

The Psychology of Debt

Using loans or credit to buy things is not a new concept. In the 1800s, some people bought food and other basic supplies from the general store using credit—the storekeeper handwrote the buyer’s name on a list, keeping track of the total owed. When the buyer came back into town the following week, he paid off his debt. For some people, buying things on credit and having a little extra time to pay was key to ensuring they could buy items to meet their basic needs.

But using credit and loans has morphed into much more than storekeepers extending credit to reliable customers. In the past decade, a plastic credit card has become an extension of a person’s hand, providing the opportunity to instantly purchase anything from a cup of coffee to groceries to a Caribbean vacation. In 2010, approximately 609.8 million credit cards were held by U.S. consumers, according to a survey conducted by the Federal Reserve Bank of Boston.

Buying things using credit cards or loans can be psychologically healthy for people, as it is the means by which they can accomplish personal goals without waiting years to save up enough money. But relying on credit can also have damaging consequences. The concept of credit isn’t bad; it’s the unhealthy behaviors that lead to uncontrolled spending and mismanaged debt that can be detrimental.

Understanding both healthy and unhealthy behaviors associated with using credit and incurring debt will help you identify what you need to do to make the best financial decisions for your life.

Healthy Behaviors and Credit

People with healthy behaviors have a realistic perception of their financial situation, and they regularly do a “reality check” to ensure their spending and amount of debt are in line with the actual state of their finances. When they buy something on credit, they know they will have the money available to pay off the balance right away. Similarly, if they’ve taken out a loan, they know they will be able to make the monthly payments on schedule or ahead of schedule.

In addition to spending within their means, people with a healthy perspective also use credit responsibly to do the

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following:

Obtain a return on investment

Loans and credit can help people make purchases that are part of an overall investment plan, with the potential to produce a large return on investment. For example, an entrepreneur may want to start a new business. Without a loan, it could take her 10 years to earn enough money to start a company that may significantly increase her income. By taking out a loan, she can establish her



David Becker

Northern Oak Wealth Management, Inc.

(414) 278-0590

www.northern-oak.com

555 E. Wells St. Suite 1625

Milwaukee, WI 53202

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business immediately and start earning her increased salary much sooner. She pays off her loan in just a few years and is then able to enjoy an earlier profit for the remainder of the time. In this case, the original loan profited both the creditor and debtor.

Make large purchases

Loans and credit also help people make major purchases—such as homes and cars—much earlier in life, giving them more time to enjoy and use them. Depending on the housing market, purchasing property especially can be an integral part of someone’s overall investment portfolio.

People with a healthy perspective on credit understand their responsibility with debt and make their car loan payments or mortgage payments on time.

Unhealthy Behaviors and Credit

When cash is required for a purchase, a person must hand over physical property and immediately deal with the consequences of his or her spending decisions. Credit cards were once used only for expensive items, meaning that the buyer fully considered the purchase because it fell outside of his or her normal spending habits.

However, now it’s become a social norm for more and more people to rely on swiping plastic for the majority of their transactions. If the person has the money to pay off all of these transactions as soon as the credit card bill comes due, there are no problems. But relying on credit can lead to many unhealthy spending behaviors including the following:

Instant gratification

Instant gratification is the personal need to have something...now. Buying things using credit is extremely appealing; peoples’ spending needs and wants can be fulfilled immediately without having to wait until the next payday or having the cash physically in their pockets. Instant gratification does not require patience and persistence to save up for purchases. Giving in to instant gratification is becoming increasingly easier, too; Internet shopping sites can store buyers’

credit card numbers for future orders, eliminating the need to type the number in every time they make a purchase.

In some cases, constantly giving in to instant gratification can lead to a spending addiction.

Lack of willpower

Instant gratification is not necessarily an unhealthy behavior in all aspects of someone’s life; but when it comes to spending, it can have detrimental consequences if the spender lacks willpower and gives in to every desire. Using credit can make some purchasers numb to the fact that they are spending money they must actually earn. It’s easier to have self-control when paying with cash; if you don’t have the money in your pocket, you don’t buy it. But credit cards allow consumers to spend freely, making it vital to have self-control.

Denial

While those with healthy spending behaviors conduct regular “reality checks” to make sure they are following their budget, those with unhealthy spending behaviors deny the actual state of their financial situations. Another appealing aspect of credit is its ability to allow users to defer their financial problems and procrastinate on paying for things in full. For people who already are having trouble making ends meet, credit allows them to delay confronting underlying financial problem or simply just deny them altogether.

Credit abuse and credit addiction

Consistently overusing credit can lead to more serious problems in someone’s life. As interest accumulates each month, over time, the debt becomes a snowball, rolling down a hill, building momentum and eventually careening out of control.

Those who abuse credit cards can be helped with budgeting and education. But for some, credit abuse can become uncontrollable, leading to a “credit addiction.” Severe credit addiction is almost never a stand-alone problem and is often related to other underlying issues. Counseling for these issues usually extends beyond simple money management.

Consequences of Unhealthy Spending

Paying down loans faithfully and paying off the credit card balance each month has positive outcomes, including an increased credit score and a higher possibility of obtaining future loans.

Unhealthy spending and managing debt irresponsibly produces the opposite result. Simple unhealthy spending behaviors can quickly develop into complicated bad spending habits. Habits are acquired behavior patterns, which then make the unhealthy behaviors become natural and voluntary.

For both simple unhealthy spending behaviors and complex spending habits, there are consequences, including:

Paying much more for something than you intended. When debt accrues interest, it means you are paying more than the original cost of the item purchased. This can be managed, or it can quickly get out of control for those who consistently spend outside of their means and take longer to pay off debt.

Dealing with collection agencies. Creditors are not imaginary people or entities. The reality is, creditors want the money owed to them, and they want it by a certain deadline. Debt that goes to a collection agency can negatively affect peoples’ credit scores and can add stress to their lives.

Filing bankruptcy. People file bankruptcy for many reasons. For some, it’s because they’ve spent outside their means and accumulated too much debt that they can’t handle or no longer have the ability to pay.

Identify Ways to Approach Credit and Debt in Your Life

Consider your personal attitudes toward spending and debt. An attitude is a learned tendency to evaluate things in a certain way. Attitudes can develop from childhood, your parents or significant other, your environment, one-time circumstances and other personal experiences. What has been your experience with credit and debt, and how has that shaped your thinking?

Loans and credit are not enemies. If used responsibly, they are the means for people to accomplish their goals and make progress in their lives. If used irresponsibly, loans and credit can pose problems that aren't always easily fixed.

Talk with a financial advisor at Northern Oak Wealth Management, Inc.. We are here to help you identify healthy ways of approaching how you think about debt, spending, and how it relates to your overall personal budget and financial well-being.

