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# Overview of indebtedness, low income and financial exclusion

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## Summary

- Borrowing is used by the majority of individuals and households at some stage in their lives. It is only problematic when repayments are too onerous.
- Over-indebtedness is measured in three main ways: arrears with payments, feeling debt is a heavy burden and making heavy use of credit.
- Using the first two measures, the best estimate of the number of individuals who are over-indebted in Wales is 16% of the population, some 400,000 people.
- Indebtedness is strongly associated with socio-economic disadvantage: the central and eastern valleys of Rhondda Cynon Taf, Merthyr Tydfil, Caerphilly and Blaenau Gwent have particularly high levels of indebtedness. The north Wales coast and some rural areas also indicate higher levels of problems on at least one measure.
- Indebtedness is strongly associated with low income and financial exclusion. Low income does not directly cause indebtedness but greatly increases the risk because of low disposable incomes, few if any savings and greater risks of being affected by trigger factors.
- About half of all those who are indebted have household incomes of £20,000 a year or less.
- Low income is not the only risk factor - indebtedness is usually the result of a combination of circumstances, events and behaviours.
- Financial exclusion is an additional factor in low income individuals and households becoming indebted. It does not *cause* indebtedness (or poverty), but it increases the difficulty of managing on a low income. Financial exclusion typically exacerbates individual and household financial difficulties.

## Introduction

The report “assesses the impact of indebtedness on deprived communities; particularly to ascertain (to the extent possible) the scale of the issue both in terms of the number of people affected, and the degree to which the issue is one of financial exclusion.”

The specific questions to be addressed were:

- How many people are affected?
- What do we know about the geographical distribution, demographics, etc. of these groups?
- To what extent is indebtedness a result of financial exclusion as opposed to income levels (particularly low income)? Is there a causal relationship between heavy indebtedness and low income?

These questions have been answered through a rapid review of the most recent and relevant data and literature. The vast majority relates to the UK or GB, with there being relatively little that is specific to Wales. Where possible, the report uses Welsh data or studies but for the most part it extrapolates from UK or GB findings.

## Context

Borrowing is used by the majority of the population of Wales and Great Britain at some time to finance major items or to cope with fluctuations in income. On average, 54% of households have unsecured debt, with the mean value of that debt being £8,500 (Department for Business, Innovation and Skills, 2013).

Perhaps surprisingly, a number of surveys suggest that credit is less widely used in Wales than elsewhere. A lower proportion of the population has financial liabilities (46% compared with 51% in GB), and both the median and mean financial liabilities of households with credit are the lowest in the UK (the Wales mean financial liability is £5,600 compared with £7,500 for GB, while the median is £2,000 in Wales compared with £3,200 for GB) (Office for National Statistics, 2013). In addition, it seems that levels of indebtedness in Wales are generally below those in many other parts of the UK. For example, the proportion of individuals who are in arrears is the lowest in GB and the proportion who feel heavily burdened by debt is also the lowest (Bryan, Taylor and Veliziotis, 2010).

Borrowing only becomes problematic when the burden of repayments on the individual or household is excessive, leaving them unable to repay the debt, meet everyday living costs or feeling heavily burdened.

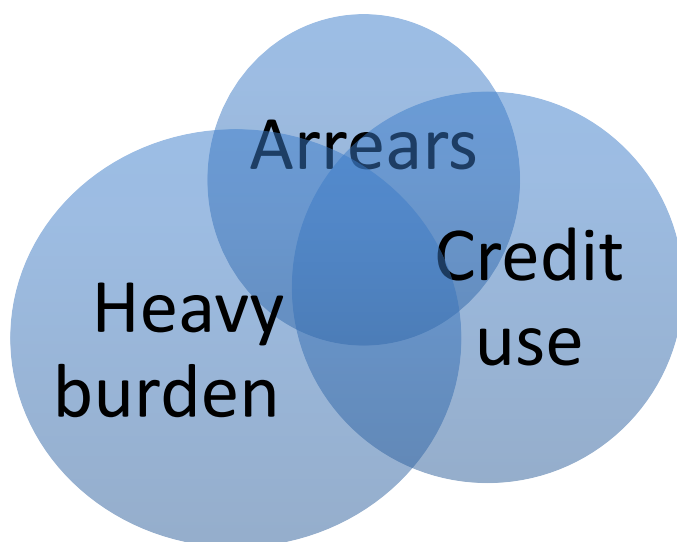
## Definitions and Measurement of Indebtedness

