Call for 'debt driving licence'

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People borrowing money for the first time should only be given small amounts until they have proved their competence, a new study says.

The paper argues that new borrowers—especially young people and those of an "impulsive" disposition—need protection to prevent them falling into long-term debt.

It says lenders should have a duty of care, requiring them to consider age, experience and personality traits, which can be detected by psychometric tests.

The study, by Professor Stephen Lea of the University of Exeter, reviews evidence on the psychology of debt, and makes recommendations to help reduce debt problems.

"I argue that—similar to obtaining a driving license—people should have to demonstrate their competence before taking out debts that could have long-term negative consequences," Professor Lea said.

"Some people are particularly susceptible to debt problems.

"This includes those of an impulsive disposition, but it particularly applies to young people—and debts contracted early in life can have long-term ill effects.

"Accordingly, steps need to be taken to protect people at this vulnerable life stage.

"Although this would involve a restriction of the financial freedom of people who are legally adults, the evidence suggests that access to credit should be controlled more carefully."

Speaking about rules relating to people of an "impulsive" disposition, Professor Lea said: "Lenders might well resist such regulations, but in fact financial advisors are already required to assess risk preference when advising people on investments.

"This shows that such a measure can be brought in without too much difficulty or expense to those who have to implement it."

Professor Lea acknowledges that debt is heavily influenced by economic inequality, and that no psychological factor can prevent debt if excessive socio-economic disadvantage is not addressed.

He also says the current Covid-19 pandemic is likely to increase debt problems.

His recommendations include tackling poverty (reducing the "decades-long drift towards greater inequality in almost all countries") and intensifying regulation of high-cost lenders.

Recommending better financial education of children, Professor Lea said: "Many people are shockingly bad at assessing credit deals.

"What seems to be needed is fluency in seeing, without effortful calculation, what is or is not a good deal when borrowing money."

The paper calls for policies to improve people's awareness of their credit position, and says debtors should be advised to seek independent advice before dealing with lenders to whom they owe money.

He concludes: "If all these recommendations were adopted overnight, the problems of debt in society would not go away.

"Credit enhances consumer choice and is a necessary function in a modern economy, and so long is credit is available, some people will get into difficulties with debt.

"But, as is the case with poverty itself, neither the extent nor the level of debt is fixed.

"Appropriate policies, such as those proposed here, could reduce both."

More information: Stephen E. G. Lea, Debt and Overindebtedness: Psychological Evidence and its Policy Implications, *Social Issues and Policy Review* (2020). DOI: 10.1111/sipr.12074

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