Britain in the Red

Why we need action to help over-indebted households

TUC

Acknowledgements

This project was jointly commissioned by the TUC and UNISON from the Centre for Responsible Credit. The author wishes to put on record his thanks for the support received from Kate Bell, Nicola Smith, Geoff Tily and Kamaljeet Gill in the TUC's Economic and Social Affairs Department, and from David Arnold at UNISON, without which this report would not have been possible. However, the author remains responsible for any errors or omissions.

Executive summary

It is now over eight years since the onset of the global financial crisis and the Great Recession. Private indebtedness is widely understood as a major underlying cause of the crisis, as high-risk loans and sub-prime mortgages fatally undermined the stability of major financial institutions. While there has been a good deal of emphasis since 2008 on the household elements of private debt, this has tended to be dominated by mortgage debt. The 'Britain in the Red' project was set up to look in more detail at what has happened to households' use of consumer credit.

Households borrow either to spread their spending over a longer period, or when their everyday costs cannot be covered by their income. With households experiencing an unprecedented decline in real earnings, the obvious concern is that more households are finding themselves unable to cover their living costs without taking on debt. In the wake of the very large build-up of debts on consumer credit over the decade from 1997 to 2007, they are also find existing repayment costs significantly harder to manage

While there has been some improvement in overall levels of indebtedness since debt peaked ahead of the crisis, unsecured borrowing began to rise from 2014 and is forecast by the OBR to return to its peak in five years' time.

Total unsecured debt for UK households (which includes credit cards, payday loans etc and student loans. but *not* mortgages) rose by £48bn between 2012 and 2015 to reach £353bn. Unsecured debt previously peaked at £364bn in 2008 and fell in the recession. The increase since 2012 increase is in part due to the major extension of student loans.

Consumer credit (i.e. household borrowing excluding both student loans and mortgages) peaked in 2008 at £230bn; it fell back to £184bn in 2012, but had risen again to £212 by the end of 2015. Bank of England figures now show consumer credit growing at an annual rate of 10 per cent, the highest for over ten years.

This report shows that many conventional measures may understate the scale of these debts and the burdens associated with repayment, due to complexities in the National Accounts measures of household debt, the increased role of student loans and the treatment of loan rescheduling and write-offs. In addition, in terms of households' ability to meet the cost of interest payments, conventional measures do not take into account recent increases in the costs of living. The report therefore suggests alternative measures of indebtedness. In particular a new measure of debt servicing is derived, showing interest payments as a share of a household sector 'surplus' – that is, the amount that households have left to meet the cost of debt payments once living costs have been taken into account. This suggests the burden of indebtedness has risen in recent years in contrast to falls on conventional measure. On this basis, interest payments on unsecured borrowing are at an all-time high, and are high relative to other countries.

This high burden comes as the cumulative effect of previous indebtedness is exacerbated by the fragility of household finances since the crisis. While spending has risen more slowly than before the crisis, it has come alongside greatly reduced income growth in the wake of the earnings crisis.

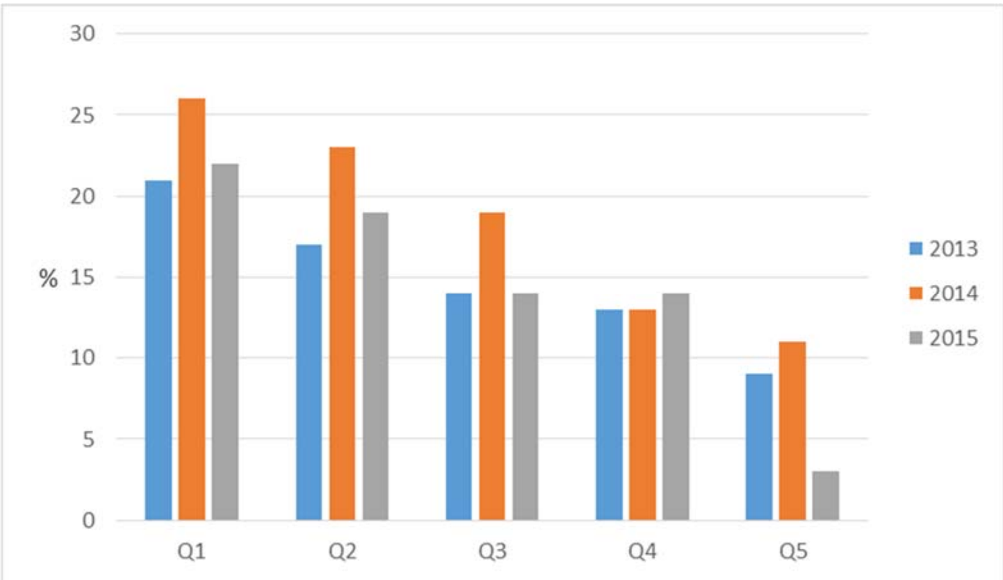
While these figures are indicative of pressures on the economy as a whole, the most significant impact is distributional. The discussion is based on two measures.

Financial vulnerability: Financially vulnerable households have debts that are worth 60 per cent of their income.
Over indebtedness: Households in problem debt have to spend more than 25 per cent of their monthly income paying the interest on their debts (credit cards, loans, overdrafts, arrears).

Financial vulnerability

Since the preliminary report was published in September 2015 there has been an improvement in measures of vulnerability, as wage growth picked up in 2015. However measures remain elevated and the acceleration in wage growth already appears short-lived.

Average debt to income ratios, by income quintile, 2013–2015

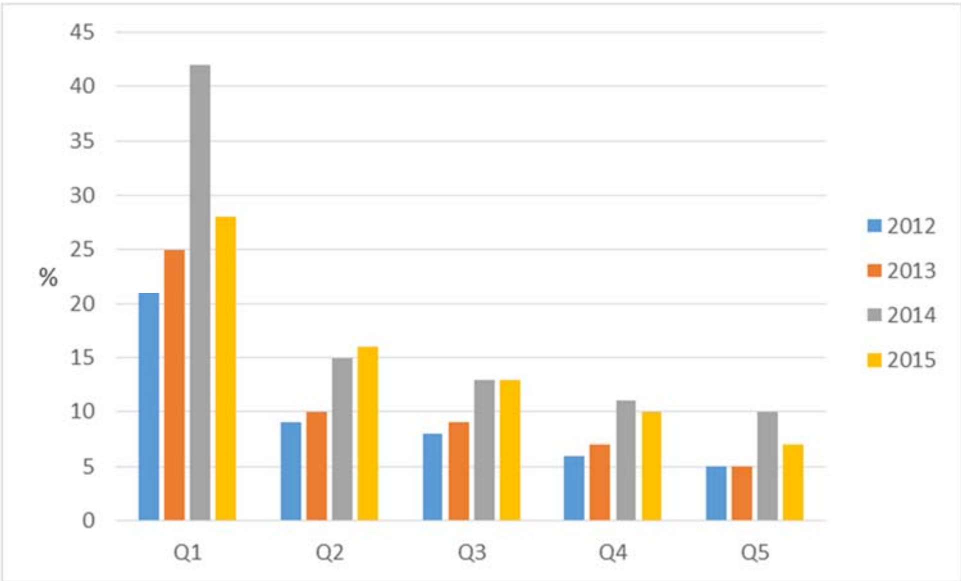


Moreover the lowest income decile is considerably more vulnerable. In 2015 the unsecured debt to income ratio of lowest income households was 22 per cent, seven times as high as the ratio of those in the highest income group (para 3.26).

Over-indebtedness

Correspondingly there has also been some improvement in debt servicing measures and hence over-indebtedness into 2015, though measures are still severely elevated relative to 2012.

Average debt servicing to income ratios, by income quintile 2012–2015



Overall, 11 per cent of households holding any form of unsecured debt are estimated as over-indebted in 2015, more than double compared to the 5 per cent in 2012. Of the over-indebted households, half are extremely over-indebted and so paying out more than 40 per cent of their income to their unsecured creditors (para 3.40).

In total, 3.2 million households or 7.6 million people are over-indebted, an increase of 700,000 or 28 per cent since 2012. On this basis nearly one in eight of all UK households are currently over-indebted (para 3.44). Likewise, 1.6 million households are in ‘extreme debt’.

For households earnings £30,000 or less, 16 per cent were over indebted in 2015 the same as in 2014 and up from 9 per cent in 2012 (para 3.41).

However the share of extremely over-indebted low income households rose to 9 per cent in 2015, up from 8 per cent in 2014 and three times as many as in 2012. Overall, 1.2 million low income households are estimated to be in extreme problem debt.

Even more worrying is that extreme over-indebtedness is growing particularly quickly in low income households that are in employment (excluding self-employment). In 2015, 9 per cent of low income households in employment were extremely over-indebted, up from 5 per cent in 2014.

The final section includes conclusions and recommendations.

Following the discussion of the measurement of household indebtedness, proposals are made for future monitoring of the household debt burden and also actions to facilitate reducing this burden.

- Improve the monitoring of the household debt burden.
- Establish a target to reduce the household debt burden.
- Implement effective measures to achieve the target.

Most obviously actions are needed to strengthen household incomes through higher wages. These should follow from actions to strengthen the economy, including increased infrastructure spending and the development and implementation of an industry plan. Specifically on debt, actions should build on existing re-packaging and refinancing initiatives to reduce both the stock of household debt and the interest paid on consumer credit liabilities. We argue that if the government took a more active role more progress could be made in both reducing the pressures on households and also in strengthening banks' revenues. The government should also review the current debt advice and insolvency system, with the aim of a system that is cheap to access and provides sufficient protections to enable a fresh start.

Introduction

1.1 It is over eight years since the onset of the global financial crisis and the 'Great Recession'. Although the credit boom prior to 2008 has been identified by the Bank of England as a contributory factor in causing the crisis[1], and the Bank has observed that the legacy of high household indebtedness has held back the recovery[2], very little has been done in that time to directly assist British households to either pay down or restructure their debts.

1.2 This is now a major concern because a number of factors have combined to increase the 'household debt burden' in recent years. The extent to which debt poses a burden on households, is contingent on three factors:

- the stock of debt that is outstanding
- the cost of servicing that debt (which is determined by the interest rate, other fees charged, and any minimum repayment obligations stipulated in credit contracts)
- the resources that are available to households to meet those servicing requirements (i.e. the surplus of their income over other expenditure).

1.3 As this report proceeds to detail, the debt burden increased significantly between 2010 and 2014, and although it has stabilised over the past year there are considerable risks ahead.

1.4 The remainder of this report is structured as follows:

Chapter two analyses the aggregate data. It reveals that there has been no significant reduction in the level of consumer credit liabilities since 2008 and presents a new measure of the household debt burden. This is based on the ratio of interest payments to the 'household surplus' (i.e. the amount of household income left after consumption spending).

Chapter three then presents an analysis of household debt survey evidence and comments on observed changes in the *distribution* of unsecured debt in recent years. In this respect we update the findings of our provisional report of 2015, based on an

---

[1] See, for example, the Bank's Financial Stability Report, October 2008, pp. 7–9

[2] In the Bank's Quarterly Bulletin, 2014, Q3, Bunn and Rostom report (pg.304) that: "Cuts in spending associated with debt are estimated to have reduced the level of aggregate private consumption by around 2% after 2007, unwinding the faster growth in spending by highly indebted households, relative to other households, before the financial crisis."

analysis of the Bank of England's annual household debt survey commissioned from NMG Consulting ('the NMG survey'). We look at the characteristics of households with the highest unsecured debt burdens in order to highlight those sections of the population which are in need of assistance.

Chapter four provides our conclusions and recommendations for the future monitoring of the household debt burden and proposes some options that policy makers should consider to address this. These include building on existing repackaging and re-financing initiatives to reduce both the stock of household debt and the interest paid on consumer credit liabilities. We argue that if the government took a more active role more progress could be made in both reducing the pressures on households and also in strengthening banks' revenues.

Section two

Aggregate data analysis

2.1 This chapter examines aggregate data sources in order to improve our understanding of the trends in household liabilities in recent years.

2.2 It begins by examining the OBR measures of debt to income, and debt servicing to income ratios, and argues that these fail to fully reflect the financial pressures on household budgets.

2.3 We then present an alternative measure of the household debt burden, firstly in respect of total liabilities (which includes mortgages and unsecured debts) and secondly in respect of consumer credit debt only. We also provide an international comparison of this measure and consider the possible risks for economic growth if the unsecured debt burden increases further.

Understanding the current OBR measures

2.4 The Office for Budget Responsibility (OBR) publishes two measures of indebtedness for the household sector, which includes both households and Not for Profit Institutions Serving Households ('NPISH')[3], based on data in the National Accounts. These are:

- the Debt to Income ('DTI') ratio, which is a measure of the stock of household sector debt relative to Gross Disposable Income. It publishes details of these both including and excluding mortgage debt
- the Debt Servicing costs to Income ('DSI') ratio, which is a measure of the interest payments on total debt (both mortgage and unsecured) relative to Gross Disposable Income.

2.5 The remainder of this section now examines these two measures in turn.

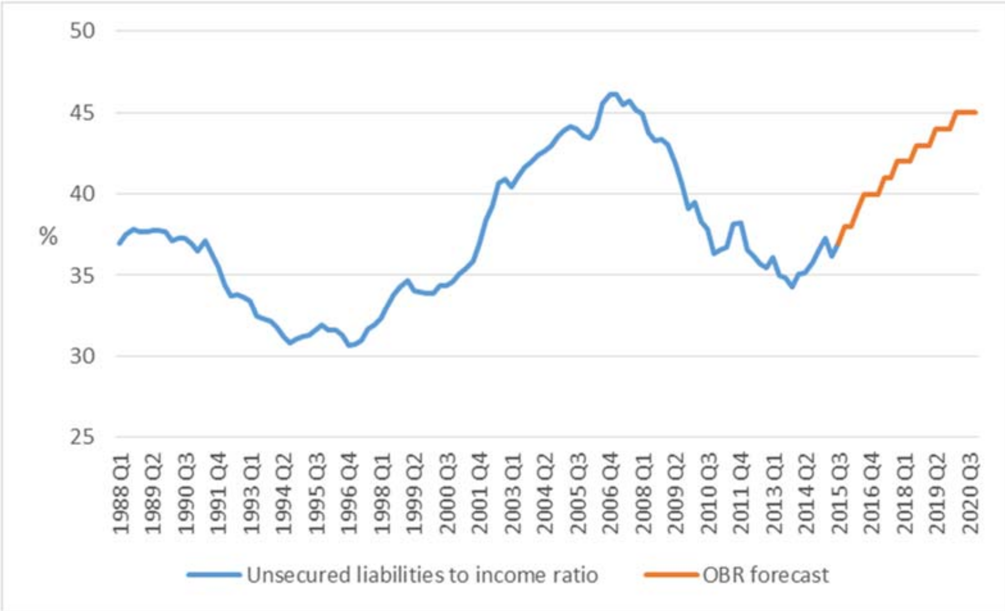
The Unsecured Debt to Income measure

2.6 As at the third quarter of 2015, this measure indicated that the household sector held unsecured liabilities of £438bn, and the OBR is forecasting that these will increase by 51 per cent to £662bn by the end of 2020[4]. The OBR then takes this stock of unsecured liabilities as a percentage of Gross Disposable Income ('GDI') to

[3] These include universities, charitable organisations, trade unions and political parties.
[4] Although this figure includes loans to non-profit institutions serving households, the Bank of England separately identifies these as accounting for only £30bn of the total as at December 2015. Series LPMB6NN.

calculate the debt to income ratio. The actual ratio is set out in Figure 1, below, for the period from 1987 through to the end of quarter 3, 2015, with OBR forecasts then included looking forwards to the end of 2020.