There is no common definition of over-indebtedness. Most studies use a mix of measures which reflect different aspects of debt. These are:

- being unable to meet payments, i.e. being insolvent or in arrears with payments - sometimes called 'structural debt' or severe financial difficulty;
- experiencing debt as a subjective burden;
- the nature of credit commitments and their relationship to income - sometimes considered to be indicative of being at risk of indebtedness rather than actual indebtedness.

These different indicators of debt overlap to some extent, as illustrated in Figure 1. However, analysis shows that each measure is a reasonably independent aspect of indebtedness and is therefore considered separately in the rest of this section. The position is further complicated because indebtedness can be measured for individuals or for households, and can take account of only unsecured debt, or all types of debt.

**Figure 1** Illustration of interrelated aspects of indebtedness



## How many people are over-indebted in Wales?

This section estimates the number of individuals and households in Wales who are indebted, using each of the different aspects of indebtedness. Where possible, it cites data specific to Wales but as this is very limited it also draws on data for GB or UK.

### **Payment arrears**

Being in arrears with one or more payments is widely acknowledged to be a strong indication of individual and household over-indebtedness.

### ***Insolvency***

The number of individual insolvencies (bankruptcy, Individual Voluntary Arrangements and Debt Recovery Orders) in Wales increased almost five-fold between 2000 and 2012, reaching a peak of 7,873 new insolvencies in 2010 since when the numbers have declined slightly, to 6,463 in 2012. The decrease (of 18%) in Wales is comparable with that in England, and is suggested by the insolvency industry to reflect the impact of the 2008 recession ‘working through the system’ (Stepchange, 2013), tougher lending by banks, a modest recovery in employment and low interest rates (Insolvency News, 2013). The rate of new insolvencies per head of 26.5 per 10,000 population in Wales is slightly above the rate for England as a whole, but below that of the north-east and north-west of England. Bishop and Grippaios’s (2010) analysis of spatial variations in insolvency suggested that underlying economic factors, including levels of self-employment and vulnerability to economic ‘shocks’, as well as demographic factors partly explained local and regional differences.

The statistics underestimate the number of people who are insolvent. The organisation representing insolvency practitioners, R3, has warned that some individuals are unable to afford the upfront fees required for bankruptcy, have debts that are too great for Debt Recovery Orders and are unable to get creditors to agree to Individual Voluntary Arrangements (Association of Business Recovery Professionals (R3), 2013). Moreover, these statistics only cover **new** insolvencies – a higher proportion of the population is affected by insolvency from earlier periods. The YouGov DebtTrack survey estimates that approximately 2% of the GB population is currently insolvent (Department for Business, Innovation and Skills, 2013).

## ***Debt Management Plans***

A Debt Management Plan is a non-statutory agreement between an individual and creditors to pay all debts, by making regular payments to a licensed debt management company. The company then shares this money out between creditors. There are no statistics on the number of individuals with debt management plans, but R3 estimates about 500,000 individuals in England and Wales have one (Association of Business Recovery Professionals (R3), undated) while the YouGov DebtTrack survey estimates that 4% of the GB adult population do so (Department for Business, Innovation and Skills, 2013: Table 6).

## ***Missed payments***

Arrears with repayments for credit or household bills are widely regarded as symptomatic of financial difficulty. Arrears of one or two months may simply be because payment has been forgotten or delayed, but being in arrears for longer than this is a strong objective indicator of over-indebtedness.

For households, the YouGov DebtTrack survey suggests that 7% were in arrears of more than three months in 2012 (Department for Business, Innovation and Skills, 2013). The Wealth and Assets survey's estimates of the proportion with missed payments are higher, with 10% of all households and 13% of households with credit (including those who are insolvent) being in arrears (Bryan, Taylor and Veliziotis, 2010). For Wales, the survey indicates that 9.7% of households with credit are in arrears (Bryan, Taylor and Veliziotis, 2010: Table 7). The difference between the two survey results may be partly because the Wealth and Assets survey defines 'arrears' differently.<sup>1</sup>

For individuals, the Wealth and Assets survey finds that 4% of all people and 6% of people with credit are in arrears with unsecured borrowing – including those who are insolvent (Bryan, Taylor and Veliziotis, 2010). An all-Wales survey (Consumer Focus Wales, 2010), found a significantly higher proportion of individuals in arrears - 19% of adults with credit were behind with repayments on unsecured borrowing, while 18% of all adults had fallen behind with household bill payments at least once in the last 12 months. Again, this higher figure may be because of the different definition of 'arrears'.

