

# Effects of debt - positive and negative



Debt can be viewed as good and sometimes also can be bad too. Debt makes people and organizations do things that they would not be allowed to do. All this while, people use it to purchase houses, cars, and other things with their cash on hand. With the debt, they can spend as much as they want on expensive things.

Besides, for those companies also use the debt as to influence the investment made in their assets. This influence of debt is considered as an important part in determining the riskiness of the investment. As we know that, the more the debt per equity, the more risky we will face. The increased risks will bring some bad effects to organizations as well as individuals. As for individuals, the cost of servicing the debt can grow beyond the ability to pay due to both external events and this causes their income loss. And there will be internal difficulties for the organizations as their poor management of the resources.

Debts will also bring some bad results to the economic systems. For example, excesses in debt accumulation in the economy. Prior to the beginning of the Great Depression, the debt ratio was very high. This excess of debt can be described as excessive expectations on future returns, accompanied by an asset bubble on the stock market. When the expectations are corrected, there will be followed by deflation. Deflation can cause the debt to become more expensive. Through this way, many of the economic agents will reduce their consumption and investment in order to decrease their debt level. And by this reduction in demand, it will reduce the business activity and cause further unemployment. In more details, this will bring more bankruptcies due to both increased debt cost due to deflation and the reduced demand.

It is very vital for the organizations to enter into alternative types of borrowing and repayment arrangements which will not result in bankruptcy. For example, the organization can convert debt that they owe into equity in themselves. By doing this, the creditors can regain something same to the debt and interest in the form of dividends and capital gains of the borrower.

In nowadays' culture of too much spending, there are also some debt will occur. For example, the British have retreated, but millions of Americans, by their own choice, allow credit card companies, mortgage lenders, and every known as a form of debt or monthly requirement to carry on the work of need. In America, we will not be made fun of for wasting our resources. In fact, we will have many cheerleaders, although most of them will be the people who profit by selling us trinkets and assorted junk. Just because millions of others share this same practice of spending everything they earn does not make it a right path for others to follow. The culture of spend, spend, and spend is necessarily created by merchants to keep their coffers overflowing. It has been said that more than 60 percent of the economy is based on consumer spending, in term of financed by consumer credit. For those who know to collect money, this spending culture is rewarding. And for those doing the spending, it is enslaving.

Many Americans regarded debt as a sign that something was morally wrong. This is because the availability of credit cards and revolving debt had made us more risky and greedy. Furthermore, we need not look far to find someone suffering from the effects of debt. Those who not yet suffering from the debt effects may not know how the effects will be in future. According Henry Taylor, in Notes from Life (1847), " A right measure and manner in <https://assignbuster.com/effects-of-debt-positive-and-negative/>

getting, saving, spending, giving, taking, lending, borrowing, and bequeathing would almost argue a perfect man." Further explanation is not everyone has the moral or intellectual stamina to set into action a purposely plan for the future. Yet only those who develop a plan and follow it just will succeed.

As we can see, many that goes further on willingly putting on the chains of debt. They not only spending all they earn but also borrowing into their future for today's excesses. They might not realize that when we utilize debt to buy products or services, it is not really a payment for the product or service, but it is a claim on future earnings.

In its early stages involve in debt, debt causes no pain. On the opposing, the insidiousness of debt lies in the very fact that the use of debt gives its victims temporary pleasure. So, a large majority of America will risk their financial to have those temporary pleasure afforded by spending in proceed of earning.

In Adam Smith theory of the invisible of hand of capitalism, he said that capital seeks opportunity to expand and grow, as this is good for the individual and the consumer. In addition, in his invisible of hand of debt theory, consumerist individuals suffer from the invisible or nearly loss of both time and opportunity.

As we must bear in mind that, debt take more from us than just money. It is easy think that debt is simply in term of just pay the bills, but it actually much more than that though. There are some major effects of debt such as loss of freedom, loss of cash flow, loss of time, and also loss of opportunities.

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Debt will eventually keep us from doing what we want to do. It makes us lose our own freedom as well. This happens while we are loaded with many of debts, it narrows down our options. For those individuals who are working while carrying a load of debt is likely troublesome in their working life. This leads to them not paying their full attention on their work by just thinking about the debt only. Freedom can be described as a concept that like a hill often it looks better at a distance. When we come closer to the hill, we begin to see that it can be a lot of work to climb to the top of it. Freedom means something that is different from other things. Maybe for someone, they might think that freedom comes from just having the bills paid and all that. For this effect, financial freedom is one of a lack of necessary worry or concern about money. As time goes by, many people have created their own wealth from far less income than we are currently earning, even during the inflation time. And, also many people will think they are worse off than anyone who went before them when financial difficulties have begun.