Figure 1: OBR household sector unsecured liabilities to gross income ratio, 1988 onwards

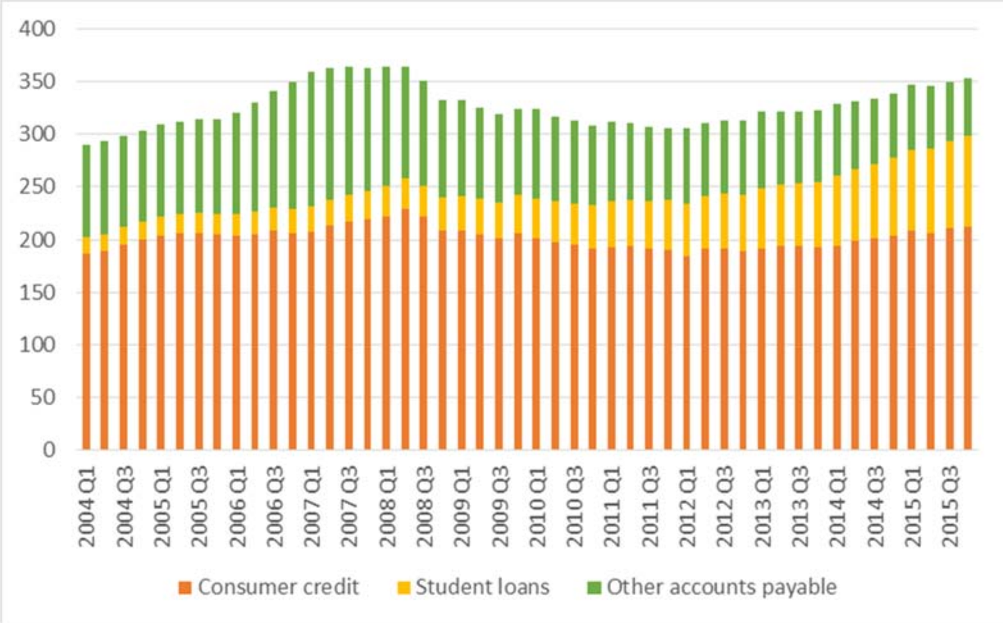


2.7 The ratio presented in Figure 1, above, indicates that there was a significant deleveraging relative to gross incomes during the period 2007 through to the end of 2013. The debt to income ratio improved by 12 percentage points during this time and returned to a level last seen in 2000. That downward trend has now reversed, with the ratio ticking up over the past two years. The OBR forecast is for this to continue to increase, rising back to the same level as witnessed during the financial crisis over the next four years.

2.8 However, the inclusion of liabilities owed by not for profit institutions has a significant effect on this ratio. As well as including their outstanding loans, the OBR measure includes the pension liabilities of these institutions, and (relatively small) amounts for financial derivatives and employee stock options. Taken together these account for around one fifth of the total liabilities included in the OBR measure.

2.9 Once the liabilities of not for profit institutions are stripped out, there is a remaining £353bn worth of unsecured debt which is held by households themselves. This is a combination of consumer credit, student loans, and ‘other accounts payable’. This latter category includes arrears on household bills such as national and Council Taxes and utilities. Figure 2, below, provides a breakdown of the three components of unsecured household debt for the period 2004 through to the end of 2015.

Figure 2: Decomposition of household unsecured liabilities, 2004–2015



2.10 A number of key points arise:

2.11 In cash terms, there has been relatively little reduction in the overall unsecured liabilities of households since 2008. This initially reduced from its peak of £364bn in the middle of that year to stand at £305bn by the start of 2012. However, it has since risen again and is currently £353bn. Over the past seven years there has therefore been a reduction of only three per cent.

2.12 There has been a significant reduction in the amount of 'other accounts payable' (shown in green). This has fallen from a peak of £127bn in 2007 to stand at £54bn by the end of 2015. Unfortunately no data is available to enable a breakdown of this figure, which includes all outstanding amounts for services received in the period but for which payments have not yet been made. The fall in 'other accounts payable' is at odds with recent evidence from debt advice agencies which indicate that there has been an increase in the number of people contacting them about Council Tax[5] and utility arrears[6]. However, increases in these types of arrears could be offset by improvements in the payment, for example, of income tax by people subject to

[5] For example, StepChange reports that the average level of Council Tax debt amongst its clients has risen from £717 in 2011 to £961 in 2015, and that "while one in seven people seeking help on debts in 2011 had serious council tax arrears, it was now around one in three". www.theguardian.com/money/2016/may/04/record-numbers-council-tax-arrears-charities-stepchange-money-advice-trust

[6] See Money Advice Trust (2014), "Changing Household Budgets", available from www.infohub.moneyadvicetrust.org/resource.asp?r_id=1004

self-assessment. We are unable to comment further until a breakdown of this data is released by the Office for National Statistics.

2.13 Student loan debt (shown in yellow) has grown from just £15bn in 2004 to £86bn as at the end of 2015. The growth in student debt has accelerated from 2012 onwards, when the maximum amount of tuition fees that universities can charge was increased from £3,290 to £9,000. However, in our provisional report, published last September, we noted that this rising level of student debt has not had as great an impact on households as their consumer debts. This is because the interest rates charged on student debt are much lower than for consumer credit agreements and borrowers have not had to make repayments if their earnings have been below £21,000. Nonetheless this is still a very significant rise in indebtedness and it is far too soon to assess wider implications. At the very least, the government's decision in November 2015 to freeze the repayment threshold for five years will mean that households holding student loans are required to pay a greater amount of interest on that debt than previously.

2.14 Consumer credit debt (extended by both lenders in the UK and from other countries, and shown in red) initially fell back from its 2008 peak of £230bn to £184bn in 2012. However, these liabilities have since risen, and stood at £212bn as at the end of 2015. The Bank of England report that consumer credit lending is now growing at an annual rate of over 10 per cent, the fastest rate for over a decade. Over the past seven years there has therefore been a reduction in consumer credit debt of just 7.8 per cent. It should also be noted that approximately £61bn (28 per cent) of the total amount of consumer credit debt is owed on credit cards[7], and that minimum payment requirements on this debt were increased for new accounts in January 2011[8]. The rationale behind this decision was to reduce the overall interest that consumers were paying on their credit cards, but this has come at the expense of higher instalments.

---

[7] Financial Conduct Authority (2015). *Credit Card Market Study: Interim Report*.

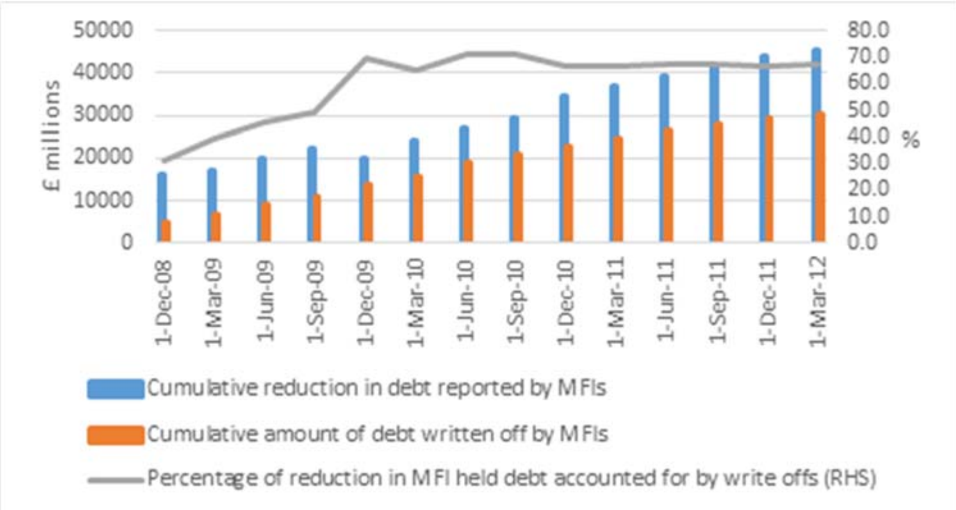
[8] These required that debtors pay off the actual interest incurred each month plus 1 per cent of the outstanding balance.

Box 1: The impact of debt write-offs, insolvencies and debt management services

It is tempting to view the reduction in the amount of consumer credit debt outstanding which took place in between 2008 and 2012 as the product of households paying down their debts. However, the evidence indicates that this only happened to a limited extent.

The data on outstanding consumer credit debt levels is net of bad debts written off by lenders. Whilst we do not have data concerning the level of debt write-offs for consumer credit owed to overseas institutions, the Bank of England does release data which allows us to calculate consumer credit write-off by UK Major Financial Institutions ('MFIs'). Between December 2008 and February 2012, the amount of outstanding consumer credit debt reported by UK based MFIs reduced by £45bn. However, 75 per cent (£30bn) of this was due to write-offs, and only one quarter of the reduction due to households paying down their debts (Figure 3, below).

Figure 3: Impact of write-offs on consumer debt held by MFIs, 2009 to 2012

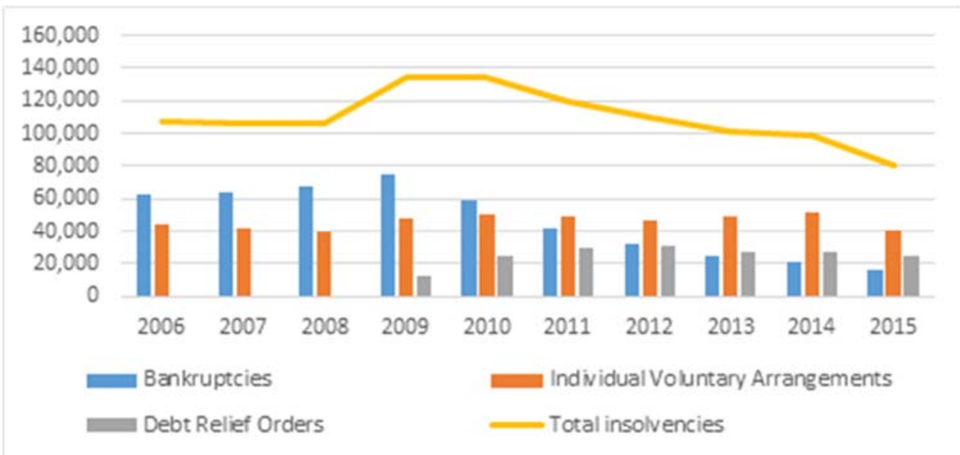


Much of the debt that was written off in this period will have resulted from the use of insolvency procedures. Three types of insolvency procedure are available to individuals in England, Wales and Northern Ireland. These are Bankruptcy, Individual Voluntary Arrangements, and Debt Relief Orders. However, the system has a number of important failings:

- Bankruptcy provides for a swift discharge from debts but the fees, which must be paid on application, are relatively high for people in debt (currently £655), having been raised by over 30 per cent in June 2011. Further to this, entering into the procedure carries a risk of debtors being forced to sell their assets including homes, which makes bankruptcy a highly undesirable option for anyone with a mortgage;
- Individual Voluntary Agreements (IVAs) are supposed to provide homeowners with a procedure for obtaining a partial write-off of their debts, but the fees associated with the procedure, which are paid to Insolvency Practitioners, can be very high and are estimated to be in the region of £5,000. IVAs are also lengthy – lasting for an average of five years. Even at the end of this period, a further year of payments can be required if equity in a property cannot be released;
- Debt Relief Orders (DROs), became available as a new remedy in 2009. They provide a means for debt write off for only those households who have very low surplus incomes (£50 or less per month) and no assets. Applicants must also not owe more than £20,000 in England and Wales or £15,000 in Northern Ireland. If these criteria are met then they are not required to make any payments for a year, after which the debts are written off. However, applications can only be made through authorised agencies, such as Citizens Advice, and there are significant delays between people getting into debt problems and seeking advice concerning possible solutions which limits take-up.

Although the Insolvency Service does not report on the value of debt which has been discharged as a result of insolvency procedures, it does provide statistics on the numbers of people entering into these (figure 4, below). In the immediate aftermath of the 2008 crisis, individual insolvencies rose by 25 per cent to peak at around 135,000 in both 2009 and 2010.

Figure 4: Insolvencies in England and Wales, 2006 to 2015



However, the number of insolvencies has since declined significantly, with this particularly apparent in respect of bankruptcies following the 2011 fee increase. Total insolvencies stood at just 80,000 in 2015 (an overall reduction of 40 per cent from their 2009/10 level) whilst the number of bankruptcies has fallen from its peak of 74,600 in 2009 to just 15,700 in 2015: a decline of 79 per cent.

This fall in the number of people entering insolvency procedures has coincided with a decline in the amount of debt written off by UK based MFIs. Only £10.2bn has been written off in the three years since March 2012: roughly one third of the write off rate in the three years previously.

It should also be noted that *not all debt which is written off on lender balance sheets ceases to be recoverable from debtor households*. There has been a burgeoning secondary market, which provides for the sale of unsecured debt by originating lenders to debt recovery firms, many of which are backed by private equity. These purchase non-performing loan portfolios for a fraction of their nominal value and continue to press debtors for repayment of the full contractual liability. The Credit Services Association, which is the trade body for debt collection agencies, reports that the amount collected on purchased debt has been growing strongly in recent years, and that just over £900m worth of payments was collected on purchased debt in 2014.

Much of this debt, and indeed other liabilities which have been identified as 'bad debts' on lender balance sheets, finds its way onto Debt Management Plans ('DMPs') which are negotiated with creditors by debt advice agencies. These include commercial as well as not for profit organisations and require regular payments from debtors without any prospect of debt write-off. As a consequence, DMPs can be very lengthy – lasting in excess of five years. In general it is very difficult to get a handle on the specific mechanisms and the amounts involved, and hence to what extent household liabilities may be understated as a result of household debts being transferred from bank balance sheets to other lenders.

As we proceed to discuss in the final sector of this report, the decline in insolvencies, growth in the secondary debt market, and increased use of DMPs has occurred at a time when the debt burden on households is increasing, and requires us to consider the introduction of other mechanisms to address this.

