



THE SOCIOECONOMIC EFFECT OF HOUSEHOLD
DEBT ON URBAN INDIVIDUAL WELL-BEING IN
KLANG VALLEY

BY

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ABSTRACT

Debt is beneficiary to individuals and households when their consumption can be extended with credit. However, the benefits gained from availability of credit have negative implications, and research on indebtedness has become a focus of many scholars from different fields of study. Nevertheless, most of the research limit their analysis within the scope of economics. In addition, the multi-aspect implications of debt have never been investigated for a single group of individuals. Therefore, this research sought to explore the implications of household debt on individuals' social and economic well-being by using 407 sample data collected from the urban households in Klang Valley, Malaysia. Several regression models were applied to investigate the impact of household debt on individual's wellbeing from various aspects such as economic, psychological, physical health and family relationships. The principle finding was that the impact of household debt extended beyond the economic aspect to all the other three dimensions as well. However, the analysis shows that there are differences with regard to the extent of the impact across the four aspects. The highest impact is on the psychological wellbeing, compared to other dimensions of wellbeing. Furthermore, the research also found there is a clear difference between the effect of the type of household debt on the social and economic wellbeing. Unsecured debts have more severe impact on individual's wellbeing compared to secured debts in all aspects considered in this study. Therefore, although an individual's overall household debt may not indicate a strong impact on certain aspects of wellbeing, however, the evidence on the impact of unsecured debt tend to be more obvious. This study also found no evidence that shows the impact of household debt differing across ethnic groups in Malaysia.

مُلخَّصُ البَحْث

من المعروف أن الفائدة المترتبة على الدين تزداد حين يمدد الفرد استهلاكه مع الائتمان، بالإضافة إلى الفوائد المترتبة للحصول على الائتمان نفسه، وقد أثارت الآثار السلبية للديون اهتمام العلماء من مختلف المجالات، ولكن؛ نادرًا ما توسَّعت الدراسات الاقتصادية في تحليلاتها لتشمل الآثار كثيرة الأبعاد للديون، ولا سيما ديون الأسر المعيشية، وعليه؛ يستكشف هذا البحث تأثير ديون الأسر المعيشية على الرفاه الاجتماعي والاقتصادي للفرد من خلال عينة من 407 أسرة مشاركة من الأسر الحضرية في وادي باسون، ماليزيا، واستُخدمت عدة نماذج لدراسة تأثير تلك الديون على رفاه الأفراد من حيث: الاقتصاد، والصحة النفسية، والصحة البدنية، والعلاقات الأسرية، وكان الاستنتاج الرئيس أن لتأثير ديون الأسر المعيشية دليلًا على الجوانب الأربعة غير الاقتصادية للسعادة لدى مجموعة من الأشخاص الذين أُجريت معهم مقابلات في المدن الماليزية، ولكن؛ يختلف مستوى الأدلة باختلاف الأبعاد، وتظهر الأدلة التي تُثبت تأثير ديون الأسر المعيشية أكثر تحديدًا من المزايا النفسية مقارنة بالمنافع الأخرى، وتظهر أيضًا اختلافات واضحة بين تأثير مختلف أنواع ديون الأسر المعيشية على مختلف مستويات الرفاه، ويترتب على أن لا رهن عقاريًا أثر أكبر على رفاه الأسرة؛ مقارنة بجميع جوانب الدين المضمون، ونتيجة لذلك؛ ربما لا يكون لديون الأسر الإجمالية أثر كبير على بعض جوانب الرفاه، ولكن الأدلة على آثار الديون غير المضمونة تكون أكثر وضوحًا في كثير من الأحيان، كما أن هذا البحث لم يجد أي دليل على أن تأثير ديون الأسر الماليزية يختلف باختلاف الأعراق.