There is a substantial overlap between being in arrears and feeling debt is heavy burden (46% of households which are in arrears feel this) and having four or more credit

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<sup>1</sup> Any missed (minimum) payments in the last 12 months on credit or store cards, and 2 or more consecutive missed payments on mail order, hire purchase and loans.

agreements (42% of households which are in arrears have four or more credit agreements) (Bryan, Taylor and Veliziotis, 2010).

## **Subjective feelings**

Individuals' feelings about their financial situation are also an important measure of indebtedness. The most commonly used indicator of over-indebtedness is whether people feel that their credit and bills are a heavy burden. Other measures of feelings about debt are whether people feel they are 'constantly struggling' or 'struggling to last to pay day'.

In Britain as a whole, YouGov DebtTrack data suggests that 13% of respondents feel their debts are a heavy burden (Department for Business, Innovation and Skills, 2013). The Wealth and Assets Survey suggests a slightly lower proportion of individuals feel this – 6% of all individuals and 9% of individuals with credit. A higher proportion of people said that debt was a heavy burden in respect of their household – 14% of all respondents and 17% of respondents with credit (Bryan, Taylor and Veliziotis, 2010). For Wales, the same survey suggested that 10.4% of respondents felt that their household debts were a heavy burden. Using a slightly different measure, Consumer Focus Wales (2010) found that 17% of respondents in Wales said that they 'constantly struggled'.

There is some overlap between feelings of being burdened and heavy use of credit - of households which feel their debt to be a heavy burden, 47% have four or more credit agreements – but less overlap with financial difficulty - only 35% are actually in arrears (Bryan, Taylor and Veliziotis, 2010).

## **Credit arrangements**

Some individuals or households make heavy use of credit, usually measured by the number of credit agreements and high levels of credit in relation to income.

### ***Number of credit agreements***

In GB, 54% of the population had some form of credit agreement in 2011 (Department for Business, Innovation and Skills, 2013) - the figure in Wales for 2010 was 47% (Consumer Focus Wales, 2010). Having four or more credit agreements in place is widely regarded to put individuals at significant risk of financial problems: in GB, 5% of individuals have more than four unsecured credit agreements (Department for Business, Innovation and Skills, 2013), with a similar proportion (4.7%) estimated for Wales (Consumer Focus Wales, 2010).



### ***Debt relative to income***

High ratios of debt repayments to income or debt to annual income are recognised as significant risks of indebtedness. The YouGov Debrack survey suggested that 14% of households with unsecured credit had debt repayments that exceed 30% of their income, and 18% have unsecured debt of more than 60% of their annual income (Department for Business, Innovation and Skills, 2013). The Wealth and Assets Survey uses slightly different measures and finds that a lower percentage of households have high debt on each count: 9% having unsecured debt repayments of 25% or more of their income and 8% having total debt (secured and unsecured) of 50% or more of their annual income (Bryan, Taylor and Veliziotis, 2010). For Wales, the figures are 6.5% and 6.4% respectively. The survey acknowledges issues with data on incomes which might account for the difference.

### ***Use of credit for everyday expenses***

Relying on credit cards, payday loans or overdrafts to meet everyday expenses regularly is an indicator of looming financial problems. In GB, 10% of individuals said they use credit for everyday expenses 'all the time' and 14% said they do so 'once in a while' – a total of 24% (Department for Business, Innovation and Skills, 2013). In Wales, Consumer Focus Wales found in 2010 that 21% used credit for everyday expenses and 13% used credit to pay household bills (Consumer Focus Wales, 2010).

For households with four or more credit agreements, 38% feel them to be a heavy burden but only 25% are in arrears – this suggests that heavy use of credit is not *inevitably* associated with becoming indebted, although further research on individual and households pathways in and out of debt is needed.