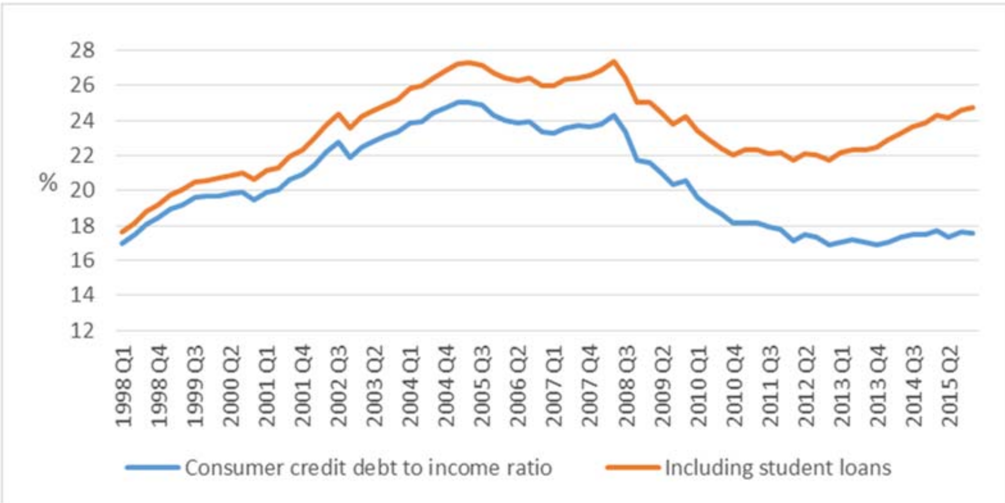
Improving the debt to income measure

2.15 It is possible to improve the debt to income ratio for households by both limiting the financial liabilities included in the calculation to those owed by households only, and also removing the incomes of not for profit institutions from the other side of the equation.

2.16 Unfortunately, there is no regularly available dataset which provides details of the contribution of not for profit organisations to Gross Disposable Income. However, the ONS did conduct a one-off exercise to strip out NPISH income in March 2015[9]. This revealed that not for profit organisations contributed an average of 3.1 per cent to total household sector income over the period from 1997 to 2013. Although there was some deviation from this average in individual years this was fairly minimal and was never more than 0.5 per cent in either direction.

2.17 We therefore adjust Gross Disposable Income downwards by 3.1 percentage points for each year since 1997 and use this to calculate two alternative debt to income ratios: the first of these includes both consumer credit liabilities and student loans and the second relates to consumer credit debt only. The results are presented in Figure 5, below.

Figure 5: Alternative debt to income ratios, 1997 to 2016



2.18 Both ratios are significantly lower than the OBR's measure due to the stripping out of NPISH liabilities. However, they also diverge from the trend indicated by the OBR's measure (see figure 1 and para 2.4, above): in a number of important respects:

2.19 Firstly, the peak on both ratios can be seen to have occurred towards the end of 2005. There followed an improvement until the start of 2007, when both then rose back towards their peak levels;

2.20 Secondly, from the middle of 2008 both of the ratios improved and there was a deleveraging of debt relative to income through to the end of 2012. However, the extent of this deleveraging was lower than the OBR measure indicates. The consumer credit debt to income ratio fell by seven percentage points, and the ratio

9 "Measuring Real Household Disposable Income 1997 to 2013: the effect of excluding Not for Profit Institutions Serving Households (NPISH) from Gross Disposable Income (GDI) and Real Household Disposable Income (RHDI)", Office for National Statistics, 2015.

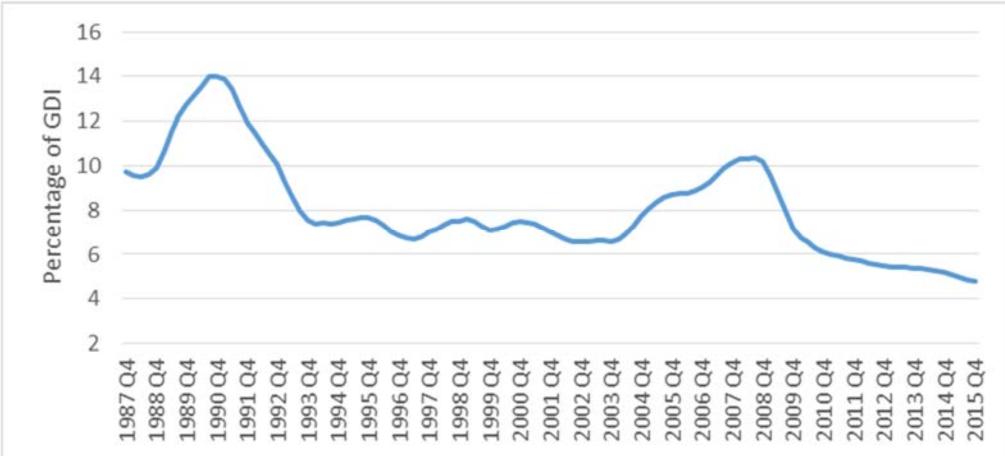
including student loans by just five points. Finally, the recent tick up in the OBR ratio, although apparent in respect of the ratio including student loans, is minimal in respect of the consumer credit debt only measure.

The debt servicing to income ratio and the 'debt burden'

2.21 We consider that the debt to income ratios set out above are more accurate than the OBR's measure, and reveal that households have not deleveraged as much as is generally considered since the onset of the financial crisis. However, they are not a good measure of the household debt 'burden' because they do not take account of the cost of servicing the outstanding debt (i.e. the monthly interest payments) and of any changes in the resources that are available to households to meet those servicing requirements, not least falls in real earnings.

2.22 The OBR published details of the household debt servicing cost to income ratios in its *Economic and Fiscal Outlook* for March 2016 (see Figure 6, below). This ratio is based on total interest payments made by the household sector (which include both mortgage debt and unsecured liabilities and include debt repayments made by NPISH) relative to gross income. It indicates that household debt servicing costs peaked at 10 per cent of GDI in 2007/08 and that they have since reduced to 4.9 per cent. The OBR is forecasting the ratio to remain between 4.6 per cent and 5.3 per cent by the end of the current Parliament, depending on the extent to which mortgage repayments rise in line with expected base rate increases, and how far lenders come under pressure to reduce their margins.

Figure 6: Household debt servicing costs, OBR methodology



2.23 On this measure, debt servicing costs are at historically low levels. Even in advance of the financial crisis they were nearly one third lower than was the case during the Lawson boom in the late 1980's, and they are now at their lowest level for thirty years. This is a reflection of the historic low base rate set by the Bank of England, which has pulled down the cost of servicing mortgages.

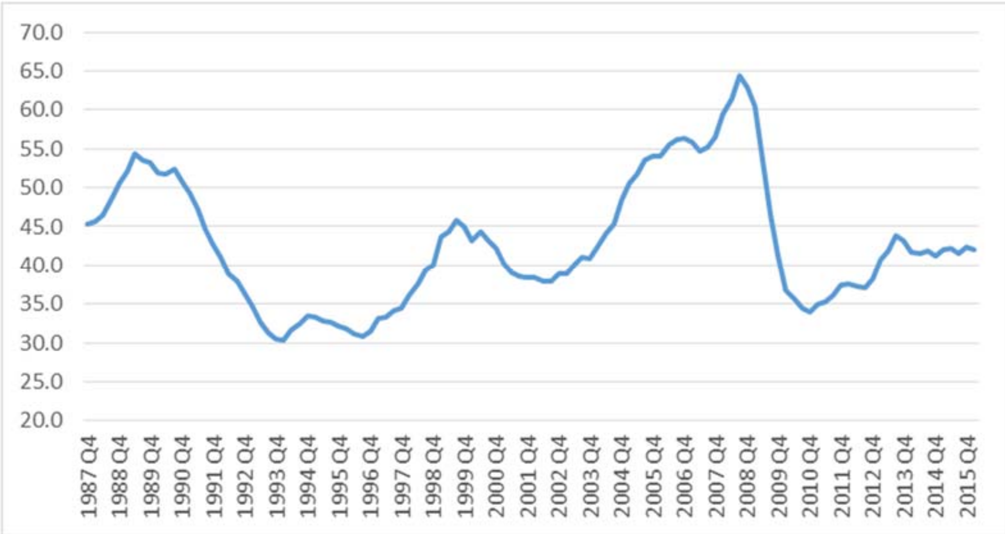
2.24 Again, it should be noted that this measure includes within it both the interest paid and income received by not for profit institutions rather than just households alone. As there is no data from the ONS which enables us to separate out the interest payments of households from those made by NPISH we are unable to address this.

2.25 However, the main difficulty with the measure is that it ignores the fact that the level of resources from which households can meet their debt servicing costs has reduced in recent years because of rising costs that have come at the same time as incomes have fallen, particularly between 2010 and 2015.

2.26 In order to illustrate this we construct a measure based not on gross incomes but on the level of interest payments relative to the available *surplus* of income over non debt related expenditure[10]. The results from this exercise are shown in Figure 7, below, for the period from 1987 onwards.

[10] The precise methodology is to calculate total interest payments (series J4X3 in the National Accounts) as a percentage of this amount plus gross savings (B.8g) on a rolling 4 quarter basis.

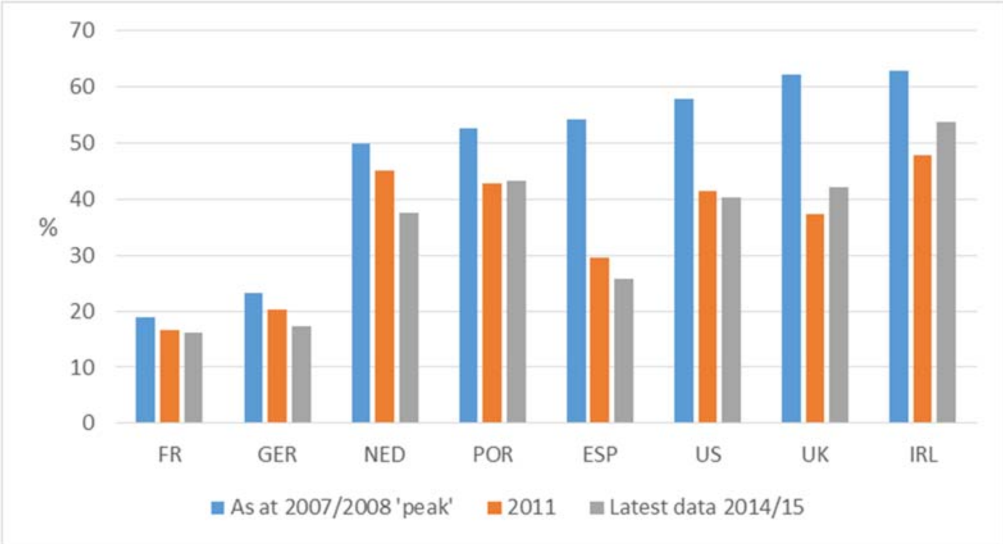
Figure 7: Total interest payments as % of household sector surplus, 1987 to 2016



2.27 On this measure the household debt servicing burden increased from 2010 through to the end of 2013, although it has since stabilised at around 42 per cent.

2.28 Comparing Britain's position on this measure with other countries indicates that our household debt burden is considerably higher than is the case in France or Germany (Figure 8, below), and only slightly lower than Portugal. Further to this, the measure in Britain has moved in the wrong direction since the crisis.

Figure 8: Changes in the household debt burden since 2007/08, selected countries[11]



2.29 The deterioration in the UK's household debt burden through to 2014 occurred despite base rates having been maintained at their historical low of 0.5 per cent since March 2009. Low base rates have reduced the overall nominal level of interest payments that households are required to make. This reduced from £99bn in 2008 to around £58bn as at the end of 2015. However, the debt *burden* has increased because households have fewer available resources from which to make their interest payments.

[11] The data used is from National Accounts data available on the OECD's database. The 'latest data' available from the OECD varies for different countries with some having submitted 2014 accounts and some having submitted accounts for 2015.

Box 2: Household spending and income before and after the crisis

It is widely recognised that ahead of the financial crisis economic growth was excessively reliant on the household sector. Over much of the 1990s and 2000s spending outstripped income, and households took advantage of easily available credit. Table 1 shows average annual growth rates over this period and afterwards.

Table 1: Household spending, income, and saving

	1991- 2007	2007-2009	2010- 2015	Post – pre
	Average % change p.a.			
Income	4.8	1.8	2.8	*-2.1*
Spending	5.3	0.4	3.3	*-1.9*
Difference	*-0.5*	*+1.4*	*-0.6*	*-0.8*

Over the course of the financial crisis, while income growth was reduced, spending was relatively much more restrained, likewise credit use. In the post-crisis period, spending growth has picked up, though not to the same extent as ahead of the crisis. On the other hand, income growth has been unprecedentedly weak, which follows mainly from the exceptionally weak earnings growth since the crisis. The consumer boom may be less explosive, but it is even more unaffordable. As a result, as the Bank of England figures show, credit growth is back up and, as the OBR and ONS figures show, household debt is on the rise again.

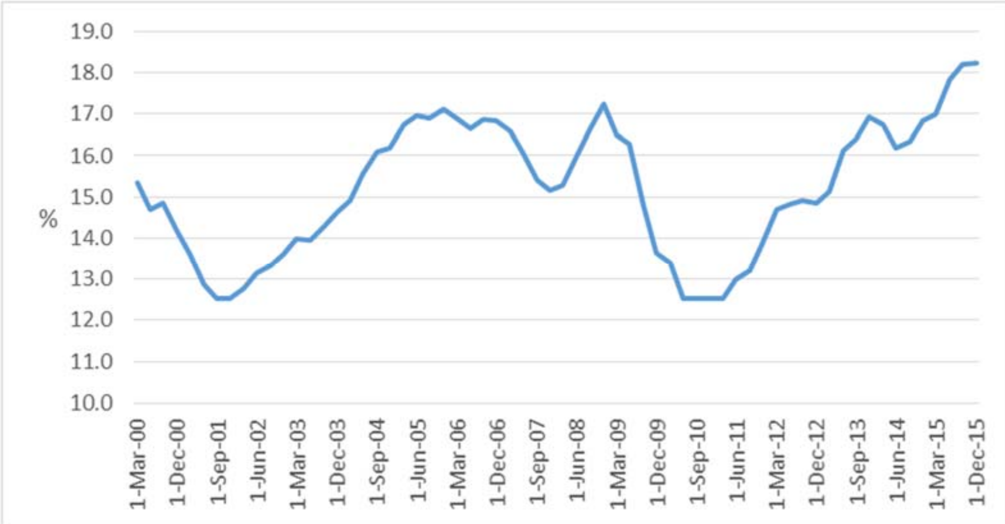
2.30 Looking in further detail at the component parts of our measure of the household debt servicing burden we find that between 2010 and 2015, the percentage of income which households are spending increased from 94.3 per cent to 97.7 percent. This increase in the propensity to spend has contributed to economic growth but has left households with less available money from which they can meet their debt repayments.

The consumer credit debt burden

2.31 Although the National Accounts provide data on the total interest payments made by the household sector, they do not provide a breakdown of this between interest paid out on mortgages or interest paid in respect of consumer credit debt or other unsecured liabilities.

2.32 We have therefore had to estimate the level of interest on consumer credit debts[12] and present these as a percentage of the household surplus. The results from this exercise are shown in Figure 9, below.