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DECLARATION

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CHAPTER ONE

INTRODUCTION

1.1 BACKGROUND OF THE STUDY

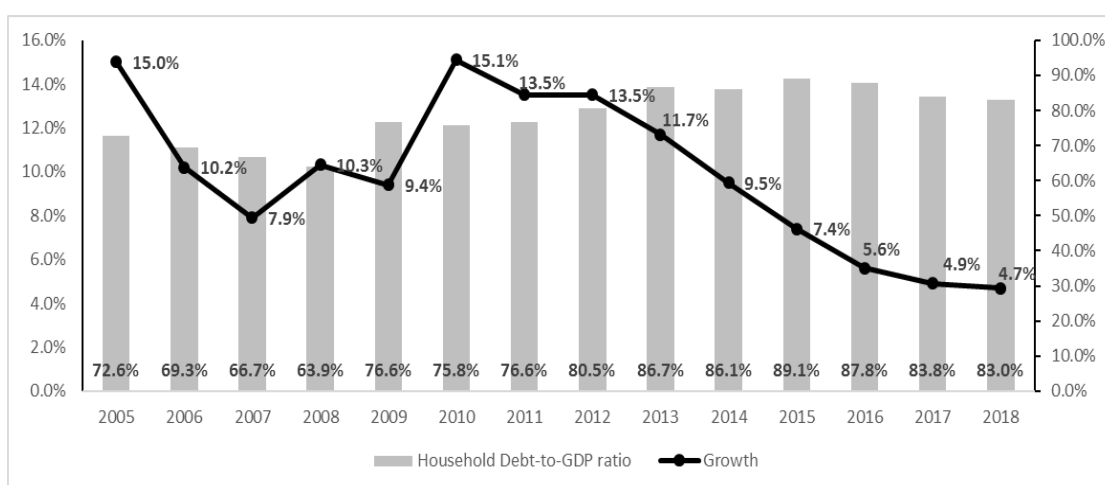
The growth of global debt has been a common phenomenon over the past few decades. Household debt as part of global debt has increased tremendously in many developed countries and was the cause of the financial crisis in 2008 (Lombardi, Mohanty and Shim, 2017). Malaysia as a fast-growing developing economy experienced the same trend as many other developed countries. Aggregate household debt in Malaysia grew rapidly at an average of 11.7 percent per annum for the decade from 2005 to 2014 (Figure 1.1). The fast-increasing rate of household debt compared to GDP has led to the household debt-to-GDP ratio reaching a historic high of 89.1 percent in 2015. Compared to other countries like South Korea (97.5%, 2017¹) and Thailand (78.6%, 2018²), Malaysia's household debt-to-GDP ratio remains one of the highest among Asian countries.

As the benefit of a loan, the ability to borrow enables households to expand their purchasing ability and increase their utility. Whereas, once the loan has been borrowed, the credit obtained will turn from a financial resource into a financial burden for the households, as a form of debt. The increase in utility through higher current credit consumption may not prevail indefinitely as portions of future incomes will need to be allocated for debt repayments. Subsequently, the continued build-up of indebtedness may expose debtors to greater financial vulnerability (Lindner, 2013; Yusof, Rokis &

¹ Source: FRED, Federal Reserve Economic Data

² Source: Bank of Thailand (central bank)

Jusoh, 2015) and financial risks (Böheim & Taylor, 2000; Gross & Souleles, 2002; Whitley, Windram & Cox, 2004; May & Tudela, 2005). An indebted household may become more vulnerable when there are external shocks such as an increase in interest rate, reduction in housing prices, reduction in income, and domestic recession. More severely, the micro-level indebtedness may also amplify to the macro level by generating the risk of general financial instability (Mian, Sufi & Verner, 2017).



Source: Bank Negara Malaysia Financial Stability and Payment System Report various years

Figure 1.1 Household debt growth and Debt-to-GDP ratio in Malaysia (2005–2018)

Apart from the financial pressure caused by a household's indebtedness, scholars from different fields of study have found that the effect of household debt extends to economic and psychological wellbeing, physical health, and family relationship. Research on household wellbeing has found that household debt is not only a source of financial stress (Worthington, 2006) but also negatively impacts financial wellness (Plagnol, 2011; Xiao & Yao, 2014), deprives consumption (Bunn & Rostom, 2014; Kuk, 2016), and impacts work productivity (Kim & Garman, 2004; Kim, Sorhaindo & Garman, 2006). Household consumption pattern may also be

impacted as debtors compared to non-debtors tend to spend more money on luxury commodities (Fan, 2000).