## **Estimates for Wales**

In estimating the number of individuals and households that are indebted in Wales there are two important caveats.

First, all three aspects of indebtedness need to be considered to gain a full picture – there is not a single number or percentage answer.

Second, there is very little Wales-specific data, so most of the estimates are derived from GB-level data applied to Wales. There are risks associated with this because the pattern of debt *may* not be the same as GB as a whole.

**So how many people or households are indebted in Wales?** The best estimate is as follows:

1. **In arrears:** the mid-point of GB surveys suggests that in Wales **around 10% of all households** are in arrears of at least 2 months.
2. **Burdened by debt:** the range of GB surveys suggests that **between 10% and 17% of individuals** feel they are burdened by or struggling with debt including their household bills.
3. **Heavy use of credit:** GB surveys suggest that about **5% of the population** have four or more unsecured credit agreements, and that **10-14% of those with any credit** have high debt in relation to their income (about 6% of all households).

These GB-based figures are supported by data from the Money Advice Service (2013a). Their survey estimated that in GB 18% of adults were either in arrears or were heavily burdened. In Wales, the figure is **16%**, equivalent to **400,000** individuals. This is, in my view, a robust estimate – it is within the range suggested by GB surveys and it combines the two indicators that best measure current financial difficulty. If a single figure is to be used, this is it.

## Location of Indebtedness

Data on the location of indebtedness is available from three sources: new formal insolvencies (Insolvency Service, 2012), Money Advice Service (2013a) survey, while data from StepChange Debt Charity (2012) sheds light on the characteristics of its clients (Table 1). A clear picture emerges.

First, there are exceptionally high levels of indebtedness and personal insolvency in the south Wales valleys, with Blaenau Gwent, Caerphilly, Merthyr Tydfil and Rhondda Cynon Taff having more than 25% of their respective populations being indebted and also reporting high levels of insolvency, at more than 28 per 10,000 people. Nearly 1,300 people became insolvent in these four authorities in 2012 alone. These are local authorities with high levels of dependence on welfare benefits, below average incomes and high levels of other forms of socio-economic deprivation, and together account for three out of ten of all people who are over-indebted in Wales (while having only 17.5% of Wales' adult population).

Second, there are some authorities where there are high levels of insolvency but below average levels of indebtedness, the most striking being Denbighshire and Conwy. It is not clear why insolvency is exceptionally high in Denbighshire in particular – there may be an issue with the use of post-code data which records the residence of the insolvent individual.

Third, indebtedness and insolvency are both relatively low in the Vale of Glamorgan and Monmouthshire, both of which have relatively low levels of socio-economic disadvantage.