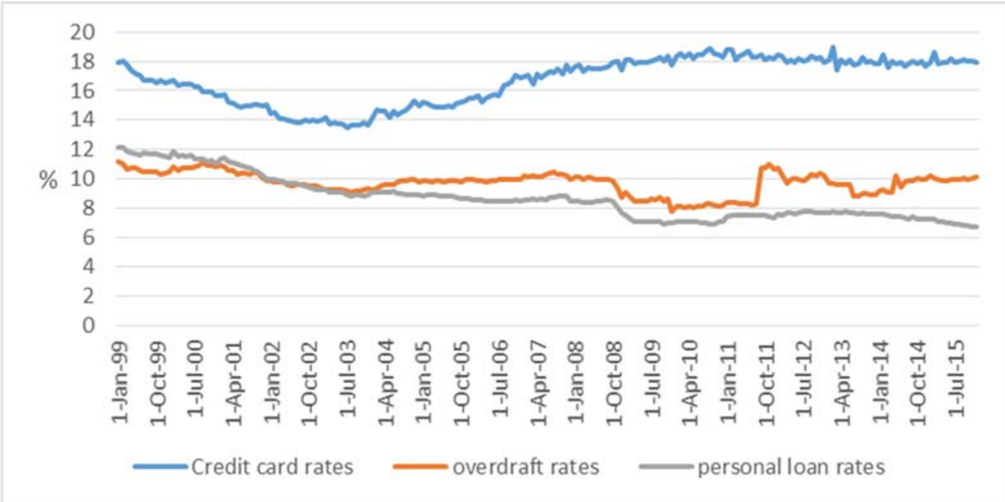
Figure 9: Estimated consumer debt interest payments as % of household surplus, 2000 to 201613



2.33 We estimate that the consumer credit interest burden on households increased from 12 per cent to 17 per cent between 2001 and 2008. This occurred because households were paying interest on the stock of debt built up over previous years and also continuing to take out more credit over this period. Interest rates also played a part. Although there has been a reduction in the rates charged on personal loans, average credit card rates for balances not repaid at the end of the month rose from 13.7 per cent in November 2003 to 18 per cent five years later[14] (see Figure 10, below).

[12] To do this we used Bank of England datasets on credit card and other lending, and applied the interest rates charged to these by MFIs. The estimate is therefore likely to be conservative as non MFI lenders are likely to apply higher rates of interest.
[13] The ratio is presented on a rolling 4 quarter basis.
[14] Bank of England Effective Interest Rates dataset.

Figure 10: Average interest rates, credit cards, overdrafts and personal loans, 1999–2016[15]



2.34 Finally, there was also an increase in refinancing activity, driven by credit card balance transfers over the period. Whilst refinancing can be helpful to borrowers in the short term by rescheduling loans at lower rates of interest – releasing more money for consumption, savings, or the paying down of other debts. However, in some cases refinancing involves the extension of the term of the loan at interest rates which were little or no better than in the original contract, which then adds to the overall interest burden moving forwards. Unfortunately, aggregate data does not allow us to assess the impact of refinancing and further research is required concerning its effects.

2.35 The consumer debt burden fell sharply in the immediate period following the financial crisis. This was in line with total interest payments reported previously, and was primarily because households cut back on non-essential consumption (see Box 2, above). However, the burden of interest payments in respect of consumer debts has increased greatly since 2010. In nominal terms, we estimate that the interest being paid on the outstanding stock of consumer credit debt is currently in the region of £25bn per year. This is roughly 45 per cent of the total level of interest payments (including mortgages) reported in the National Accounts, despite the fact that consumer credit debts account for only 20 per cent of total household debt.

[15] The data are taken from Bank of England series CFMHSDG; CFMHSDG, and CFMHSDI.

2.36 We estimate that the level of interest charged on Britain's consumer debt is equivalent to around 1.4 per cent of GDP. Importantly, the nominal level of interest payments required in respect of consumer debts has changed little since 2008. This is because there has been very little deleveraging over the period, and interest rates, particularly in respect of credit card debt, have not responded to the low base rate environment, instead remaining very high throughout the period, at around 18 per cent.

Section three

Analysis of household survey data

3.1 The previous chapter detailed the aggregate position for households based on the National Accounts, this chapter now focuses on the findings from the Bank of England commissioned NMG household debt survey[16], and reports in detail on the changing distribution of indebtedness in recent years. Just under half (49 per cent) of households in the UK had any form of outstanding unsecured debt in 2015, and so the debt burden detailed in the previous chapter is concentrated, with interest payments representing a transfer of wealth away from debtor households, through the financial system and, to a certain degree, to those other households and institutions which have savings and investments. The chapter therefore seeks to identify which households have the greatest financial difficulties, with a view to informing the design and implementation of policies to help these.

Measures of financial vulnerability, over-indebtedness and financial 'burden'

3.2 The chapter reports the findings from the NMG survey using three different indicators:

- A debt to income ('DTI') ratio. This is generally viewed as a measure of household *vulnerability* to debt problems in the event of income or expenditure shocks. In this respect, the previous reports from the Department for Business, Innovation and Skills ('BIS') have reported those households with a ratio of 60 per cent or more to their annual income as highly vulnerable. We therefore use this as our definition of vulnerability throughout the remainder of this report.
- A debt servicing cost to income ('DSR') ratio. This is a much more current measure of over-indebtedness. In a report for the then Department for Trade and Industry, Kempson (2002) used a consumer credit repayment to gross income ratio of 25 per cent to identify over-indebted households, and this measure was subsequently used by the Department in its 'Tackling Over-indebtedness Action Plan' published in 2004 and in its subsequent follow-up report of March 2010. However, BIS reports from 2010 through to 2013 used a 30 per cent or larger ratio as an indicator of over-indebtedness. There does not appear to have been any explanation from government concerning their redefinition of over-indebtedness at this level. In this report we revert to using a debt repayment to gross income ratio of 25 per cent as an indicator of over-indebtedness, but also add in our own

[16] For a review of the methodologies and sample sizes of recent household debt surveys see our preliminary report.

measure of *'extreme over-indebtedness'*, which we define as a repayment to income ratio of 40 per cent or greater.

3.3 The remainder of this chapter reports on the general trends observed from the NMG survey. In doing so, we update the findings reported in our provisional report of September 2015. That report highlighted that over-indebtedness increased significantly between 2012 and 2014:

- the number of over-indebted households increased by 28 per cent between 2012 and 2014. We estimated that 3.2 million households (one in every eight in the UK) were paying out more than one quarter of their gross incomes to their unsecured creditors in 2014, and
- half of these households were extremely over-indebted: required to pay out more than 40 per cent of their gross income to their unsecured creditors.

3.4 These findings are consistent with our analysis of the aggregate data in the previous chapter, which indicate that the household debt burden was rising over this period.

3.5 The provisional report also indicated that over-indebtedness was particularly concentrated amongst lower income households (defined as having incomes of less than £30,000 per year), and that there had been a trebling in over-indebtedness amongst households containing someone in employment (from 3 per cent to 9 per cent of such households holding any form of unsecured debt).

How representative is the NMG survey?

3.6 In our provisional report, we noted that although the NMG survey is designed and weighted to be representative of British households in terms of age, social grade, region, working status, and housing tenure, it does not claim to be representative of the general population by income. Participants tend to have a slightly higher income level than those within the Living Costs and Food Survey ('LCF'), which is conducted by the Office for National Statistics and used by HM Treasury to model the impact of possible changes in tax and benefits on different households.

3.7 In addition, we found that the NMG survey substantially under-estimated the overall level of debt as a whole. This is common with all household surveys and grossing up the debts contained within them never comes close to matching the aggregate sums contained in the National Accounts. For example, when commenting on the results of the NMG survey in 2004,Tudela & Young reported:

> A common feature of household surveys is that the amount of unsecured debt reported by survey respondents falls well short of that implied by aggregate data... Some of this discrepancy can be accounted for by differences in the basis on which the statistics are calculated. For example, the survey asked respondents to exclude balances which would be paid off in full at the end of the month, whereas the official statistics include all consumer credit balances outstanding at a particular date, including balances that do not bear interest...It is unclear whether the remaining gap is a result of deliberate understatement

> by respondents, ignorance of debts they or other members of their household (on whose behalf they are responding) owe, or misunderstanding of what constitutes a debt: for example, some may not consider borrowings as a 'debt' if they are up to date with repayments.

3.8 Moving the NMG survey online in 2012 may have been an intended to mitigate some of these problems, as online surveys have been found to have a higher disclosure rate in respect of sensitive questions.[17] However, they may also suffer from a greater degree of measurement error.[18] There were also a high number of respondents (approximately 10 per cent of the sample) to the 2015 survey which, although indicating that they had unsecured debts, either did not know the amount of these or refused to disclose it, making it impossible to calculate their 'Debt to Income' ('DTI') or Debt Servicing to Income ('DSI') ratios.

3.9 Whilst recognising the general nature of these problems with household debt surveys it would appear that the NMG survey particularly under-reports the level of unsecured debt. For example, grossing up the reported levels of unsecured debt from the YouGov DebtTrack survey from 2012 accounts for £126bn, which is one third higher than the grossed up amount from the NMG survey of the same year.

3.10 Despite these issues, the consistent methodology applied within the NMG survey since 2012 years does make it suitable to study *changes in the distribution* of debt over time. This is particularly the case because the survey contains a panel element, with around 50 per cent of respondents having undertaken previous surveys each year. As Anderson et al put it when reporting on the survey's findings in respect of mortgage debt for the Bank of England in 2014:

> The survey is weighted to be representative of the population of Great Britain. It is, however, possible that these survey data do not present a true picture of households' finances. That may be because certain types of individuals are more likely to respond to online surveys, or that answers given are not accurate. Nevertheless, the survey data do have broadly similar trends to the aggregate data and are a good source of information for assessing distributional issues.

3.11 In the absence of recent household survey data from other sources, we therefore use the NMG survey to show how the distribution of debt has changed over the past three years, but then use this information to update findings from the more representative YouGov DebtTrack survey for 2012 in order to arrive at estimates for the current numbers of households who are financially vulnerable and over-indebted.

Levels of unsecured debt

3.12 In 2015, we find that 49 per cent of all households had some form of unsecured debt. This section now reports on the amounts owed by these **debtor**

[17] Dayan et al (2007) cited in Bunn et al (2012)
[18] See footnote 7, page 10, in *Credit, Debt, and Financial Difficulty in Britain*, 2012. Department for Business, Innovation and Skills.

households. In total, there were an estimated 13.2 million such households in 2015, containing 31 million people.

3.13 The average (mean) level of debt held by these households has increased in recent years (see Table 2, below).

Table 2: Mean debt levels, households with unsecured debts, 2012–2015

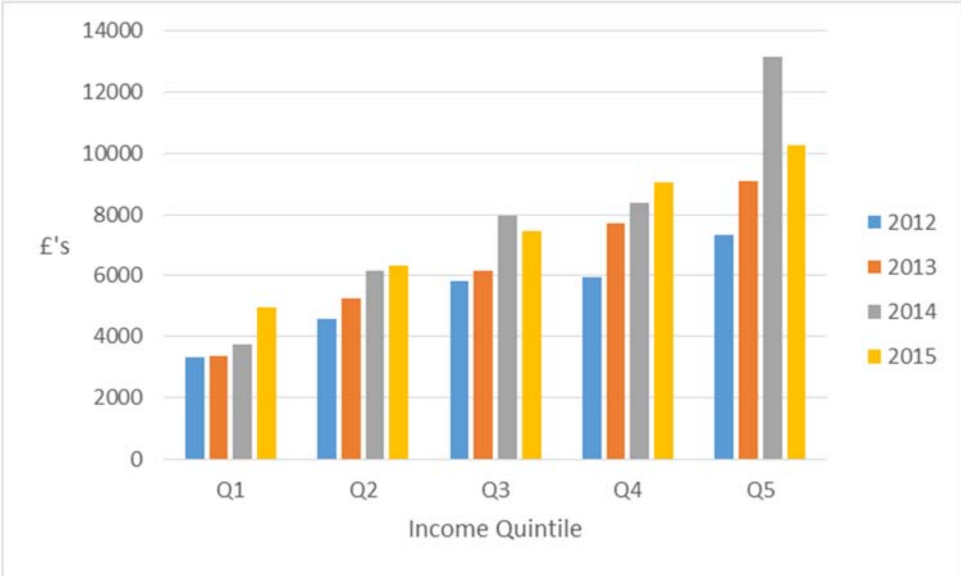
	Average unsecured debt, including student loans	Average unsecured debt, excluding student loans
2012	£5,634	N/A
2013	£6,502	£4,206
2014	£8,007	£4,934
2015	£8,139	£6,092

3.14 The level of unsecured debt levels reported by households holding any form of unsecured debt in the NMG survey, including student loans, increased by 44 per cent over the period from £5,634 in 2012 to £8,139 in 2015. Unfortunately, the 2012 survey did not record student debts separately and we are only able to assess the growth in consumer debt between 2013 and 2015. This indicates that the average level of consumer debt increased by 17 per cent between 2013 and 2014 and by a further 23 per cent between 2014 and 2015. Given that the Bank of England has reported consumer credit lending growing by about 10 per cent per annum over this period this seems a little high, although the variation may be explained by increased borrowing from non-standard lenders (the role of these was examined in more detail in our preliminary report).

3.15 While annual growth is higher, the level of debt reported in the NMG survey is much lower than the aggregate data on consumer credit liabilities suggests. Dividing total consumer credit liabilities reported in the National Accounts amongst the 49 per cent of households understood to hold consumer debt would imply that each household should hold just under £16,000 of debt, and that each individual would hold around £6,700. That latter figure is close to the amount reported through the NMG survey, and it is possible that the under-reporting of debt within the survey results from individual respondents not knowing the extent of debt which other members in their household are holding.

3.16 Turning to the distribution of debts within the NMG survey, we find that all income quintiles increased their average level of unsecured debt over the period 2012 through to 2015. However, the pattern of this growth in indebtedness over these years has varied (see Figure 11, below).

Figure 11: Average level of unsecured debt (incl. student loans) by income quintile, 2012–2015



3.17 Amongst the lowest income quintile, the average level of unsecured debt particularly increased between 2014 and 2015, and now stands at just under £5,000.

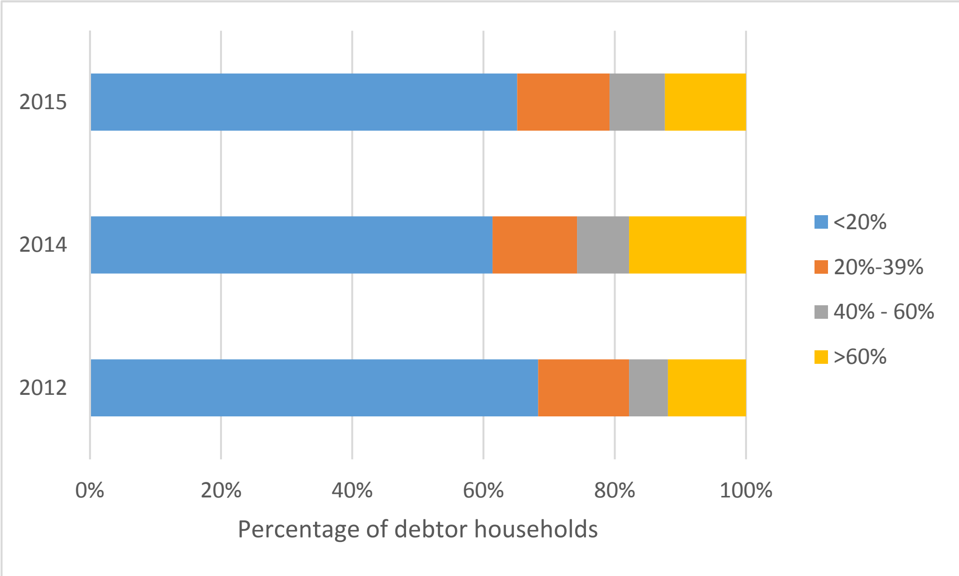
3.18 For the second income quintile, the growth in the average level of debt was more pronounced in the period 2012 to 2014, and this was also the case for those in the third quintile, although this group also saw a reduction in the average level of their debt in 2015. In this respect, it is likely that the improvement in real wages observed in the first half of 2015 has been important. The NMG survey took place in September 2015, and so the deterioration in wages growth the TUC has identified in the second half of that year would not have had time to impact on respondents in the survey.

