁶⁰ Hartarska, V. & Gonzalez-Vega, C. (2006). Evidence on the effect of credit counseling on mortgage loan default by low-income households. *Journal of Housing Economics*, 15, 63–79. doi:10.1016/j.jhe.2006.02.002.