Applied Financial Economics ›

Volume 18, 2008 - Issue 15

Original Articles

The impact of unsecured debt on financial pressure among British households

Ana del Río & Garry Young

Pages 1209-1220 | Published online: 21 Jul 2008

Cite this article https://doi.org/10.1080/09603100701604233

Abstract

This article uses the 1995 and 2000 waves of the British Household Panel Survey to examine how a self-reported indicator of financial pressure is related to household finances and other characteristics. Using an ordered-logit model we find that the burden of debt is affected by the unsecured debt-income ratio, mortgage income gearing, financial wealth, health, ethnicity and marital status.

Acknowledgements

The views expressed in this article are those of the authors, and not necessarily those of the Bank of England or Banco de España. We are grateful for helpful discussions to

Peter Brierley, Jonathan Crook, Orla May and Merxe Tudela and seminar participants at the Bank of England and Banco de España. Any remaining errors are our own.

Notes

[1] The Insolvency Service estimates that only around 10% of bankrupt individuals have secured debt arising from mortgaged property. Similarly, around two-thirds of the debt clients of Citizens Advice Bureaux are tenants and so without mortgages (Citizens Advice, 2006).

[2] The BHPS is managed by the ESRC UK Longitudinal Studies Centre with the Institute for Social and Economic Research at the University of Essex. The BHPS is an annual national survey whose sample has remained broadly representative of the population. The BHPS sample excludes households located north of the Caledonian Canal in Scotland. The sample we use excludes new samples that were included in BHPS since 1997. Detailed information can be found in Brice et al. (2002).

[3] See Berthoud and Kempson (1992), Cox et al. (2002), Kempson et al. (2004) and May et al. (2004) for household-level analyses of factors likely to affect financial distress among British households and Canner et al. (1995) for an analysis of the affordability of debt among US households. Brown et al. (2005) examine the relationship between debt and psychological distress using the BHPS.

[4] Whitley et al. (2004) examine trends in credit card and mortgage arrears at the aggregate level.

[5] The BHPS is an annual national survey whose sample has remained broadly representative of the population. The first wave corresponds to 1991 when 5500 households and 10 300 individuals (aged over 16 years) were included. The BHPS sample excludes households located north of the Caledonian Canal in Scotland. Our sample also excludes new samples that were included in BHPS since 1997.

[6] In 2000 which part of the debt is a sole commitment is known but we do not use this information since it is not available for 1995. Joint commitments affect 984 and 709 individuals out of 3481 and 3458 debtors in 1995 and 2000, respectively.

[7] A likely reason for the addition of the student loan category in the 2000 survey is that loans had by then become the main form of financial support for students. Details on the extent of student loan finance are provided by Callender and Wilkinson (2003).

[8] We have also considered the case excluding households with at least one member reporting student loans and overdrafts in 2000. Since there is no information on the amount of debt by instrument, excluding households with overdrafts implies also excluding the debt that these borrowers may hold in other instruments. All figures are available upon request.

[9] A fuller description of the distribution of unsecured debt and an econometric investigation of its determinants is in del-Río and Young (2006).

[10] We use annual household income provided by BHPS which contains a conversion factor to allow for the effects of household size and composition. Income groups are percentiles of the income distribution for the sample in 1995. For 2000 the percentiles are updated using the Retail Price Index.

[11] Assuming there is not substantial variation across households. However, terms and interest rates depend largely on the type of unsecured debt.

[12] The results presented in this section are qualitatively similar to those obtained with BHPS weights. SEs do not vary if the estimation takes into account the fact that some households participate in both 1995 and 2000 surveys.

[13] Thus, the probability of no problem for the reference group is given by exp(1.39)/[1+exp(1.39)].

[14] Average quoted credit card rates fell from 22.77% at end-September 1995 to 18.79% at end-September 2000. Over the same period unsecured loans of more than £10 000 fell from 17.12 to 11.7% and the standard variable rate on mortgages fell from 8.36 to 7.59%.

[15] The fact that debt problems are generally increasing in the debt-income ratio suggests that there are no clear thresholds for this ratio which, once crossed, move a household from one state to another. If this were the case, the coefficient on debt-income ratios below the threshold would be small and insignificant, only becoming large and significant for those above the threshold. In this way the probability of facing debt problems would move from close to zero to close to one as the threshold were

crossed. Instead, it is likely that the level of any such thresholds vary by household. In this sense the appropriate information is the proportion of households of a particular type that would face debt problems with debt-income ratios above a particular threshold.

[16] Note that with cross-sectional data it is not possible to separate age and cohort effects.