**Table 1: Local Indicators of Indebtedness**

| Authorities                  | Insolvencies, 2012                  |                                  | In arrears and feel heavily burdened |                       | Heavy Credit use  |
|------------------------------|-------------------------------------|----------------------------------|--------------------------------------|-----------------------|---|
|                              | Number of new insolvency cases 2012 | Rate per 10,000 adult population | Number indebted                      | Percentage adult pop. | % StepChange clients with contractual payments > than 25% of income |
| <b>Isle of Anglesey</b>      | 118                                 | 20.9                             | 6,351                                | 12                    | 55.4  |
| <b>Gwynedd</b>               | 216                                 | 22.0                             | 13,323                               | 14                    | 55.9  |
| <b>Conwy</b>                 | 289                                 | 30.9                             | 9,675                                | 11                    | 56.5  |
| <b>Denbighshire</b>          | 397                                 | 53.1                             | 10,485                               | 13                    | 63.7  |
| <b>Flintshire</b>            | 472                                 | 39.2                             | 12,291                               | 10                    | 55.9  |
| <b>Wrexham</b>               | 308                                 | 28.9                             | 17,205                               | 16                    | 53.6  |
| <b>Powys</b>                 | 260                                 | 24.3                             | 11,285                               | 10                    | 57.4  |
| <b>Ceredigion</b>            | 122                                 | 19.2                             | 5,047                                | 9                     | 50.6  |
| <b>Pembrokeshire</b>         | 233                                 | 23.8                             | 10,918                               | 12                    | 54.0  |
| <b>Carmarthenshire</b>       | 349                                 | 23.8                             | 20,410                               | 14                    | 56.6  |
| <b>Swansea</b>               | 469                                 | 24.3                             | 35,239                               | 19                    | 54.2  |
| <b>Neath Port Talbot</b>     | 275                                 | 24.5                             | 25,140                               | 23                    | 59.7  |
| <b>Bridgend</b>              | 278                                 | 25.1                             | 23,279                               | 22                    | 53.3  |
| <b>The Vale of Glamorgan</b> | 190                                 | 19.1                             | 8,249                                | 8                     | 55.5  |
| <b>Cardiff</b>               | 594                                 | 21.5                             | 29,862                               | 11                    | 56.4  |
| <b>Rhondda Cynon Taf</b>     | 557                                 | 30.0                             | 52,663                               | 28                    | 57.3  |
| <b>Merthyr Tydfil</b>        | 132                                 | 28.4                             | 14,340                               | 32                    | 65.6  |
| <b>Caerphilly</b>            | 394                                 | 28.2                             | 33,647                               | 25                    | 57.9  |
| <b>Blaenau Gwent</b>         | 190                                 | 34.1                             | 20,105                               | 37                    | 56.2  |
| <b>Torfaen</b>               | 168                                 | 23.4                             | 16,808                               | 24                    | 56.7  |
| <b>Monmouthshire</b>         | 142                                 | 19.4                             | 3,210                                | 5                     | 53.4  |
| <b>Newport</b>               | 310                                 | 27.5                             | 19,896                               | 10                    | 49.5  |

Sources: Insolvency Service (2013), Money Advice Service (2013a) data supplied by MAS, StepChange Debt Charity (2012).

Data on the indebtedness of clients of the charity StepChange confirms the concentration of debt in the valleys and north Wales (StepChange Debt Charity, 2012). While it is to be expected that clients approaching the charity would have high levels of indebtedness in general, there is considerable geographical variation in the proportion of their clients with debt repayments in excess of 25% of income. The areas with the highest proportions are Merthyr Tydfil (65.6%), Denbighshire (63.7%), Neath Port Talbot (59.7%), and Caerphilly (57.9%). They also found a high repayment to income ratio in Powys (57.4%). What is striking is that there are high levels of indebtedness in the same areas using three very different measures – the most narrow measure of insolvency, a population survey and the circumstances of clients of a debt charity all, separately, show that indebtedness is greatest in Merthyr Tydfil, Blaenau Gwent and Caerphilly, Rhondda Cynon Taf and Neath Port Talbot in the south and Denbighshire in the north.

**There seems therefore to be a very close association between high concentrations of indebtedness and deprived communities.**

## Indebtedness and Low Income

There is a strong but complex association between low income and indebtedness. Although low income households use credit slightly less than middle and high income households, they are more likely to be indebted using all three different measures of indebtedness. Table 2 provides a summary.

In terms of arrears, 22% of households with incomes of less than £13,500 a year are undergoing insolvency action or are in arrears compared with 14% of those with incomes of £13,500 to under £25,000, 10% of those with incomes of £25,000 – to under £50,000 and just 6% of those with incomes of £50,000 or more.

In terms of subjective feelings, people in households on low incomes are also much more likely to feel that their debts are a heavy burden than middle and high income households – 20% of those on incomes of less than £13,500 a year say this compared with just 6% of those on high incomes.

Some studies suggest that the actual value of credit has less effect on how much of a burden it is perceived to be by low income households than its 'perceived manageability' - - low income household may be extremely worried by a debt of a few hundred pounds if they believe it cannot be repaid (Dearden et al, 2010).

In terms of use of debt, although low income households use unsecured credit less than high income households, they are more likely than those on middle and high incomes to have high debt repayments in relation to their income.