Let's come to the second effect where the loss of cash flow is. Surely it is the most obvious debt effect. This effect is first noticed when the money of us is going out either going in. While we are working, most of our disposable income covers the basic necessities, this view as a portion that could be used to eventually replace our job is busy repaying bad debt. For example, while we are unable to get rid of every consumer debt, it is very safe that we can start to invest for our future. If we are spending 15 percent of our income on bad debt, the first goal is to get down to 10 percent, and then the other 5 percent. By practicing this while redirecting the cash flow to savings and investments, and this can be helpful in replacing our job. This was not

happen in a short time, it takes some period of time to get to know the last results.

In year 1981, there are some savings banks were paying 15 percent per annum. The return is not the lesson here, though the savings habit is the lesson. In the beginning, do not worry too much about the return. Just make sure that we are stacking up the capital. The most important thing is we must have capital to capitalize. Many also sacrifice their true passions to debt. Soon most of their money is allocated or for repaying for past spending. They will lose simply if they are giving debt too large of a vote in their future.

Third, effect of debt will create loss of time. If we are in debt, we must be somewhere that we like to be. According to Bennett, A. (1910), the beauty of time is that everyone has the same amount and you cannot spend it in advance. From this view, we also must consider those people who are deeply in debt- bad debt. They basically have spent their time usefully, for they are required to be at their jobs to repay their debts. They have spent their time in advance of its arriving. For example, we sell our skills in the marketplace, but more than that we must realize that what we sell is a part of our remaining time. As we grow in wealth and influence, we will value time is more important than others. The amount of time that we use to worrying about the bad debt is useless than we use the time more usefully by spending on some positive pursuits. Freedom from debt will lead us to spend more time with family and friends. Many people still wish free time more than additional money. By this way, they can stick with their own family with more time as well.

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Finally is loss of opportunities. When we see a great opportunity just in front of us for the financial gain, it is unlikely that we will be able to take advantage on it, because we know that we are unable to do so. The first rule of all enterprise is to get to know a solid value when we see it. The second is to be able to act on an opportunity when it arises. For some example, if our friend suddenly decides to sell his extra car for 50 percent of its true price but only if we can have the amount of cash to pay him in 24 hours time, through this situation, can we respond? The moral of the story is that, we lose if we have not developed the habit of preparing for opportunity. But at the same time also, there should be lessons that we need not to miss the next chance. So that we must hold in your arms the lesson, not the loss; embrace the light, not the dark. Truly this debt effect reaches the heart of all the debt effects. It is silent killer of possibility and promise.

### **Effect of debt on country**

Debt has several effects on a country as well. A country's debt is called sovereign debt. It can describe as the loans that are taken out by the sovereign, or the authority of the country. Through this way, it brings it positive and also negative effects for all. The positive effects include money for new construction projects and increased sales from exporters. On the other hand, the negative effects is led the citizens of a country to give up benefits, including land, natural resources and government services.

Besides, sovereign debt can also serve as an economic stimulus. For example, the expensive projects such borrowing money to open additional storefronts as performed by the company can produce advantages in the future. In the time, a country also uses deficit spending which means the <https://assignbuster.com/effects-of-debt-positive-and-negative/>

spending is more than the state receives to fund all those expensive projects such as highway construction and building up new power plants in agriculture sectors that will provide future benefits.

Furthermore, since the country is borrowing more money, it must sell more of its bonds and there make the risk increase that they cannot pay them back. By this way, the currency exchange rates will totally drop with those additional debts. The country's credit rating also will drop in extreme cases and also the cheaper currency has an economic stimulus effect. For example, if British pound drops in value, it helps exporters since British exports are now cheaper for customers in other countries. Yet, imported goods prices increase, helping local manufacturers while increasing costs for other citizens. These effects will occur across all countries in the group if the country is a part of an economic group with a shared currency.

Land and resource sales are also one result of debt. Example, the Louisiana was the result of U. S. President Thomas Jefferson buying land from French Emperor Napoleon Bonaparte so that Napoleon could pay off sovereign debts from his military campaigns. In addition, California Governor Arnold Schwarzenegger offered the state's possessions at an auction and sold state properties, including state fairgrounds, by this way, they can reduce California's debt in 2010.

Furthermore, debt can lead to political instability. A country will generally raise taxes and reduce services when debts reach a high level. By the increasing of taxes, the country may not be able to afford its military or police, increasing risks of foreign assault and crime. Debt also will let the



government down, such as Iceland's did following the 2008 economic collapse, especially if a bailout of politically connected investors is the cause of sovereign debt.

Privatization of state enterprise also is the one result of debt. For overall in Russia, the state paid off its bills by selling state oil companies to the oligarchs. Countries in South America sold off state firms such water companies, metal mines and fruit plantations to reduce their obligations.

### **Credit Card Debt Effects**

As we know that credit cards provide us with the convenience by using it to spend cash with more easily. By this way, it can also bring many negative effects that might be occurred in our financial life.

