Why people go into debt: The money isn't really theirs

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Credit: AI-generated image (disclaimer)

In 2019, U.S. consumer debt reached an all-time high, surpassing levels last seen during the 2008 financial crisis. Such debt takes many forms, including mortgages and student loans. But credit card debt alone exceeded $870 billion, and most of that is the result of discretionary spending. Why are so many Americans needlessly putting themselves in the hole?

The answer might lie in the psychological profile of the debtor, according to Stephanie M. Tully, an assistant professor of marketing at Stanford Graduate School of Business. In a recent paper, Tully and her coauthors found that not all consumers feel the same way about available financing.

On one side of the continuum are those who perceive borrowed money to be entirely their own, and thus are more willing to spend it freely. On the other side are those who perceive such funds as decidedly not their own. This latter group is more likely to see the money as belonging to the bank, and thus more conservative about how they spend the money.

"What we found is that people's feelings about the ownership of money can predict their interest in taking on debt," Tully says. "It seems some people are fine with going into debt as long as it doesn't feel like debt."

The idea of psychological ownership of money came to Tully after she realized that consumers often use more costly forms of borrowing like credit cards rather than cheaper options such as personal loans. She wondered if funding through credit cards felt less like debt than other forms of borrowing.

"There are times when debt can be beneficial," she says. "You invest in a home or higher education. But the choice to go into debt over discretionary purchases isn't a rational calculation, and for many it's suboptimal."

The Psychology of Borrowing

Tully and her coauthors, Eesha Sharma of Dartmouth and Cynthia Cryder of Washington University in St. Louis, are the first to explore the "psychological ownership of money" and its link to consumer debt. "Nobody's really tried before to measure this feeling of ownership and its effects on borrowing habits," she says.

The researchers found that the sense of psychological ownership—a concept first used in management literature to describe employee attitudes toward organizations—is distinct from such factors as debt aversion, financial literacy, income, and self-control, and that it's even more predictive of one's willingness to incur debt. The more consumers feel a sense of ownership over-borrowed funds, the more likely they are to use those funds.

To demonstrate this, the researchers conducted eight studies that used various methods to measure psychological ownership of money. The first pair of studies presented each participant with a real ad (one used an Amazon credit card ad, another used a personal loan ad from American Express), measured psychological ownership of the available financing, and then gauged their interest in the offer.

Another group of studies compared perceived ownership across debt types (credit cards, lines of credit, loans, and payday loans). In other experiments, the researchers offered identical borrowing options using different language, the variable being the marketing literature's emphasis on "ownership."

In the first two studies, as predicted, those who scored high on the "psychological ownership" scale were more willing to incur debt. The second group of studies showed that the type of debt matters, too (credit, for example, inspires feelings of ownership more than loans). And it turns out that psychological ownership is malleable: When marketing language for borrowed money de-emphasized ownership, there was less interest in the offer.

Crucially, it's not that participants failed to understand the terms of the credit card or loan offer. Everyone in these studies knew that the money had to be repaid; they differed only in how much they felt the borrowed money was theirs.

A final pair of studies found that differences in psychological ownership across debt types even manifest in online searches.

"When people are considering credit cards, which are high in psychological ownership, they are more likely to use search terms, such as 'spending,' that reflect they feel like the money is theirs," Tully says. "But when they search for loans, which are low in psychological ownership, they are more likely to use search terms, such as 'repayment,' that reflect they feel like the money is owed."

Beyond Financial Literacy

There are many possible reasons why some consumers have a higher sense of psychological ownership over borrowed money. Research has shown that certain borrowers see their credit limits as an indicator of future earnings, which suggests that such people feel they are borrowing from their future selves, as opposed to a lender. It might also be that some are deceived by "motivated reasoning," a cognitive bias toward processing information in a way that confirms preexisting beliefs or emotions. After all, the money helps produce desired outcomes.

"We hope to explore this further," Tully says. "The purpose of this paper is really to understand that people experience different degrees of psychological ownership toward borrowed money and that it influences their behavior."

The research also has implications for those designing products or programs that push financial literacy, many of which have had mixed success, especially at a time when fintech innovations have led to more lending options, and therefore an overall increase in loans.

"This research suggests that it may be less about understanding the details of compound interest and more about basic attitudes," Tully says. "If you can change the way people think about borrowed money from an early age, that could make an impact across their lifetime. Credit card companies do a great job of making us feel like they're granting us access to our money. They're not. It's important to understand that this is debt."

More information: Psychological Ownership of (Borrowed) Money: www.gsb.stanford.edu/faculty-r … rship-borrowed-money

Provided by Stanford University

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