**Table 2 Low Income and Characteristics of Indebtedness, GB 2012 (percentage of households in each income bracket)**

| Annual household income | Insolvency or arrears | Keeping up is a heavy burden | Has any unsecured credit | Repayment: income ratio 30%+ | Debt: income ratio 60%+ |
|-------------------------|-----------------------|------------------------------|--------------------------|------------------------------|-------------------------|
| Less than £13,500       | 22                    | 20                           | 52                       | 29                           | 35                      |
| £13,500 > £25,000       | 14                    | 16                           | 54                       | 15                           | 24                      |
| £25,000 > £50,000       | 10                    | 11                           | 58                       | 10                           | 14                      |
| £50,000 +               | 6                     | 6                            | 56                       | 7                            | 5                       |
| Not known               | 7                     | 8                            | 42                       | -                            | -                       |

Source: Tables A5, A24, A33 and A35, Department for Business, Innovation and Skills, 2013

Unfortunately the income groups used in the Department for Business, Innovation and Skills (2013) survey are not comparable with any household incomes data available for Wales. Nevertheless, other sources show that, before housing costs and with adjustments for household composition, Wales has a larger proportion of households in the lowest income quintiles compared with the UK – 23% of households were in the lowest fifth and 22% in the second lowest (at UK level each quintile has 20% of households) (Department for Work and Pensions, 2013).

### **Why are low income households at greater risk of being indebted?**

There is no clear answer to the question of why low income households are at greater risk of being indebted. Very often it is a whole series of often complex circumstances, both individual and external, occurring over a period of time which result in indebtedness (Dearden et al, 2010). These have been described as a 'credit and debt journey'.

The most important underlying factor is the limited resources of low income households in relation to the cost of living. Numerous studies of low income families report their financial precariousness, with there being limited income left after the essentials of rent, bills and food are paid (Institute for Public Policy Research, 2010; Dearden et al, 2010; Mather and Sharma, 2011). The Family Expenditure Survey (2012) shows that 47% of the lowest income decile's expenditure is on food, housing and household goods and services compared with

31% of the highest decile's expenditure. In cash terms, the households in the lowest income decile have £99.80 a week left for non-food, housing and household items (e.g. clothing, transport, recreation and health) compared with £335.70 left for households in the highest decile. On top of this, low income households typically pay more for essential goods and services – known as the poverty premium – because they do not pay by direct debit, bulk buy etc.

Hardly surprisingly, low income households are less likely to have savings than other income groups. In GB, 61% of households with incomes of less than £13,500 a year had savings of less than £1,000, compared with only 20% of households with incomes of £50,000 or more (Department for Business, Innovation and Skills, 2013 Table A28). In Wales, Consumer Focus Wales (2010) found that 49% of adults did not have any savings to help with unforeseen expenses or a drop in income. This rose to almost two-thirds of those with a monthly income of £1,000 or less and amongst people under 50 years old.

All households have to cope with rising and / or fluctuating costs, but those already managing on low incomes have much less scope to manage. Households on low incomes report how they juggle their commitments – ‘robbing Peter to pay Paul’ – particularly if they do not have even modest savings to fall back on (Dearden et al, 2010). Only two in five of the GB population would be able to find £200 for unexpected expenditure without cutting back on essentials or dipping into savings, while one in five would have to borrow if they needed this sum (Rawlingson and McKay, 2013).

Sometimes households use credit to ‘smooth’ income and expenditure (Dearden et al, 2010). Households without any savings are very much more likely to use credit than those have savings: 51% of those using unsecured credit have liquid savings of less than £1,000, compared with 17% which have liquid savings of £10,000 or more.

Although this suggests that low income households seek credit to help with everyday costs, data from the YouGov DebtTrack survey suggests that low income households in general are no more or less likely to borrow to meet everyday expenses ‘all the time’ as higher income households, and are less likely to do so from time to time – the reason for this is not clear.

The importance of household income to indebtedness is clear from the analysis in the Wealth and Assets Survey: an increase of £100 per month in household income reduces the debt to income ratio by approximately one percentage point (Bryan, Taylor and Veliziotis, 2010). Extrapolating, a loss of income of £3,480 - the average loss per household affected by reforms to Incapacity Benefit (Beatty and Fothergill, 2013) – would potentially trigger an

increase of just under 3 percentage points in the ratio of debt to income in that household. Another comparator is the level of debt – a loan of £7,200 exceeds the 60% debt to income ratio if a household's income is £11,500 a year. To put this in context, the average price of a used car sold at auction in 2013 was £7,056 (British Car Auctions, 2014).