One of the most important impacts of credit card debt is its negative impact on wealth accumulation. A goal for most workers over the course of their income-earning years is to save money and build wealth so that they can have a good life after their retirement. By building wealth it requires sum amount of savings that can be used to earn interest in savings account or to invest in things such as stocks, bonds, retirement plans, and investments. Credit card debt usually carries high interest rates, which means it forces us to pay out money in the form of interest. In the other words, if credit card debt is larger, the more interest we will have to pay and the less money we will left over to save or earn a return for the retirement. For overall, credit card debt can bring us burdens in retirement savings plan.

Another of common impact of credit card debt is it bring a high level of financial stress. If we carry the more debt, the higher our monthly expenses

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will be. Many people face this problem and lead them to depression and in rare cases of suicide. Debt can also potentially cause stress with personal relationships, for instance, financial issues are the common things of the primary causes of arguments between spouses. This happen due to if we are forced to borrow money from our family members, this can alter and possibly damage the relationships.

If we have more credit card debt also it will tends to hurt credit scores as the amount of debt gets closer to credit limit. This can make us to get loans for important purchases will be more difficult. In addition, credit card debt will make people in leading to personal bankruptcy. This is how many people cannot able to pay for the debt, and then at least they will declare as bankruptcy. While this can significantly ease the burden of debt, bankruptcy severely hampers credit, which can put us in a bad place financially for many years.

### **Effects of Debt on Family**

As debt, is a large debt especially, can lead to stress and arguments. If one spouse is causing the increase in debt, it can lead to a fight among them. Additions, if the debt is based on bills, the bill collectors will keep on calling and this make them become more stress. However, when whole family is in debt, their stress will be more increase and make them become more worried about the debt they face.

When family is in debt, they must make sure that they realize on how to reduce the daily expenses. If a family work together to decrease their debt, this allows them to have a better communication. The families act as a role

model of making financial decisions, which can assist them to prevent future debt. With a better communication skill, it can be a powerful tool for future family harmony yet.

As the conclusion, there are many negative effects of debt on family, and there also can be positive effects as well. If family takes bad situation and uses it as motivation to change, it can have a good of solving the problems. However, if debt becomes a bigger player in a family than can be handled, it could lead to the breakup of a family unit.

### **Household debt in Malaysia**

- Level and growth rate of household debt

Due to the 1997 Asian financial crisis, the share of household credit in total outstanding bank loans was relatively small compared to share of loans extended to businesses. At the end of 1997, lending to the corporate sector held for 67% of total loans outstanding. But consumer financing have increased from Year 2000 onwards. This may be due to the economy is become more stable than the year before cause if the financial crisis. The average annual growth rate for the year 2001 - 2007 was 14. 8%. and after six years of continuous growth, household debt grew at the more moderate pace which is 7. 9 % in year 2007. As at end of year 2007, household credit accounted for 56% of total outstanding bank loans.

- Composition of household debt

The composition of household debt changed little over the period 2000-07. There are big amount for house financing, which accounted for 55% of total household debt as at end-2007. Total loans for housing purchases grew at an <https://assignbuster.com/effects-of-debt-positive-and-negative/>

average annual rate of 15% during the period, in line with government efforts to promote home ownership. In addition to that, financial institutions have been willing to finance residential mortgages because such loans are typically viewed as a low risk. As we can notice that, loans for the purchases of passenger cars account for the second largest proportion of household debt. As the end of year 2007, car loans accounted for 23% of total household loans. Besides, strong consumer demand for motor vehicles is attributed mainly to the revision of the tax structure for passenger cars, new launches of mid-range passenger cars and the promotional activities undertaken by car companies to expand their sales.

Beside that, financing via non-secured credit cards has been growing faster than mortgage lending, although the amounts are less significant. Reflecting the strong demand for consumer loans, coupled with aggressive marketing and advertising strategies by banks to attract customers, outstanding credit card loans grew by 17.8% a year, on average, over 2001-07. As at end-2007, credit card loans accounted for slightly more than 5% of total household debt.

- Financial vulnerabilities and household debt

As a result of heavy borrowing by Malaysian households, the ratio of household debt to GDP grew to 67% in 2007, from 47% in 2000. As with most forms of credit, the rapid development of household debt can create vulnerabilities, in particular if the debt reaches an unsustainable level.

However, the level of household indebtedness in Malaysia, which is comparable to that of other countries in the region, remains manageable.

Because of the household sector's strong financial position and a resilient

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banking system, the risk to the financial system is limited. These have been enhanced by the Central Bank of Malaysia's adoption of a comprehensive approach to the preservation of financial stability. The approach encompasses observation at both the institutional and the systematic levels; this is to assure the bank will be more careful on the practices and supervisory activities.