Beyond economists, psychologists have also paid close attention to the impact of household debt. Psychological studies have found that indebtedness is associated with different psychological problems such as depression (Bridges & Disney, 2010), anxiety (Drentea & Reynolds, 2012), mental disorder (Meltzer et al., 2012), compulsive buying (Koran et al., 2006), psychotic disorder (Jenkins et al., 2008), and others (e.g., Chen et al., 2006, 2007; Kidger et al., 2011; Meltzer et al., 2011). Psychological studies into the relationship between household debt and health and health-related behaviour also suggest that higher household debt raises the risk of poor health, specifically poorer general health (Lee, Lown & Sharpe, 2007); obesity and alcohol drinking (Webley & Nyhus, 2001), back pain (Ochsmann et al., 2009), smoking (Drentea & Lavrakas, 2000), and drug dependency (Jenkins et al., 2008; Meltzer et al., 2012). Household debt has also been associated with aspects of family relationship such as declining marital satisfaction (Dew, 2008), likelihood of divorce (Dew, 2011b), poorer child relation (Conger et al., 1992, 1993), and marital conflict (Dew, 2007).

Despite the increasing level of household debt in Malaysia, studies so far have focused less on the impact of household debt on Malaysian households. Previous studies have mostly covered the causes rather than the consequences of debt to Malaysian households. Studies on the impact of household debt in Malaysia have been limited only to issues related to bankruptcy (Nazni et al., 2012; Hilmy, Mohd Z. & Fahami, 2013), vulnerability (Yusof, Rokis & Jusoh, 2015), and financial wellness (Delafrouz & Paim, 2013). Studies on the implications of household debt on various dimensions of wellbeing are scarce.

1.2 PROBLEM STATEMENT

As discussed above, the impact of household debt has been examined in literature from four dimensions of wellbeing. Household debt affects variables from the economic, psychological, physical health and health-related behaviour, and family relationship dimensions. Studies on a dimension of wellbeing provide evidence of the impact of household debt on variables in that dimension only. However, studies examining the effect of household debt across different dimensions are limited and the impact of debt beyond the economic dimension rarely concerns economic studies. Particularly, there has been no economic studies examining the effect of household debt on variables from all the four dimensions of wellbeing.

Findings of studies in each dimension confirm the impact of debt on the respective dimensions of wellbeing. However, it is difficult to draw a general conclusion of the impact of debt on an indebted individual in all four dimensions of wellbeing. This is because different studies have examined the impact of household debt using different sets of respondents; the debt measurement and sample focus vary between studies. Studies have examined respondents having debt problem (Brown, Taylor & Wheatley Price, 2005; Bridges & Disney, 2010; Gathergood, 2012b), based on debt status (Drentea & Reynolds, 2012; Meltzer et al., 2012), with foreclosure experience (Cannuscio; Carolyn C. et al., 2012), and with recession experience (Bunn & Rostom, 2014; Kukk, 2017). Therefore, it is necessary to examine the effect of household debt on variables in the four dimensions of wellbeing using one set of respondents to provide evidence of the effect of household debt on individual wellbeing in all four dimensions. This extends the study of the impact of debt beyond the economic dimension to psychological, physical health and health-related behaviour,

and family relationship dimensions; and provides a more comprehensive review of the economic impacts of debt.

