

Credit and debt in low-income families

Findings
Informing change

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This study examines the experiences of credit and debt for low-income families over a twelve-month period. It was conducted against the backdrop of the global 'credit crunch', when a sustained period of readily available credit was followed by recession, increasing unemployment and rising household costs.

Key points

- Over-indebtedness was more typically due to inadequate income than to 'consumerism'.
- Patterns of borrowing/over-indebtedness varied across people's lives:
 - consumer spending with credit/store cards and loans on becoming eligible for credit at 18, and when setting up home;
 - taking on arrears and formal/informal borrowing to 'make ends meet' when supporting a family;
 - 'inheriting' debts following family break-up; and
 - getting further credit to pay accumulated debts, leading to a 'debt trap'.
- Triggers into over-indebtedness included moving in and out of low-paid work and associated delays in the processing of benefit payments; long-term benefit income; unanticipated and/or large costs; and ill-health/disability.
- The targeted marketing of expensive credit to vulnerable borrowers, punitive bank charges, and up-front lump-sums to start repayment plans all discouraged progress towards manageable levels of debt.
- Previously documented links between over-indebtedness and mental ill-health were confirmed.
- Work offered a route out of over-indebtedness and poverty, but only if it was permanent sustainable employment that paid adequately.
- Savings offered protection, but even small amounts of saving were only feasible for those in work.
- The complexity of people's financial situations meant that ongoing money advice was more likely to be effective than a one-off consultation.
- The evidence supports greater regulation of lenders, rather than limiting the accessibility of credit for people on low incomes.

The research

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Background

Household debt in the UK has increased over the last decade. This raises concerns about the medium- to long-term financial implications for households and their ability to service these debts and, particularly for people in low-income households, to maintain their standard of living whilst doing so.

Until relatively recently, research on debt (and policy in this area) tended to take a cross-sectional, static approach. This has led to a lack of understanding of how people on low incomes manage credit and debt over time.

This research aimed to address the gap in the evidence and provide new insights into how debt is defined and experienced over time by households on low incomes. It provides information for policy-makers, credit providers and advice services, to help them reduce the numbers of over-indebted people and to support people who experience financial crisis.

Types of debt

Arrears on utilities and rent were the most common form of debt and were most prevalent among those in receipt of benefits and those who had typically 'churned' between low wage and benefit income. This demonstrates the inadequacy of participants' income levels for sustaining a minimum standard of living over time, and the need for sustainable jobs.

It's not as though I'm not aware of budgeting, and this is what I normally do as a family, but there just isn't enough to cover everything and if I've got one thing under control, then I'm taking from something else, for something we need, like (food) shopping or rent – general living. (31-year-old single woman on a low income, one child)

Delays in processing benefits, local authority rent recovery practices and some utility companies' demands for up-front lump-sums to start repayment plans also reduced some participants' ability to manage their debts more effectively.

For many, the interest on credit card debts for items purchased years ago, when in a more financially secure position, continued to mount long after they had become ineligible for this form of credit. It was still possible for some to access credit via a partner,

however, pushing the household further into over-indebtedness. Many incurred high bank charges on unarranged overdrafts. There were also participants struggling to repay bank loans taken out during an earlier period of employment, and evidence of unsecured loans being placed in the hands of debt collection agencies. Experiences of relationships with such agencies varied, but some found agency personnel intractable, and occasionally highly unpleasant.

Instalment buying was commonly used to buy furniture and household goods and services. This could be from catalogues, from stores like 'BrightHouse' where goods are primarily bought on a 'pay weekly' credit basis, or from a TV 'pay to view' arrangement, where a television meter is fitted and a tariff set in accordance with usual viewing patterns and monthly repayment levels. Many people were fully aware of the disproportionately high levels of interest, but saw no alternative way of purchasing these goods. In these circumstances, the affordability of the weekly repayment was more important than the added expense compared with being a cash buyer.

Those using doorstep lenders tended to do so in a 'serial' way, having a long-standing relationship with the company through the agents who collected payments. Serial borrowing was often encouraged, by 'rewarding' customers' ability to repay by offering a further loan. Again, the 'manageability' of instalment amounts, and the flexibility for borrowers to miss repayments from time to time was seen as more important than the interest being charged. Less common forms of borrowing included the Social Fund and Credit Unions.

Triggers for debt

People often reported that a common event triggering later over-indebtedness was 'going mad with a credit card' at the age of 18. This had major repercussions later on in life, when setting up home, and starting a family, for example, particularly in a context of insecure employment and low pay. However, a highly complex picture of credit use, involving arrears and other kinds of debt, did not necessarily match the notion that 'one-off events' were the key factor moving people into over-indebtedness. Problematic debt was more often due to a gradual accumulation of circumstances over time, sometimes in a fairly chaotic fashion that made it hard for people to clearly see their overall circumstances, or to exercise financial control.

Once in debt, single event 'triggers' could make it harder to find an escape route. 'Adverse shocks', such as loss of employment, marital breakdown and poor

financial management continued to have a cumulative effect, placing further strain on an individual's ability to stay in the labour market, keep their family together and manage their finances effectively.

Participants were critical of many creditors' practices, which they saw as being unfair, discriminatory and pushing them further into debt. Examples included:

- utility companies' charging policies;
- bank charges and fees that were seen as excessive;
- marketing of loans and credit cards to vulnerable people; and
- high levels of interest charged by those specifically targeting poorer people, such as doorstep lenders and those selling goods on credit door-to-door.