3.19 A more consistent growth in the average level of debt can be observed for the fourth income quintile, with the average amount nearly doubling over the four years. Finally, there was a dramatic increase in the average level of unsecured debt amongst the highest income quintile through to 2014, when it stood at just over £13,000. However, in 2015 this has fallen back to a little over £10,000.

3.20 On their own these nominal averages tell us very little about the extent to which debt is a problem for households. More important are the distribution of debt to income ('DTI'), and debt servicing cost to income (DSI) ratios. As mentioned previously, we are particularly interested in the proportions of households with DTI ratios of 60 per cent or more, and DSI ratios of over 25 per cent.

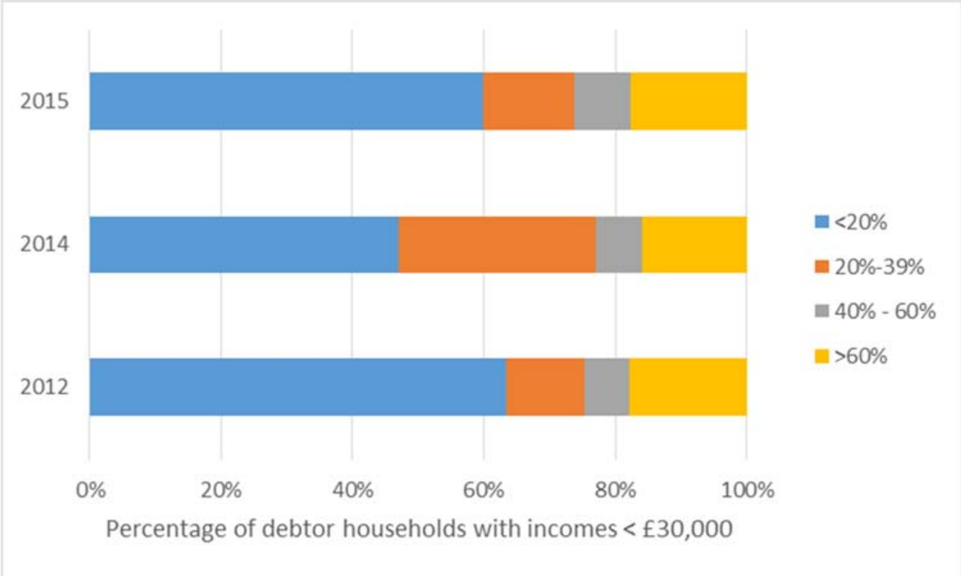
3.21 Figure 12, below, sets out the distribution of DTI thresholds for all debtor households in 2012, 2014 and 2015. As can be seen the percentage of debtor households whose DTI ratios were in excess of 60 per cent increased between 2012 and 2014 (from 12 to 18 percent) but then reduced back to its 2012 level in 2015.

Figure 12: Distribution of debt to income thresholds



3.22 However, this picture changes if we look at households with incomes of less than £30,000 (Figure 13, below). A higher proportion of these have DTI ratios in excess of 60 percent, and this has stayed broadly constant at between 16 and 18 per cent over the past four years.

Figure 13: Debt to income thresholds, debtor households with incomes < £30,000



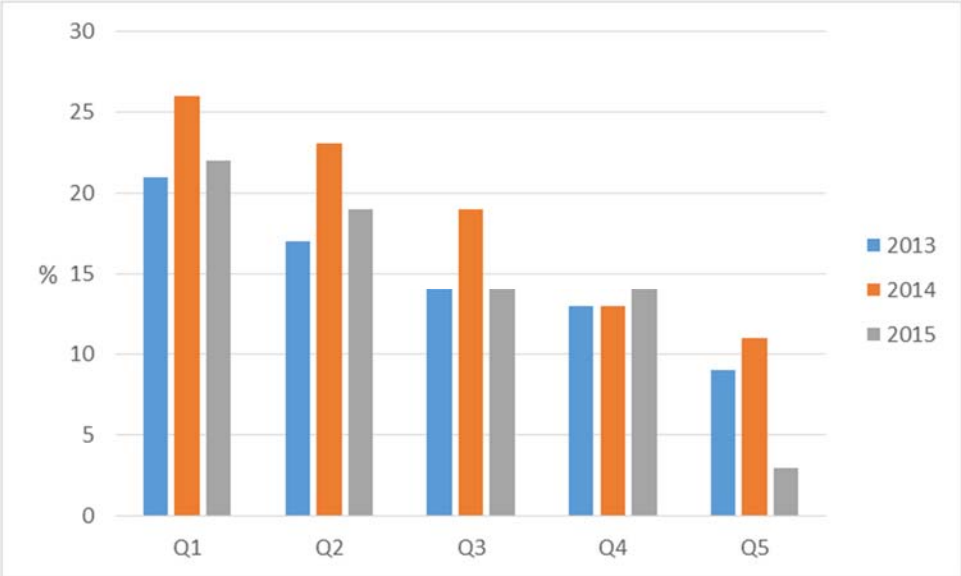
3.23 It is also apparent that there was a worsening in the DTI ratios for many of these households between 2012 and 2014, when there was a fall in the percentage with ratios of less than 20 per cent, and an increase in those with DTI ratios between 20 and 39 per cent. However, this group appear to have subsequently reduced their DTI ratios again in 2015. Finally, there has been an increase in the percentage of these households who are on the 'cusp' of vulnerability (with DTI ratios of between 40 and 60 per cent). In 2015, one in twelve of all households holding some form of unsecured debt and with incomes of less than £30,000 was in this position.

The impact of student loans on DTI ratios

3.24 The NMG survey has collected information on student debt levels separately from consumer debt from 2013 onwards. This is important because although student loans have expanded to become a larger component of household unsecured liabilities in recent years there are reasons to be cautious about the extent to which these currently pose a risk to households in comparison to consumer debts. This is due to the lower interest rates applied to student debt and the earnings thresholds which have to be met before payments are required.

3.25 We therefore present (in Figure 14, below) the average DTI ratios for debtor households with consumer debts only for each income quintile.

Figure 14: Average DTI ratios, excluding student loans, by income quintile, 2013–2015

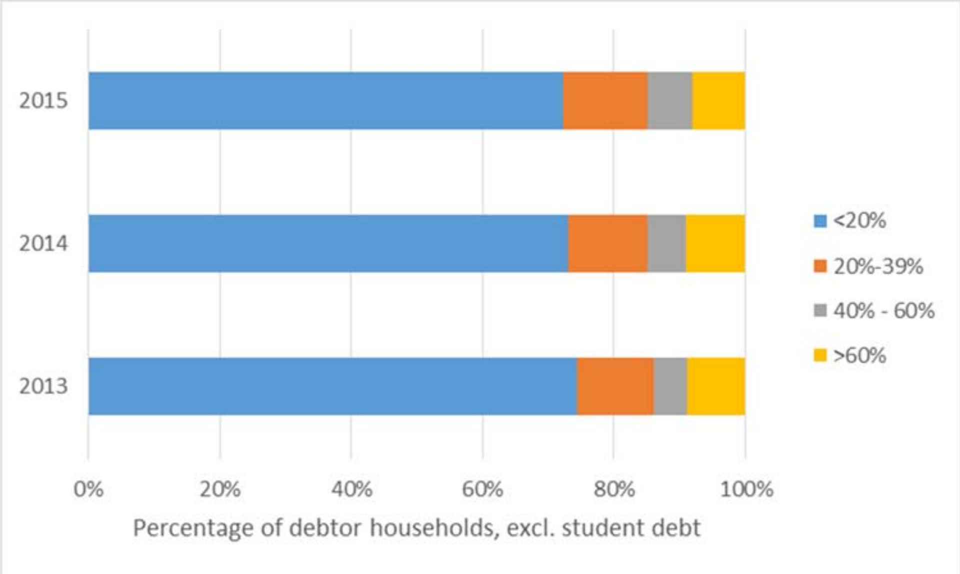


3.26 Looking purely at these consumer credit debts, we can see that the DTI ratios of households reduce as income increases. In 2015, the average DTI ratio for households in the lowest income quintile was over seven times greater than for those in the highest income group.

3.27 However, there have been some changes in the distribution of DTI ratios from 2012 through to 2015. Specifically, the lowest three income quintiles saw worsening DTI ratios through to 2014. They have recovered somewhat, though not entirely, since then. Again, this may reflect the timing of the NMG survey, and the slight improvement in real wages in the first half of the year. Whilst that improvement was welcome, it is also evident that the greatest reduction in DTI ratios in 2015 occurred for those on the highest incomes.

3.28 Looking at the distribution of DTI ratios for all income groups and with student loan debt removed (Figure 15, below), we find that there was little change since 2012. Roughly one in ten of indebted households within the NMG survey can be classed as vulnerable on the basis that consumer debts exceed 60 per cent of their income.

Figure 15: DTI thresholds, excl. student debt, 2013–2015



How many vulnerable households are there?

3.29 As mentioned previously, the NMG survey reports far less debt than the YouGov Debt Track survey. In 2012, the distribution of DTI ratios reported by the two surveys were also different (see Table 3, below)

Table 3: DTI ratios reported by YouGov DebtTrack and NMG surveys, 2012

DTI ratio	YouGov DebtTrack (percentage of debtor households)	NMG survey (percentage of debtor households)
<20%	54	69
20% - 39%	20	13
40% - 60%	9	6
> 60%	17	12

3.30 Comparing these results, the NMG survey indicated that a significantly higher proportion of households had DTI ratios of less than 20 per cent in 2012, and that there were 5 per cent fewer households with DTI ratios in excess of 60 per cent.

3.31 We consider the YouGov survey findings to be more accurate than those from the NMG survey. This is because the reported level of debt (as a percentage of our aggregate measure) is greater and because the YouGov survey weights its responses back to national averages in respect of household income, which the NMG survey does not.

3.32 Nevertheless, due to the consistent nature of the NMG survey methodology, and its use of a significant panel element, this provides a good indication of percentage *changes* in the distribution of DTI ratios from 2012 to 2014.

3.33 To arrive at our estimate of the number of financially vulnerable households we therefore take the 2012 YouGov survey results as our starting point and apply the percentage point changes observed from the NMG survey to these through to 2015 (see Table 4, below).

Table 4: Estimated DTI ratios, debtor households, 2015 [19]

DTI ratios	2012 (YouGov Debt Track), percentages of debtor households	Percentage point change from 2012 through 2015 within NMG survey	2015 estimates, percentage of debtor households within DTI thresholds
<20%	54	-4	50
20%–40%	20	0	20
40%–60%	9	+3	12
> 60%	17	+0.5	17.5

3.34 Extrapolating to national data on household number and sizes, we estimate that there are 2.4 million households, containing 5.6 million people with DTI ratios in excess of 60 per cent. Approximately one in ten of all households in the UK are financially vulnerable.

3.35 Disregarding student debt, we estimate that 1.5 million households, containing approximately 3.5 million people were financially vulnerable in 2015. This is 5.5 per cent of all households.

Debt servicing costs

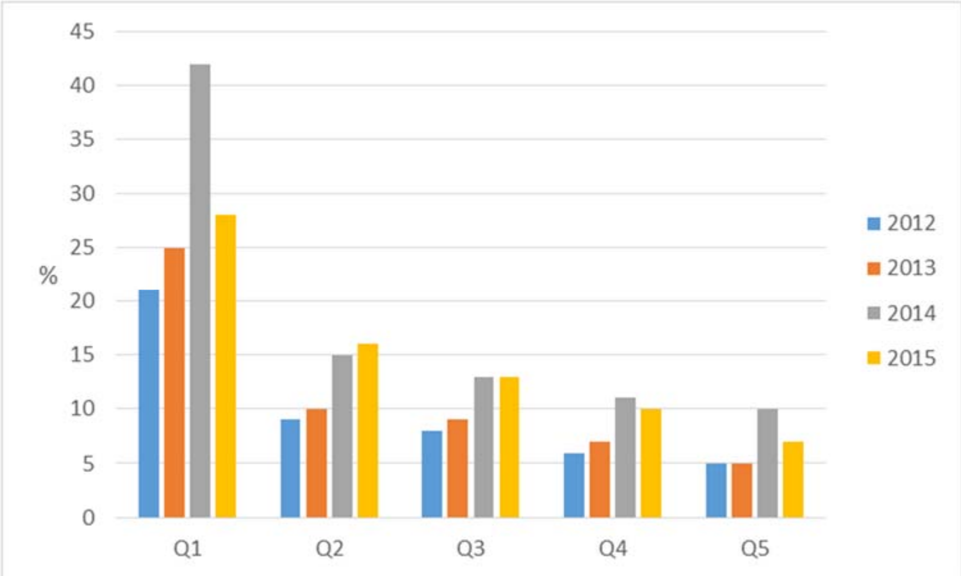
3.36 Turning to the amount of money that debtor households are paying out to their creditors, the NMG survey indicates that there has been a general increase in the average debt servicing costs relative to income (the 'DSI ratio') across all quintiles in the past three years.

3.37 However, the increase in DSI ratios has been most apparent amongst debtor households in the lowest two income quintiles (Figure 16, below). The average DSI ratio of the lowest income quintile doubled between 2012 and 2014, when it exceeded 40 percent, but has since fallen back considerably in the past year to stand at 28 percent. It should be noted that this is still seven percentage points higher than in 2012 and is four times the level of the average DSI ratio for households in the top

[19] Totals do not add up to 100 due to rounding

income quintile. It is also still higher than the 25 per cent threshold which would indicate that households are over-indebted.