Low income households are often tipped into debt by one or more trigger factors which deliver 'income shocks'. Trigger factors are typically changes in people's personal circumstances or in their incomes with common triggers including:

- Relationship breakdown
- Bereavement
- Ill health or disability
- Redundancy or unemployment
- Wages not being paid on time
- Delays receiving benefits, overpayment of benefits and, more recently, cuts to benefits
- Unexpected or large items of expenditure.

Low income households are at higher risk of encountering the work- and benefit-related trigger factors than other households: they are more likely to depend on various social security benefits for some or all of their income and they are more likely to be made redundant or have short-term, fluctuating employment e.g. with zero hours. Low income households also experience generally higher levels of disability and ill-health.

The Wealth and Assets Survey found that, for all types of household, increases in household size (notably the addition of a child aged under 16) and changes in marital status (notably relationship breakdown) have a statistically significant effect on the likelihood of indebtedness (Bryan, Taylor and Veliziotis, 2010).

Trigger factors are not necessarily the sole cause of financial difficulties - Dearden et al (2010) noted:

'adverse shocks' and events which expose households to the risk of financial problems – such as loss of employment, marital breakdown and poor financial management – often have a cumulative, rather than an immediate, effect on households' financial circumstances'

The key issue is the resilience of low income households to cope with income shocks, including their savings and assets, existing commitments as well as their financial capability.

The higher risk of indebtedness amongst low income households means that those on low incomes comprise a substantial number of all those who are in debt. The Money Advice Service (2013a) found that of the indebted population as a whole, half have a household income of less than £20,000 per annum.

It is worth noting that low income is by no means the only household characteristic closely associated with indebtedness – age, household composition, housing tenure, and gender are also closely related. The risk of indebtedness is higher for young people, for people in social housing, for lone parents and for women. As a result, looking at the over-indebted population as a whole, the Money Advice Service (2013a) research shows that:

- The majority are of working age
- 58% of those who are indebted are in work
- 48% of the indebted live in privately-owned homes
- Women account for 64% of the indebted population.
- People aged 35-44 account for nearly one third of those indebted.

## Indebtedness and Financial Exclusion

The relationship between indebtedness, low income and financial exclusion is equally complex. Most people agree that financial inclusion is:

A state in which all people have access to appropriate, desired financial products and services in order to manage their money effectively (*www.transact.org*)

Achieving that state is generally to be through financial literacy and financial capability on the part of the consumer, and by the provision of access to products and services on the part of financial product, services and advice suppliers.

Some (such as the Money Advice Service<sup>2</sup>) regard this definition as too narrow, and suggest that financial inclusion encompasses attitudes to and understanding of money and the ability to manage it, as well as access to products and services. Salter (2014) echoes this view, arguing that debt has very different meanings for different people.

### Access to Credit

In Britain, approximately 3% of the adult population has used high cost lending (defined as payday loans, home-collected loans and pawnbroker loans) in the last year (Department for

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<sup>2</sup> Discussion with MAS, 28<sup>th</sup> March 2014



Business, Innovation and Skills (2013), while in Wales 4% of adults have taken out at least one payday loan in previous 12 months to help to meet living expenses (Citizens Advice Cymru and Shelter Cymru, 2013). The figure rose to 11% of 18-24 year olds.

There is a close association between low income and use of high cost credit. People in low income households are much more likely to be rejected for credit cards, overdrafts and store cards than people on higher incomes (Department for Business, Innovation and Skills, 2013), and are therefore much more likely to use high cost credit than other income groups.

The association is also seen in the characteristics of users of high cost credit. In GB, 58% of those using high cost loans had an annual income of less than £25,000, compared with 32% of all users of unsecured credit as Table 3 shows (Department for Business, Innovation and Skills, 2013).