Remarkably, Malaysia as an emerging country has experienced rapid growth in household debt in the past two decades. The Bank Negara Malaysia³ (BNM) believes that the high level of household indebtedness may not fall but to endure in the following years due to the long average maturity of borrowing for housing, transportation, and rapid urbanization (Bank Negara Malaysia, 2017). The BNM anticipates the situation for the lower-income group (60% residing in urban areas) and urban borrowers who are subject to higher living expenses (Bank Negara Malaysia, 2018) will not at ease. The impact of household debt on the wellbeing of urban households, which goes beyond economic wellbeing, should not be neglected. Warnings given by psychologists on the causal relationship between household debt with psychological and physical health problems (Skapinakis et al., 2006; Gathergood, 2012a; Maya Clayton; Jose Linares-Zegarra; & John O.S., 2014) suggest that psychological health problems may act as a “triggering event” to further amplify household financial burden and lead to arrears, default, and bankruptcy (Böheim & Taylor, 2000; Bertrand et al., 2005; Cairns & Pryce, 2008). These raise the importance of examining the implications of household debt before the severe consequences of default and bankruptcy affect urban households in Malaysia. Knowledge of the effect of household debt during debt repayment may help Malaysian policymakers in formulating and implementing policies and strategies to tackle this risk before it causes more serious impact. Thus, in order to examine the effect of household debt on Malaysian urban households, this study uses sample data from households in the most urban area in Malaysia, the Klang Valley, to analyse the effect

³ Central bank of Malaysia

of household debt on variables from the economic, psychological, physical health and family relationship dimensions.

Moreover, it is common that, like in other countries, Malaysian households also engage in various types of debt such as mortgage, credit card debt, motor vehicle loan, personal loan, and others. Different types of debt have different interest or payment terms, and different legal consequences for default. This leads to specific types of debt having different impacts (Fitch et al., 2011). Studies, especially in psychology, have found different impacts on wellbeing of different types of household debt (Drentea & Lavrakas, 2000; Brown et al., 2005; Norvilitis et al., 2006; Berger, Collins & Cuesta, 2013; Richardson, Elliott & Roberts, 2013). This, in turn, raises the question of whether different types of debt have different implications on wellbeing in the context of Malaysia. Therefore, this study also examines, from the four dimensions of wellbeing, the implications of household debt by specifying different types of debt.

Lastly, Malaysia has a multiracial population. Among the major ethnic groups in Malaysia, the Malay, Chinese, and Indian peoples are different in terms of culture, religion, and language. Different ethnic groups have been found to have different risk-bearing capacities (Yusof, Rokis & Jusoh, 2015). Moreover, literature has shown that financial behaviour tends to vary among different ethnic groups (Spencer & Fan, 2002; Yilmazer & DeVaney, 2005). Therefore, an assessment of the implications of household debt among the different ethnic groups in Malaysia extends the literature on the subject. More importantly, if there are differences in the implication of household debt among ethnic groups, the coping strategies can be adjusted accordingly.

1.3 OBJECTIVES OF THE STUDY

To study the implications of household debt on different dimensions of individual wellbeing, the objectives of the study are:

- i. To investigate the impact of household debt on variables from the economic, psychological, physical health, and family relationship dimensions among urban households in the Klang Valley.
- ii. To determine whether the impact of different types of household debt on variables from the economic, psychological, physical health, and family relationship dimensions differs among urban households in the Klang Valley.
- iii. To determine whether the impact of household debt on variables from the economic, psychological, physical health, and family relationship dimensions differs among different ethnic groups in the Klang Valley.

1.4 RESEARCH SCOPE

This study focuses only on examining the relationship between household debt and four dimensions of wellbeing mentioned in the objectives. Eleven variables chosen from different aspects of household life are consumption deprivation, financial wellness, and work productivity for the economic dimension; depression, anxiety, and stress for the psychological dimension; health condition, smoking behaviour, and alcohol drinking for the physical health dimension; and marriage satisfaction and child relation for the family relationship dimension.

This study also focuses on household debt obtained from financial institutions such as mortgage, loan for the purchase of motor vehicles, personal loan, credit card

debt, and others. Other debts such as borrowing from a friend or money lender, utilities in arrears, or outstanding medical expenses are excluded.