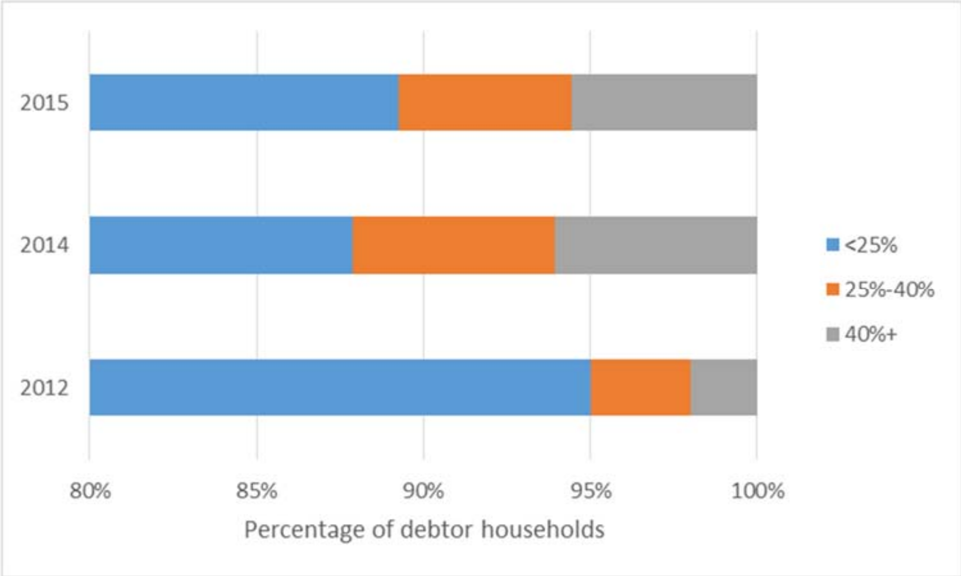
Figure 16: Average DSI ratios, including student debt, by income quintile



3.38 The increase in the average DSI ratio of the second income quintile was less dramatic through to 2014: rising from 9 to 15 percent, but there has been no subsequent reduction, and in fact 2015 saw a marginal further increase to 16 percent. This pattern is reflected for middle income households also. This group saw their average DSI ratio rise from 8 to 13 per cent since 2012. In contrast, households in the top two income quintiles have average DSI ratios of 10 per cent or less.

3.39 Again, it should be noted that these are average DSI ratios and the distribution of these is important. This is illustrated for all debtor households in Figure 17, below.

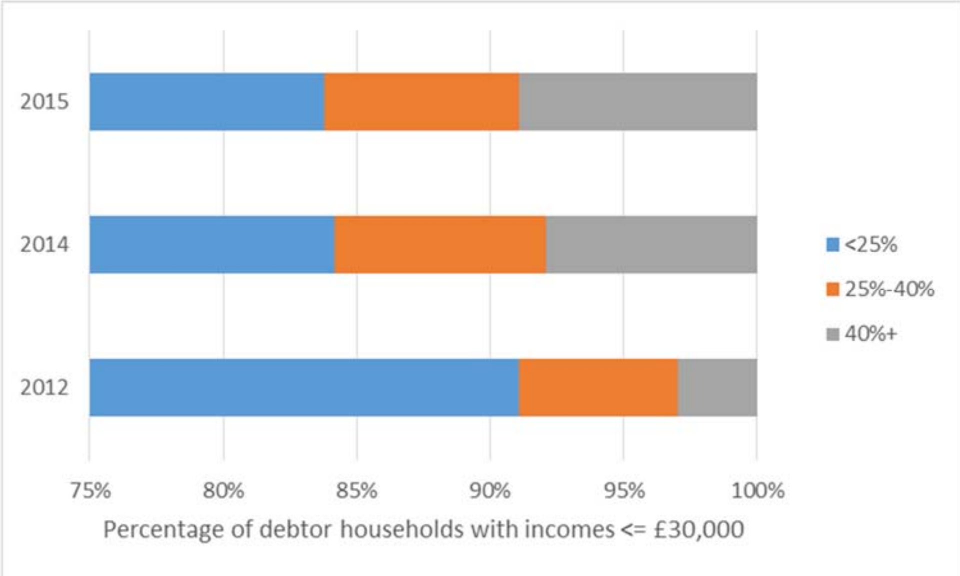
Figure 17: DSI thresholds, 2012–2015



3.40 The above indicates that the percentage of over-indebted households (i.e. those with DSI ratios in excess of 25 per cent) has more than doubled since 2012. In that year 95 per cent of all debtor households had a DSI ratio of less than 25 per cent, but this reduced to 87 per cent in 2014 and improved only slightly to 89 per cent in 2015. The remaining eleven per cent of debtor households are now over-indebted, compared to 5 per cent in 2012, and half of these are extremely so – paying out more than 40 per cent of their income to their unsecured creditors.

3.41 Problems of over-indebtedness are greater in lower income households. Looking at households with incomes of £30,000 or less (Figure 18, below), we find that 16 per cent of these were over-indebted in both 2014 and 2015 compared to 9 per cent in 2012. Further to this, the percentage of extremely over-indebted lower income households has tripled from 3 per cent to 9 per cent. Relating this to the findings from the latest Family Resources Survey concerning the numbers of households with gross incomes of less than £30,000, we estimate that there are now 1.2 million extremely over-indebted low income households, compared to just 400,000 in 2012. Again, these increases took place between 2012 and 2014, since when the position has stabilised but not improved.

Figure 18: DSI thresholds of lower income households, 2012–2015



The impact of student debt on debt servicing costs

3.42 The NMG survey does not collect details of the amounts paid in respect of student debt separately from consumer debts. However, in our provisional report we reported on an exercise to assess the impact of the increase in student debt levels on DSI ratios. This involved comparing the DSI ratios of households without any student debts with those of households with any form of unsecured liability. The exercise revealed that the presence or otherwise of student debt does not make a significant difference to the DSI ratios of households.

How many households are over-indebted?

3.43 To arrive at an estimate of the number of over-indebted households we again use the YouGov DebtTrack findings as our starting point and apply the percentage point changes identified from the NMG survey to these (Table 5, below)

Table 5: Estimates of DSI ratios, debtor households, 2015

DSI ratios	2012 (YouGov DebtTrack), percentage of debtor households	Percentage point change to 2015 (NMG survey)	CfRC 2015 estimates, percentage of debtor households within DSI thresholds, 2014
<25%	82	-8	74
25%–40%	9	+2	11
>40%	9	+4	13

3.44 Extrapolating to national data concerning household numbers and size, and taking account of the fact that only half of all households hold unsecured debts at all, we estimate that in 2012 there were 2.54 million over-indebted households (DSI>25per cent), containing approximately 6 million people. By 2014, this had risen to 3.2 million households, containing 7.6 million people, and there has been very little change since. On this basis, nearly one in eight of all UK households are currently over-indebted.

3.45 Further to this, we estimate that roughly half of all over-indebted households are extremely so, and are paying out more than 40 per cent of their pre-tax income to creditors. 70 per cent of these extremely over-indebted households are in receipt of incomes of less than £30,000 per year.

3.46 These estimates are broadly consistent with the StepChange 'Life on the Edge' report, published in 2014, which indicated that 8.8 million people were in 'problem debt'. That report was based on a YouGov survey of 4,442 adults conducted in December 2013, but used a number of different indicators to determine whether or not people were struggling financially. These did not measure the level of repayments relative to income but instead focused on financial behaviours, including whether or not people used credit to pay for household bills, paid only the minimum amount on credit cards for extended periods, or were in arrears with payments. Similarly, in March of this year the Money Advice Service estimated[20] that 8.2 million people had 'problem debt': either reporting their debts to be a 'heavy burden' or having missed bill payments in three or more months out of the last six months.

[20] Money Advice Service (2016), "A Picture of Over-Indebtedness". Downloaded from www.moneyadviceservice.org.uk/en/corporate/one-in-six-adults-struggling-with-debt-worries

Box 3: Over-indebtedness and 'heavy burdens of debt'

Because the NMG survey collects information which allows for the calculation of DSI ratios and also asks respondents whether or not their debts are a 'heavy burden' we were able to explore whether or not the use of subjective indicators leads to a higher number of people being identified as in 'problem debt'.

Looking at this issue in detail we found that a greater proportion of respondents in the survey reported their debts to be a heavy burden than were over-indebted on the DSI measure. There was a three percentage point difference in this respect.

However, we found no simple correlation between those reporting debts to be a heavy burden and their DSI ratios. For example, fewer than one quarter of extremely over-indebted households (DSI>40 per cent) reported that their debts were a 'heavy burden', whilst a tenth of households with very low DSI scores (<10 per cent) felt that their debts were so.

A number of demographic factors appear to have a significant impact on the likelihood of households reporting that their debts are a 'heavy burden'. These particularly relate to the costs of raising children, housing, and the additional costs of living with long term illness and disability.

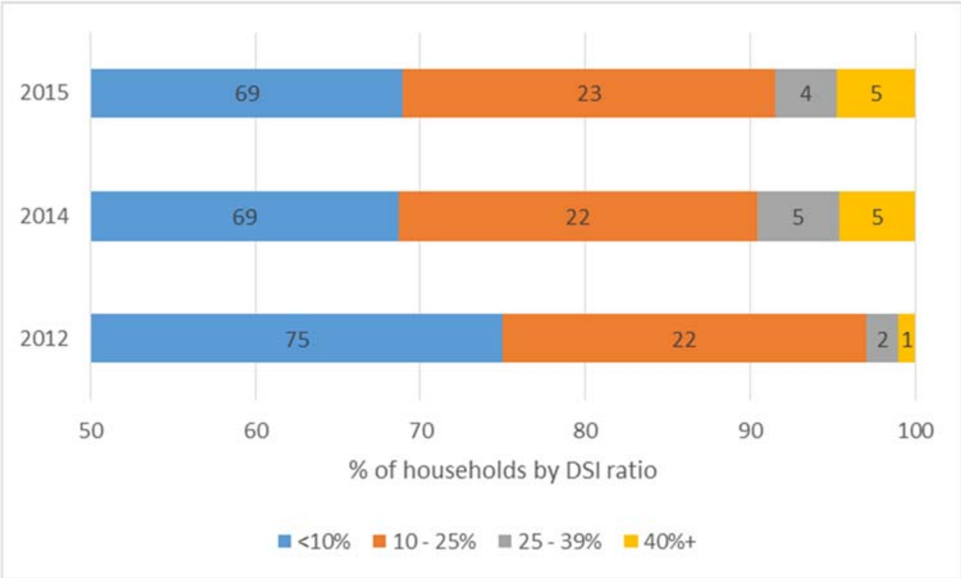
The demographic characteristics of over-indebted households

3.47 The remainder of this chapter now provides more detail on the changing distribution of over-indebtedness since 2012, with a particular focus on changes in the past year, by examining levels of over-indebtedness (defined as a debt servicing ratio greater than 25 per cent) across households according to their employment status. Where sample sizes allow, we further cross tabulate findings in respect of income, age and housing tenure.

Households with someone in paid employment

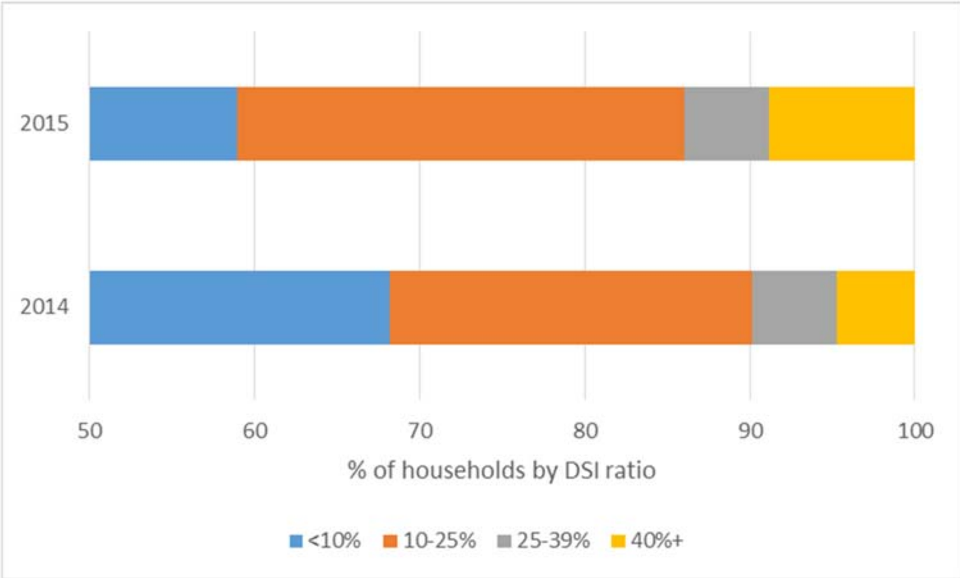
3.48 Approximately two thirds of households containing someone in paid employment, but excluding self-employment, hold unsecured debts – a proportion which has changed little from 2012 through to 2015. However, as figure 19, below, indicates the proportion of those households which are over-indebted increased significantly between 2012 and 2014. In 2012, just 3 per cent of working households which held any form of unsecured debt were over-indebted. This increased to 10 per cent in 2014. The past year has seen precious little improvement – with over-indebtedness amongst this group reducing by just one percentage point.

Figure 19: DSI thresholds, households containing someone in paid employment 2012–2015



3.49 However, the position has worsened over the course of the past year for working households with incomes of £30,000 or less. Nearly three quarters (72 per cent) of these households hold unsecured debts, and there has been an increase in the number of these who are over-indebted over the past year, with this rising from 10 per cent to 14 per cent (Figure 20, below). Worryingly, this four percentage point increase has occurred in respect of households who are extremely over-indebted (paying out more than 40 per cent of their income on debt repayments).

Figure 20: Over-indebtedness amongst low income, working, households 2014 & 2015

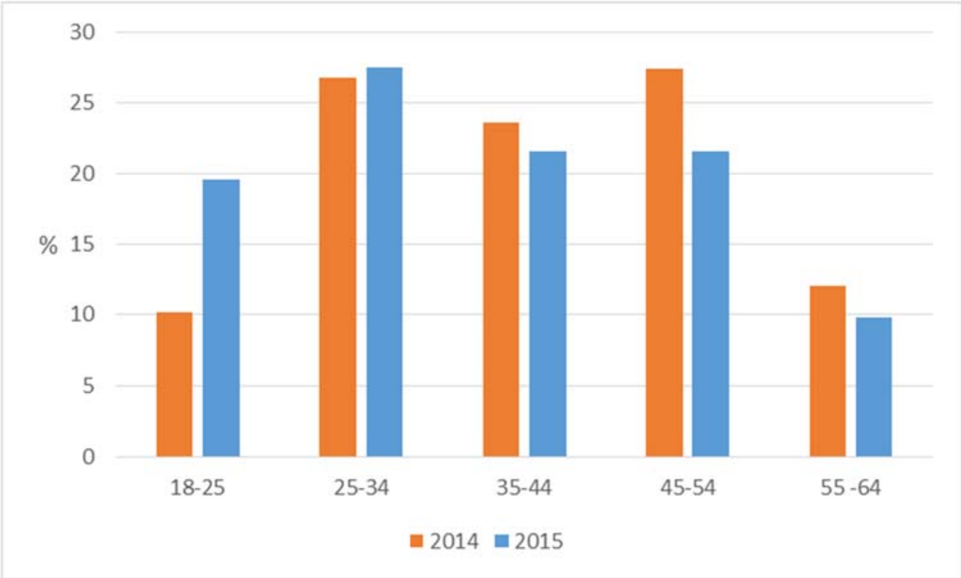


3.50 It should also be noted that the percentage of lower income working households with DSI ratios of between 10 per cent and 25 per cent has increased by 5 percentage points over the past year.

3.51 Although some caution is needed because of low sample sizes when cross tabulations are involved[21], it would appear that there have also been significant shifts in the age distribution of over-indebtedness amongst lower income working households over the past year (Figure 21, below). Households aged between 18 and 25 years now make up 20 per cent of all over-indebted lower income working households compared to half this level a year ago.

