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Carles Sudrià, Universitat de Barcelona (sudria@ub.edu)

Rafael Castro Balaguer, Universidad Autónoma de Madrid (rafael.castro@uam.es)

Héctor García Montero, UCM y Univ. Bocconi, Milán (hector.garciamontero@unibocconi.it)

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“Consumer credit's recent history, empirical facts and theories: The United Kingdom during the 20th century”

Autor y filiación académica:

Sergio Castellanos-Gamboa Bangor University

Director/es y filiación/es académica/s:

Bernardo Bátiz-Lazo Bangor University

Santiago Carbó-Valverde Bangor University

Dirección electrónica de contacto: abp305@bangor.ac.uk



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UNIVERSITY

Consumer credit's recent history, empirical facts and theories:
The United Kingdom during the 20th century*

Sergio Castellanos-Gamboa[†]

Supervisors: Bernardo Bátiz-Lazo and Santiago Carbo-Valverde

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1 Introduction

Having in mind the importance of household debt, the necessity of understanding its different components and how they affect the welfare of the household comes clear. Household debt can be broadly divided into two components: mortgages and other consumption debt. The former constitutes the main share of household indebtedness and is a long-term commitment that is secured. The latter is a more complicated one in the sense that it is the sum of many products that are sometimes secured, but are as well in many occasions unsecured. It is precisely on this unsecured debt that the dissertation will be focused on.

The purpose of this research project is to have a better understanding of the development and growth of the consumer credit market during the 20th century in the UK. Through my dissertation I will tackle thoroughly the phenomenon of consumer credit to build a chronological narrative with quantitative evaluations that will allow me to test the robustness and accuracy of the neo-classical theories that try to explain consumption credit demand behavior over the life-cycle within the British economy.

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[†]E-mail: abp305@bangor.ac.uk

2 Research aims

The research objective is to analyze the growth and development of the consumer credit market in the United Kingdom. For this phenomenon to be able to develop, some previous facts were required. First of all, households had to be able to earn an income that was higher of that needed to acquire the subsistence-level consumption basket, in order to start saving income for future consumption. Moreover, the financial institutions and other retail institutions had to be interested in financing household consumption and for that, profits in this market, given the level of default risk, had to be attractive enough. Additionally, the regulatory environment had to be favorable for this market to develop, given that in the British case, law was very specific when assigning the activities into which different financial institutions could engage. Finally, technological development had to be at a stage that would allow the financial and retail sector to analyze credit risk rapidly, efficiently and at a low cost to make them able to realize the expected profits.

This set of previously required facts locates the starting point of the research around the beginning of the 20th century. The reason for that is especially the definition of middle-class that will be used throughout the research. Particularly for the case of the United Kingdom, the Industrial Revolution brought with it a new societal structure. Some concepts of middle-class or similar were proposed by many ideological streams, but it was not until 1911 that in the 74th annual report of the Registrar-General¹, Stevenson presented an occupational-based social stratification for the UK that defined the middle-class as that with high-skilled labor and important accumulation of human capital, which was located between the high and low-classes.

Given the fact that these households were now able to save a fraction of their income for future consumption, they were able to increase their inter-temporal consumption path. With these growing disposable resources that households were supplying to the financial markets, financial institutions were also able to lend money not just to firms and for investment projects, but also to these households as well. Developments in the available technology and a dynamic transforming legal environment affected and were influenced at the same time by the growth of this credit demand for consumption purposes. Nonetheless, at some point, UK households increased their demand for credit above a certain threshold that affected their balance-sheets significantly and turned them from net-savers into net-borrowers. This is precisely the research question:

When and why households went from being net-savers to net-borrowers in the UK?

¹Szreter, S. R. S. (1984). The genesis of the registrar-general's social classification of occupations. The British Journal of Sociology 35 (4), 522-546.

3 Expected contributions to the state of the art

This research project will contribute to the literature through a better understanding of the development and growth of the consumer credit market in the UK and its effect on household welfare. It will address the issue of current over-indebtedness of British households from a historical setting. I expect to be able to establish and test the following hypothesis:

- The availability of consumer credit is one of the drivers that have allowed UK households to increase their consumption baskets through the last decades.
- With a constantly increasing economic output through the last century, British households were able to rely on credit to boost their consumption, having the confidence that their income flows would rise steadily as well.
- The increasing expected future income and the objective to “*keep up with the Joneses*” of British households determined the demand for consumer credit vis-à-vis neo-classical theories of consumption smoothing over the life-cycle.

4 Data and methodology

The data that will be used for this research will be found mainly in archives such as the London Metropolitan Archives, the National Archives, the archives of the Bank of England and the archives of several British newspapers. Through this archival work the objective is to construct a thorough narrative analyzing the development of the consumer credit market in the UK and through an inductive process establish a theoretical framework that will improve the understanding of these events.

Furthermore, to the extent that the consulted archives and the documents found allow it, I will build a new macroeconomic-historical series to be used for quantitative analysis within an econometric setting to evaluate the theoretical framework proposed. Moreover, with the quantitative analysis I will be able to measure the magnitude and significance of the effects of regulation, technological development and institutional development on the demand for consumer credit in the UK during the 20th century.

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