By far the worst relationships reported were with mainstream banks. Many spoke of their frustrations at excessive bank charges and penalties for unpaid direct debits and unauthorised overdrafts – the one often leading to the other. The inflexibility of banks on these charges and penalties was an area of deep resentment and reflected the fact that few respondents felt they had a personal relationship with bank staff. Further, the application of bank charges and penalties exacerbated many participants' debts, making it even more difficult for them to meet their outgoings and service their existing debts. It was striking that there seems to have been an apparent shift in attitude from banks being seen as legitimate, responsible lenders who offer flexibility to their customers to a situation where many people see them as irresponsible lenders, inflexible with their customers and unfairly applying punitive charges.

Managing over-indebtedness

Juggling bills and 'robbing Peter to pay Paul' were common. Food prices rose during the research period, and there were many examples of 'shopping around' for bargains, 'cutting back', prioritising children's food needs, and 'going without' food. For those participants who had some financial leeway, getting bargains was not restricted to food. They were also able to get better financial deals and cheaper tariffs on utilities. However, accessing these resources was more problematic for those with large debts and/or poor credit ratings. In these cases, there was sometimes a reluctance to look at the whole picture in relation to income and expenditure/debt, or to look too far ahead. There was also a tendency to make spending or borrowing decisions and commitments based on present circumstances – having secured a job for example – regardless of how far this could be relied on for its permanence, and despite experience of life being precarious, unpredictable or 'uncontrollable' in the past.

A period of restraint imposed by unemployment might also be followed by increased levels of spending (for example on more, varied or better quality food) when income improved, rather than, or before, prioritising the repayment of debts or arrears.

People's assessments of the severity of their debt seemed to be closely linked to its perceived 'manageability'. For example, debts of a few hundred pounds could be experienced as 'severe indebtedness' by some participants if there had been an ongoing but unsuccessful struggle to reduce or clear them. 'Severity' seemed to be measured by the constant worry participants experienced, or the prospect of the debt ever being paid off seeming remote.

In contrast, others seemed able to separate out comparatively large debts (for example, from credit cards) that were felt to be completely insurmountable and therefore 'ignorable', from those they felt they had some chance of clearing in the foreseeable future (for example, arrears), on which repayments were being made. In such circumstances, it was clear that participants' assessment of their overall debts as of only 'mild' or 'moderate' severity was being applied only to the part they felt able to address. It was evident that often considerable psychological energy was required to keep *trying* to make progress, against the experience of repeated set-backs and an assumption that these would continue to happen in the medium- to long-term. Insufficient income and lack of creditors' flexibility were routine features of people's experience. Women in particular, who typically carried primary responsibility for budgeting, became depressed and anxious as a result of the constant struggle, setbacks and worry resulting from their circumstances, especially when they felt that there was little hope of change.

Resilience: work, saving and advice

People's resilience against becoming over-indebted came from a mixture of 'structural' factors, cultural beliefs and values, and experience. Work was a route out of over-indebtedness (and poverty) over time – but only if people were able to avoid moving in and out of work, which only exacerbated over-indebtedness. There were a few examples of single 'events' (for example, an inheritance or a loan or gift from family) helping to improve things. Individuals' wider social and cultural circumstances were also significant, for example family values of thrift or an aversion to using credit, in some cases due to religious beliefs or a past history of over-indebtedness, bankruptcy or repossession. Financial capability was something people developed over time, often as a result of hard experience.

Even modest savings could reduce the risk of people moving into a situation of over-indebtedness, but notably this study found little evidence of widespread saving amongst participants. Many said they could not afford to commit to regular saving for some unidentified future occurrence because they needed to retain the flexibility to juggle bills and commitments on an ongoing basis, requiring ready access to any surplus. Many, particularly those who were in employment, aspired to save, but for those in receipt of benefit income it was generally considered impossible. There was, however, some evidence of 'instrumental' saving (for Christmas or holidays), but those who managed this were clear that putting this money aside could be stalled and that it could be (and often was) 'raided' if necessary.

Professional money advice protected some from the worst effects of over-indebtedness, although use of such services was not widespread, sometimes because of lack of appointments due to over-demand. Where this was taken up, timely money advice made a big difference, enabling some to access the 'clean slate' option of a Debt Relief Order and others to become more aware of their circumstances and options. Although the researchers did not offer advice, it was not unusual for participants to comment on how helpful they had found simply discussing their finances, the way they budgeted, what their debts were and how they made decisions. This and the complexity of their financial circumstances suggested that a one-off appointment with money advice services may be less helpful than on-going contact (either face-to-face or by telephone) with an advisor.

Conclusion

This research suggests that the cause of over-indebtedness is not widespread profligate use of credit to get a high materialistic standard of living. More typically, the use of credit and accumulation of debt were because of persistent low levels of income, both benefit- and earnings-derived, often exacerbated by moving in and out of work. The overall picture that emerged is of people using credit to 'smooth' income and expenditure flows. Subsequently, since their ability to plan and manage their finances was so constrained, other factors tipped them into problematic debt: the interactions between jobs, income and expenditure (including, crucially, lenders' behaviour), as well as other factors, such as changes in health, disability or marital status.

About the project

This study, by the Centre for Research in Social Policy, used a longitudinal qualitative method designed to allow regular and intensive contact with 60 participants between May 2008 and June 2009. This period was selected to include an annual cycle of household financial management, changes in circumstances and 'triggers' to credit use/over-indebtedness, so that their consequences could be identified and explored.

For further information

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The full report, **Credit and debt in low-income families** by Chris Dearden, Jackie Goode, Grahame Whitfield and Lynne Cox, is published by the Joseph Rowntree Foundation. It is available as a free download from www.jrf.org.uk

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