[21] The total number of lower income, working, and over-indebted households in the 2014 and 2015 NMG surveys was 164 and 103 respectively.

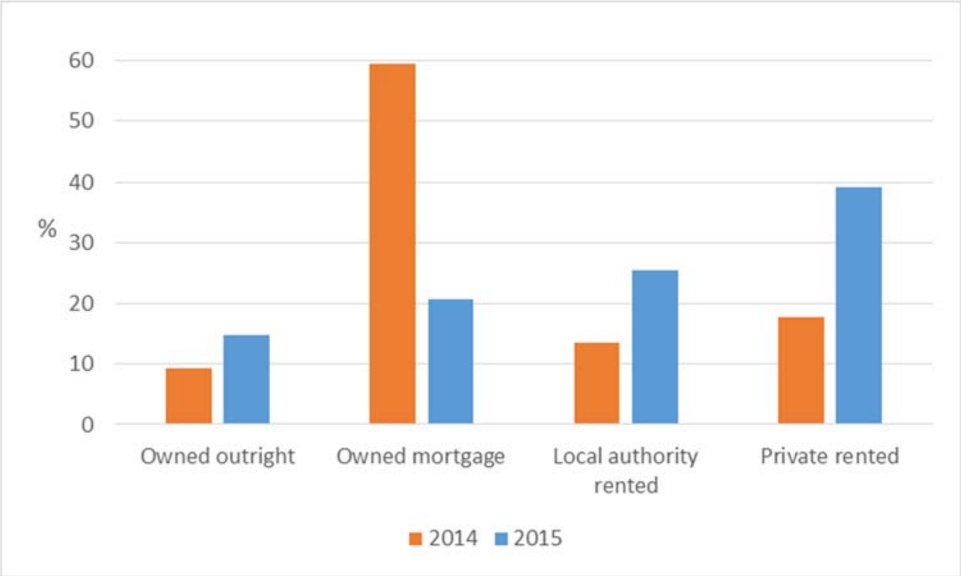
Figure 21: Over-indebted, lower income, working households by age, 2014 & 2015



3.52 However, as Figure 21 also illustrates, over-indebtedness amongst lower income working households is most likely to be present in households aged 25 to 34, and is much less likely in those aged 55 to 64.

3.53 The percentage of over-indebted, lower income, working households living in mortgaged accommodation (Figure 22, below) also appears to have significantly reduced in the past year – falling by one third – whilst the percentages of these households living in either social or private rented accommodation have both doubled.

Figure 22: Over-indebted, lower income, working households by housing tenure, 2014 & 2015



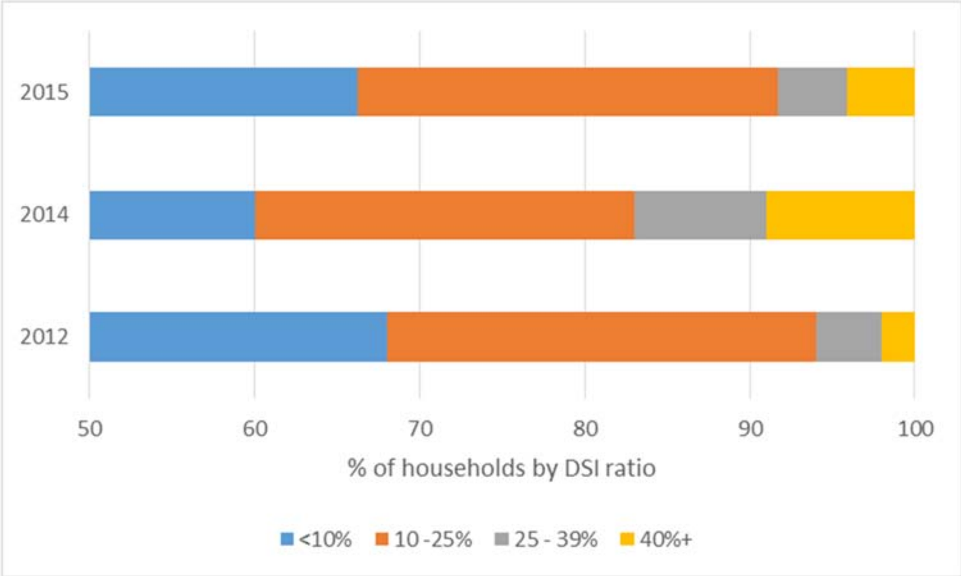
3.54 This could imply that a significant number of lower income, working, and over-indebted households have moved out of mortgaged accommodation and into the rented sector over the past year.

Self-employed households

3.55 Self-employed households are much less likely to report that they have unsecured debts than those in paid employment. In the 2015 survey, just over one third of self-employed households had outstanding debts. This was considerably reduced on 2014, when over 58 per cent reported doing so.

3.56 Over-indebtedness amongst the self-employed has also fallen considerably. Of those with debts, 8 per cent are currently over-indebted, compared to 17 per cent a year previously. However, current levels of over-indebtedness are still higher amongst this group than they were in 2012 (Figure 23, below).

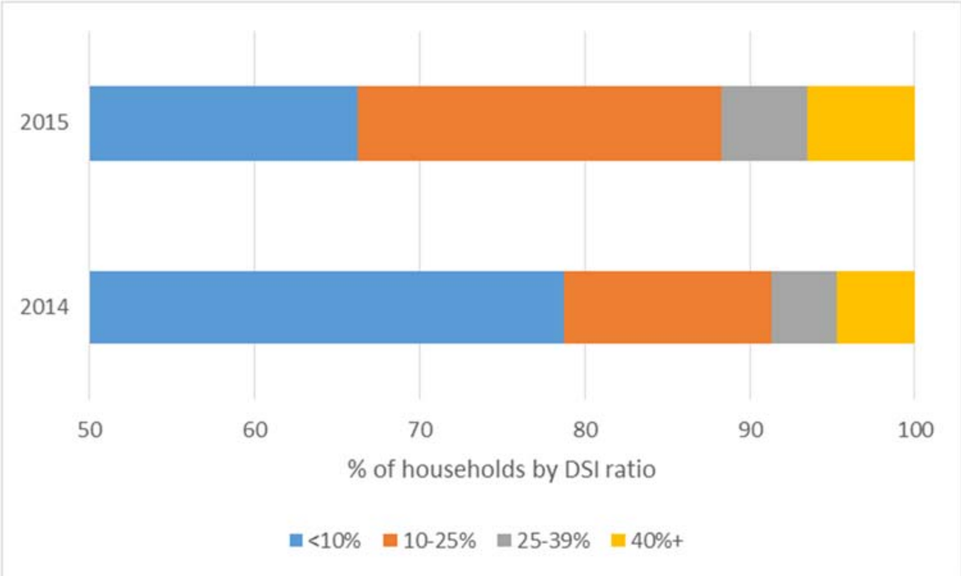
Figure 23: DSI thresholds of self-employed households



3.57 Although there has been an overall reduction in the numbers of over-indebted self-employed households in the past year, there has been a small increase in the proportion of *lower income* self –employed households that are over-indebted[22] (Figure 24, below).

[22] Again some caution is needed due to the relatively low sample size of this group within the NMG survey. In 2014, there were 275 lower income self-employed households in the survey, but this reduced to just 136 in 2015.

Figure 24: DSI thresholds of lower income, self-employed households, 2014 & 2015



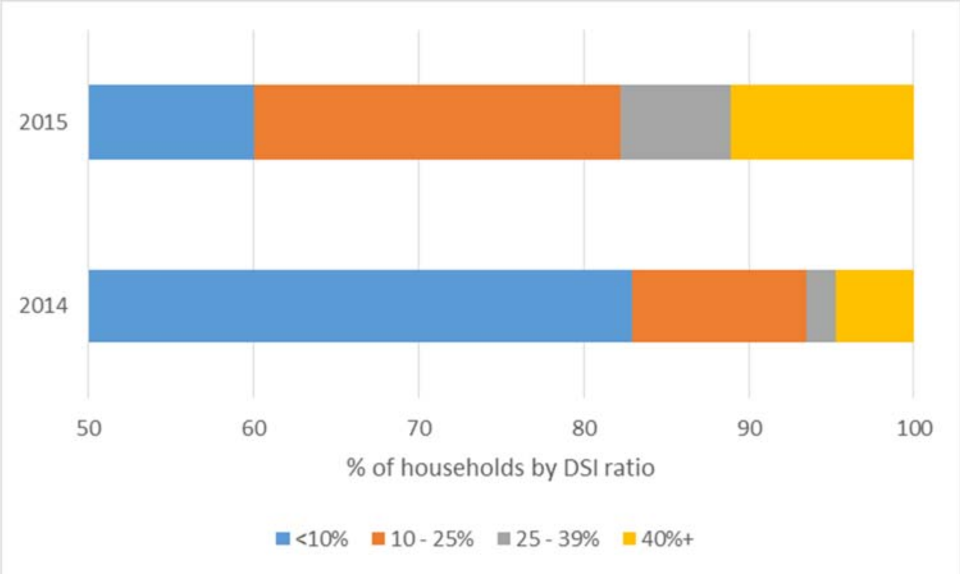
3.58 Although the sample size for 2015 is small, the NMG survey suggests that eleven per cent of self-employed households, who have incomes of £30,000 or less, are currently over-indebted, and six per cent of these households are extremely so.

Unemployed households

3.59 Although unemployed households are slightly more likely than the general population to have unsecured debts, they are less likely than working households to do so. Just over half (51 per cent) of all unemployed households in the 2015 NMG survey had unsecured debts, which was slightly down on 2014, when 56 per cent did so.

3.60 Despite this slight reduction in the overall proportion of unemployed households holding unsecured debts, those with debts were much more likely to be over-indebted in 2015 (18 per cent) than the year previously (7 per cent). In 2012, the proportion of these households was 14 percent, indicating that following an initial reduction in over-indebtedness through to 2014, this has since increased. In addition, the proportion of these households who are likely to be extremely over-indebted has more than doubled in the past 12 months, with more than one in ten (11 per cent) in this position.

Figure 25: DSI thresholds of unemployed households, 2014 & 2015

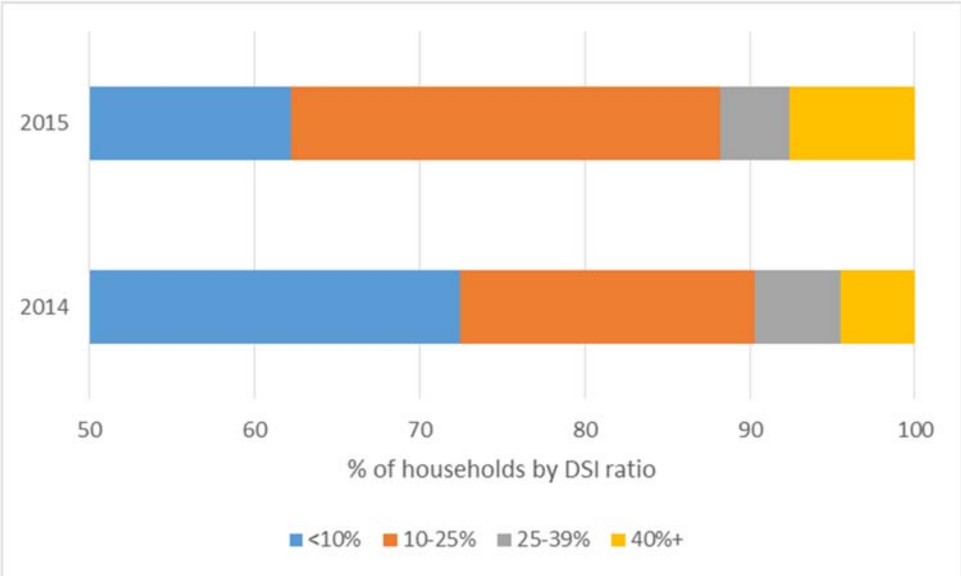


3.61 Unfortunately, the number of unemployed households in the survey is too small to cross tabulate this finding to other demographic factors such as age and housing tenure[23].

3.62 A similar pattern is observed in respect of households in the NMG survey who contained someone with a long-term sickness or disability. In 2014, 59 per cent of these households reported holding some form of unsecured debt, but this reduced slightly to 55 per cent in 2015. Of those households with debt, around 13 per cent were over-indebted in 2012, and this initially reduced to 9 per cent by 2014. However, the past year has seen an increase in over-indebtedness – to 12 per cent (Figure 26, below). As with unemployed households, the past year has also seen the doubling of extreme over-indebtedness amongst this group but sample sizes do not allow for further cross-tabulations[24].

[23] There were 215 unemployed households contained in the 2014 survey, but just 132 in 2015.
[24] There were 298 households containing someone with a long-term sickness or disability in the 2014 survey and 270 of these in 2015.

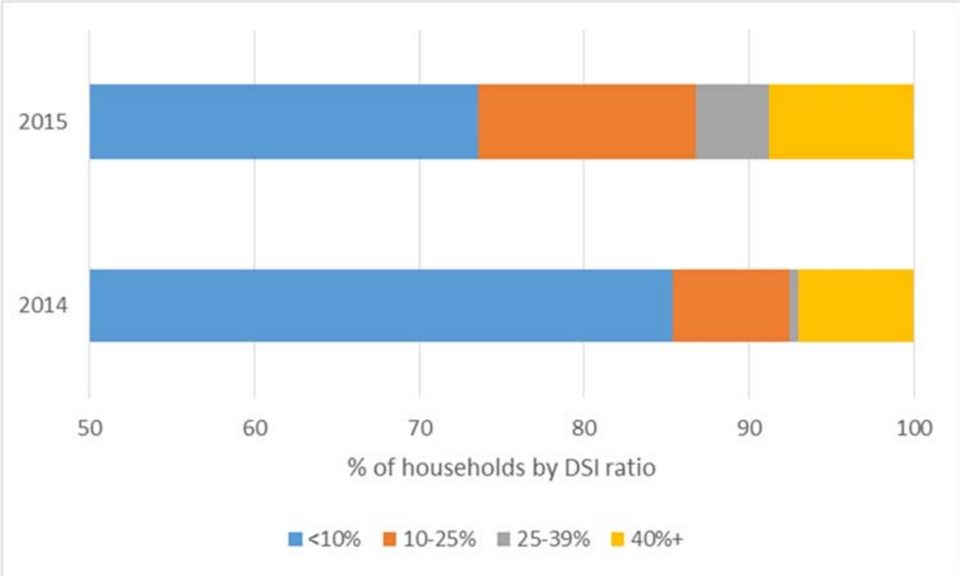
Figure 26: DSI ratios of long-term sick or disabled households, 2014 & 2015



Full-time students

3.63 Nearly three quarters of full-time students have unsecured debt, which is unsurprising given the expansion of student loan debt in recent years. However, over-indebtedness amongst this group is also rising. In 2012, just seven per cent of student households with unsecured debts were paying out more than a quarter of their income on repayments. By 2014, this proportion had risen only marginally to 8 percent, but in the past year it has increased significantly to 13 percent. There has also been a near doubling in the number of full-time student households spending between 10 and 25 per cent of their income on debt repayments over the period.