Lastly, to empirically test the above relationships, data for this study is collected from urban households in the Klang Valley, Malaysia; the sample households are randomly selected by the Department of Statistics Malaysia. This is due to limitation in resource for data collection to cover other parts of Malaysia.

1.5 SIGNIFICANCE OF THE STUDY

This paper contributes to the current discussion in the following ways: First, this study is an attempt to document a more comprehensive understanding of the household debt issue in Malaysia. Considering Malaysia's household debt is reaching a historically high level, and studies on the characteristic of household debt are still limited, this study thus tries to gain a deeper understanding of the household debt issue in Malaysia before the debtors end up with more severe consequences. This study may help to determine the implications of the high level of household debt in Malaysia to assist strategic planning by credit counsellors and specific planning by general debtors.

Secondly, this study is an attempt to extend research on the implications of household debt by analysing the relationship between economic, psychological, health and social factors and household debt in Malaysia. Since a review of literature has found that debt has different financial, physiology, and social implications, this study attempts to simultaneously analyse the implications of debt on variables from all four dimensions. This may reveal existing adverse relationships with household debt and extend our understanding of these relationships. From the evidence we can further study the inter-relationships between different household debt implications.

Thirdly, by including different types of debt in the analysis, we may be able to see the different implications of different types of household debt. This slight extension may enable us to investigate the characteristics of debt and gain a deeper and detailed understanding of the implications of household debt. This will help in adjusting the strategy in issuing different types of credit or credit risk evaluation process by considering the potential impact of different types of debt.

1.6 LIMITATIONS OF THE STUDY

The limitations of this study are as follows:

1. This research focuses on households in the Klang Valley, Malaysia only. Even as the findings may be generalized for Malaysian urban households, data from other parts of Malaysia may give more complete results. The 407-sample data from the Klang Valley is small relative to Malaysia's overall population.
2. Since this study uses data collected from the Klang Valley, Malaysia, which is an urban area, it may only present the implications of household debt on urban citizens. Rural household data may generate more insights on the subject.
3. The objective of this study is to investigate the implications of household debt from multiple dimensions of household life covering 11 variables. This precludes the use of detailed expert-designed questions on the psychological, physical health, and family relations dimensions. If detailed questions were used, the questionnaire would be too long, making data collection more challenging.

4. This study has applied ordinary least square (OLS) method in analysing the direct relationships. Even as OLS provides accurate estimations of the direct relationships, other methods like structural equation modelling are more capable to indicate complex relationships. The availability of more data will enable the use structural equation modelling to analyse direct and indirect relationships between debt and the wellbeing indicators.
5. Lastly, the different types of debt considered has led to small sample sizes collected for specific debts; for example, less than 100 for property loan. The problem of limited sample size also affects dependent variables like child relationship. A larger sample size may reduce this problem for such multi-dimensional study.

CHAPTER TWO

LITERATURE REVIEW

2.1 INTRODUCTION

The purpose of this study is to investigate household debt and its relationship with multiple dimensions of socioeconomic well-being in the context of Malaysia. This chapter presents a review of related studies on household debt and its implications in four dimensions. The literature review covers household debt in Malaysia, and the implications of household debt on variables from the economic, psychological, physical health, and family relationship dimensions. The conceptual framework and research gap of this study will also be discussed in this chapter. This chapter ends with a summary of the literature review.

2.2 HOUSEHOLD DEBT AND ITS SITUATION IN MALAYSIA

2.2.1 Definition of Household Debt

Taking on debt is a central practice in human history. The Oxford English Dictionary defines debt as “a sum of money that is owed or due” (Oxford, 2016). Someone, therefore, is ‘in debt’ if they have outstanding money to pay. Debt is also known as borrowing, credit, loan, and liability (Xiao, 2015). Household debt is a component of the household balance sheet. It is “all liabilities that require payment or payments of interest or principal by household to the creditor at a date or dates in the future” (OECD 2019). It comprises loans to purchase properties, securities, durable goods, and finance family consumptions (McKinsey Global Institute, 2015).