Figure 27: DSI ratios of full-time student households, 2014 & 2015

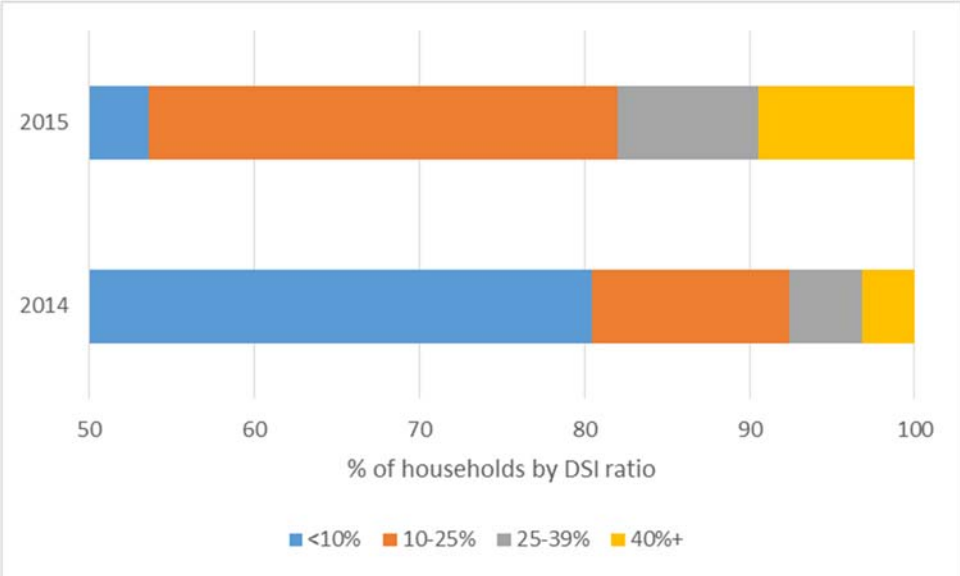


Retired households

3.64 In contrast with all other groups, retired households are much less likely than the general population of have any unsecured debts. Only around 40 per cent of retired households were in debt in 2015, and this was constant with the percentage in debt a year previously.

3.65 In 2012, only 6 per cent of retired households holding unsecured debts were over-indebted. This then increased only marginally to 7 per cent in 2014, but by 2015 was 17 per cent. There has also been a considerable increase in the past year in the percentage of these households which are extremely over-indebted (Figure 28 below).

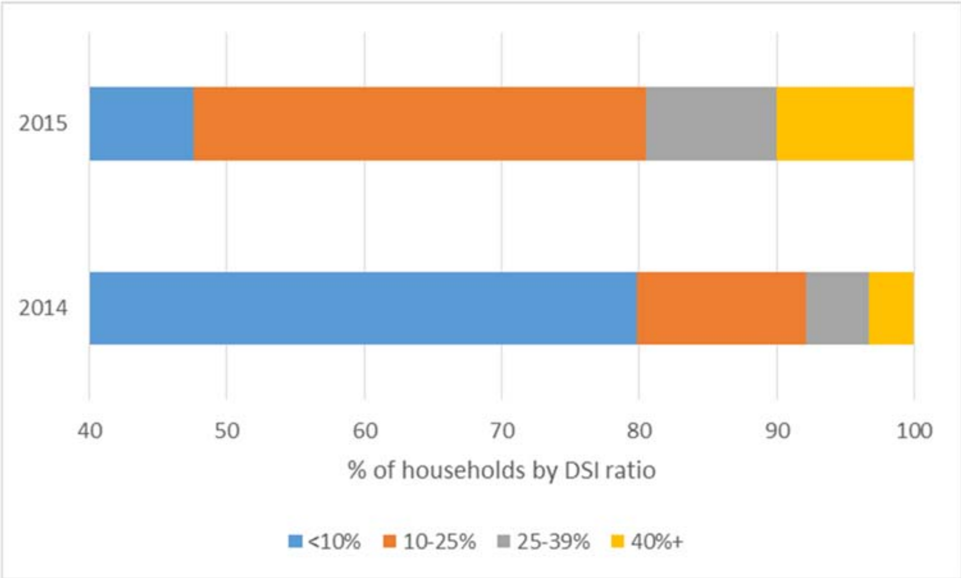
Figure 28: DSI ratios of retired debtor households, 2014 & 2015



3.66 It should also be noted that there has been a dramatic increase in the proportion of retired debtor households who are now paying more than 10 per cent of their income in repayments to their creditors. In 2014, just one fifth of retired households with debts were in this position, but nearly half are now so.

3.67 Some cross tabulations for this group are possible, as there were over 1,500 such households in both the 2014 and 2015 surveys, and over half of these were in receipt of incomes of less than £30,000 in each year. These lower income pensioners were much more likely to be over-indebted than the overall group. A fifth of all pensioner households with debts and incomes of £30,000 per year or less were over-indebted in 2015 compared to just eight per cent a year previously, and one in ten are now extremely over-indebted.

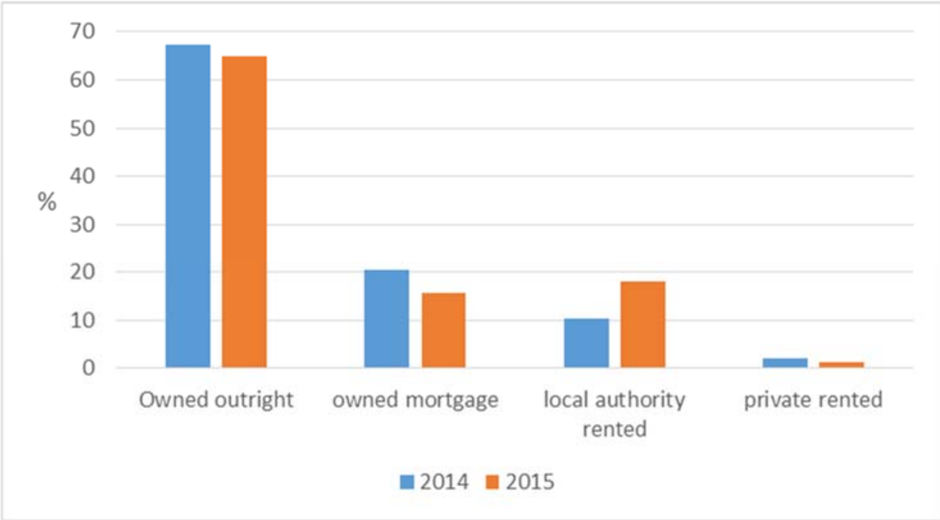
Figure 29: DSI ratios of debtor pensioner households, incomes of £30,000 per year or less, 2014 &2015



3.68 Although sample sizes become very small when examining the housing tenures of low income, over-indebted, pensioners[25], the NMG survey suggests that the vast majority (nearly 70 per cent) of these households are living in accommodation that they own outright. However, there has also been a significant increase in the proportion of these households that are living in social housing in the past year (up by 8 percentage points to 18 per cent). As with the findings in respect of low income, over-indebted working households, these results need to be treated with some caution but should, in our view, also be examined in larger scale surveys.

[25] There were just 101 of these in the 2014 survey and 78 in the 2015 survey.

Figure 30: Over-indebted low income pensioner households, by tenure 2014 &2015



Section four

Conclusions and recommendations

4.1 This project has analysed both aggregate and household survey data in order to provide a deeper understanding of the household debt burden. Although household surveys have reported on the extent to which debts pose a heavy burden for households for some time, the aggregate measures that are conventionally used, which are based on the level of outstanding debt or on debt servicing costs relative to gross incomes, do not take account of other pressures on the budgets of households.

4.2 We believe this to be a significant failing. The ability of households to service their debt is not contingent on their income alone, but rather on the amount of *surplus income* available after other costs of living have been met.

4.3 Following the Brexit vote, the financial pressures on households are likely to increase as a consequence of sterling's depreciation and the rising cost of imported goods and services. This is likely to prove particularly difficult for those households who have high levels of outstanding debts. Other threats are also apparent, particularly in respect of rising rental costs and in relation to childcare. These costs are closely related to those demographic factors which are most closely linked to the reporting of debts as a heavy burden: specifically, living on a low income in the private rented sector, and raising children. In the event that the cost of living does increase then many of these households will be faced with a choice between cutting back on non-essential spending, defaulting on their debts, or somehow rescheduling their commitments.

4.4 Either way there is a real threat to growth unless real incomes rise or the debt repayment burden is reduced in other ways. For example, if households reacted to increased debts by cutting back on spending this would add to risks to the economy given increased uncertainty from the Brexit vote and the forecasts for a substantial decline in investment spending.

4.5 The obvious way to support the economy and relieve the pressures on households is through a material reversal in the decline in real wages. The TUC has repeatedly argued for action on infrastructure spending and the removal of the public sector pay cap as well as the development of a coherent and wide ranging industry plan.

4.6 Almost by default the alternative is for households to try to borrow their way out of the impasse. Indeed, as discussed, this has already started to happen. Despite falling to £185bn at the start of 2012 the amount of consumer credit debt outstanding has since increased to £212bn. This is unsustainable as the interest payments on this consumer credit debt constitute a growing element of the overall debt burden on households, and the resources available to meet repayments are declining and are likely to do so further.

4.7 Households would clearly benefit from rising real wages, which would increase the resources available to them to meet their debt repayments. However, in the absence of this, then direct measures to reduce the household debt burden are likely to be needed.

4.8 As discussed, our debt management and insolvency system is not fit for purpose. The number of insolvencies has fallen in recent years despite problems of over-indebtedness increasing. Providing increasing numbers of long-term debt management plans is also likely to constrain aggregate demand in the long-term as these contain no mechanism to write off a proportion of the debt except under the DSO schemes that are not widely used and operate only on small amounts.

4.9 Rapid changes to our debt advice and insolvency systems are therefore likely to be required, and the following recommendations are designed to assist with the design and implementation of these.

Recommendation 1: Improve the monitoring of the household debt burden

4.10 Given the findings from this project, our starting point is to call for improvements in the monitoring of the household debt burden. In our view, the conventional measures can be misleading. The debt servicing cost to income ratio is particularly dangerous as this indicates that household debt repayments are at a record low when, on these measures there has been an increase in over-indebtedness and in the burden of debt in recent years. We therefore urge policy makers to adopt our measure of total interest payments as a proportion of the household surplus, and for HM Treasury and the Bank of England to report on how their actions will ensure that this ratio stays at safe levels.

4.11 Further work is also needed to refine the measure. In particular, the effect of Non-Profit Institutions Serving Households needs to be removed. We also need to have a better understanding of the component parts of 'other accounts payable' in the National Accounts, and of the levels of debt being written off through insolvency procedures and being sold on the secondary markets. We therefore hope that both ONS and the Insolvency Service will respond positively to this report and bring forward proposals to address these problems.

4.12 Further work is also needed to improve the household survey data that is available. The NMG survey suffers from a large-scale under-reporting of consumer credit debts, and the Bank of England should seek to address this moving forwards.

Recommendation 2: Establish an official target to reduce the household debt burden

4.13 In line with the need to improve the monitoring of the household debt burden, policy makers should seek to determine what a 'safe' level of unsecured debt in the economy actually is, and to set out an explicit strategy to achieve this.

4.14 With base rates at their record low, it is unlikely that an increase in the household debt burden can be effectively countered by reducing these further. In any event, this would be a poorly targeted measure.

4.15 We should therefore focus attention on the consumer credit market. As this report indicates, as much as 45 per cent of the total interest burden on households is caused by consumer credit debts, despite these accounting for only one-fifth or so of the total outstanding stock of debt. We consider that a reduction in the consumer credit interest burden from its current record level of 25 per cent is required, and that this should form the basis of a new joint target.

Recommendation 3: Implement effective measures to achieve the target

4.16 A reduction in the overall annual interest charged on consumer debts could be achieved by either:

- taking measures to ensure there is a material recovery in economic growth that leads to higher real earnings; or

- restructuring debts so that interest payments and the stock of debt are reduced.

4.17 The TUC has argued the former approach involving infrastructure spend and an industry plan is essential and the most promising approach for the latter may be to build on processes that are already in place. Debt advice agencies, including Citizens Advice and StepChange, help over-indebted individuals to restructure debts and reduce interest payments. Banks willingly engage in these processes for it is preferable to have the possibility of reduced payments than outright default. However, such processes can only go so far, and depend also on indebted individuals seeking advice from charities (or parallel but less beneficial processes through private sector businesses).

4.18 Other opportunities to identify specific groups of debtors in need of assistance should also be sought out. For example, the credit card market review currently being conducted by the Financial Conduct Authority has identified that 2.1 million people, predominantly from more deprived demographic groups, have maintained a balance of over 90 per cent of their credit card limit for over 12 months. It also found that 5.1 million accounts will, on current balances and repayment patterns, take over 10 years to pay off. These debtors are good candidates for assistance, with many likely to already have paid excessive levels of interest and fees. It should, in addition, be possible for credit reference agencies to pro-actively identify people who are in financial difficulties.

4.19 So far these processes have operated without significant government involvement. The government (and/or other financial authorities) should consider what form of public intervention may greatly increase the efficiency of debt reduction, improving prospects for both borrower and lender. This might involve costs but this has not precluded other financial interventions on a vast scale. Moreover intervening more directly is likely to deliver significant advantages not only to well-being but also to the economy as a whole.

4.20 In our view it is now also essential that government conducts a rapid review of our current debt advice and insolvency ‘system’. There is a strong case for ensuring that debt management plans provide at least a partial write off of debt in specified circumstances. This is because it is likely that a large proportion of those debts that have been written off by originating lenders and sold to debt recovery companies have ended up in these plans.

4.21 The continued recovery of this debt is of no real economic value, and is unjust to debtors because originating lenders will have written off this debt against their tax liabilities. HM Treasury and the Financial Conduct Authority should conduct research to establish to determine precisely how much debt is being managed through DMPs, how this is treated within the tax system, and ensure that debtors receive their fair share of this write down.

4.22 We also believe that major changes are needed to the insolvency regime, and in particular that government should consider the abolition of Bankruptcy and Individual Voluntary Arrangements and their replacement with a single procedure which is cheap to access, protects the main home of debtors to a reasonable value, and provides for a fresh start within a reasonable period. The limited disposable income threshold, of just £50 per month, which is a condition for people who have no assets to obtain a Debt Relief Order should also be significantly increased, and the upper limit on the amount of debt that can be included within these should be removed.

4.23 A joint 'Consumer Credit and Personal Insolvency Review' was conducted by HM Treasury and the Department for Business, Innovation and Skills (BIS) in 2010, but this did not address the lack of suitable options for debtors and did not consider the economic role that insolvency procedures can play. A new review, focused on how insolvency can play a role in addressing the 'debt overhang', and act as an 'automatic stabiliser' when the debt burden is too high, is urgently needed.

The TUC produces regular reports on economic and social issues, providing up to date analysis and commentary on key policy debates.

You can also read TUC policy officers' comments on the issues in the report series and the ongoing economic situation at the TUC public policy blog: **touchstoneblog.org.uk**

TUC

Published by
Trades Union Congress
Congress House
Great Russell Street
London WC1B 3LS

Tel: 020 7636 4030
Fax: 020 7636 0632
tuc.org.uk

August 2016