**Table 3      Income and Use of High Cost Credit (GB, percentage of households)**

| <b>Annual household income</b> | <b>Users of high-cost credit arrears</b> | <b>Users of any credit</b> | <b>Total sample</b> |
|--------------------------------|--|----------------------------|---------------------|
| Less than £13,500              | 31                                       | 14                         | 14                  |
| £13,500 > £25,000              | 27                                       | 18                         | 18                  |
| £25,000 > £50,000              | 23                                       | 30                         | 28                  |
| £50,000 +                      | 4  | 16                         | 15                  |
| Not known                      | 14                                       | 22                         | 25                  |

Source: Table B11, Department for Business, Innovation and Skills (2013)

High cost credit users are more likely than other credit users to have applied for mainstream credit products and are much more likely than other borrowers to have had their application rejected (Department for Business, Innovation and Skills, 2013). Similarly, a survey by Bristol University found that only 10% of home credit customers and 24% of online payday loan customers had access to mainstream credit, typically a credit card or overdraft (Collard et al, 2013). Use of high-cost credit appears to be strongly associated with being in financial difficulties. The YouGov DebtTrack survey found that high-cost credit users had high objective and subjective measures of financial problems (Department for Business, Innovation and Skills, 2013): nearly half had four or more types of unsecured credit, many had markedly higher repayment to income ratios than other users of unsecured credit, and high cost credit users were 'very likely' to be experiencing financial stress and feeling heavily burdened. The Wealth and Assets Survey similarly found financial difficulty to be widespread amongst people using pawnbrokers, retail and online payday lenders but, interestingly, not amongst those using home credit (Bryan, Taylor and Veliziotis, 2010).

Bristol University found that nearly half the customers of payday and pawnbroker loans had missed payments on credit commitments or household bills in the previous 12 months (Collard et al, 2013).

The affordability of high cost loans seems to be key. Collard et al (2013) found that 13% of users of short-term credit could not recall being asked for information that could be used to assess affordability. A similar proportion said they were not asked about their income in a survey by Christians Against Poverty and an even higher proportion could not recall being asked about their outgoings (Christians Against Poverty, 2013). Citizen's Advice's (2013) analysis of 600 clients who had used a payday loan found that nine out of ten loans did not comply with the code of practice with 62% of loans being inadequately checked – the higher proportion probably reflects that Citizens Advice clients were seeking help because of their difficulties.

Collard et al (2013) also found use of roll-over loans was common: between a quarter and a third of borrowers had not repaid their most recent loan, resulting in them renewing the loan, borrowing to repay borrowing or losing a pawned item. The Office of Fair Trading (2013) noted that 28 per cent of payday loans are rolled over or refinanced at least once, and that debt advisers say that clients with payday lending debts had on average rolled over at least four times and had six separate payday loans. Citizens Advice (2013) found that 7 out of 10 of its clients with debt problems had been pressured to take out a rollover loan.

Data from providers of debt advice suggests that increasing numbers of clients have difficulties associated with high cost lending. In Wales, StepChange (2012) has noted a 'dramatic increase' in the proportion of its clients with payday loans – up from 2.6% in 2010 to 18.3% in 2013. They also report an increase in the amount owed, with clients on average having a debt of £1,335. Citizens Advice Cymru has noted similar trends amongst its clients.<sup>3</sup> The cumulative impact of having multiple loans and high repayments can be severe, although robust evidence is scarce. The Trussell Trust reports that nearly 10% of vouchers to access its emergency food banks are issued because of debt (Bull and Harries, 2013). Using high cost credit is clearly very strongly *associated* with being in - sometimes considerable - financial difficulty. However, it cannot be said that using high cost credit is *necessarily* the cause of financial difficulties. There are two reasons for saying this. First, lack of access to mainstream credit appears to be associated with existing financial problems which makes the individual a poor risk (e.g. missed payments, a large number of pre-existing loans or low repayment to income ratio). Accessing high cost credit almost

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<sup>3</sup> Citizens Advice Cymru (2014) Personal correspondence

certainly exacerbates these financial difficulties, but is unlikely to be the primary cause alone. Without information on people's routes into and out of indebtedness it is impossible to say more. Indeed Salter (2014) has suggested that the focus on financial services and products distracts attention from the underlying problems of low incomes and high cost of living. Second, people who use high cost credit are only a minority of all people in financial difficulty. As indicated earlier, it is estimated that about 3-4% of adults use high cost credit. Even if it is assumed that **all** high cost credit users are indebted, the proportion is small compared with the total adult population who are estimated to be indebted – 16-18%. Put another way, for every four people who are indebted, only one of them uses high cost credit. Again, without more information on people's pathways into and out of debt, it is impossible to determine why only some of them use high cost credit.

## **Financial capability**

How effectively individuals manage their personal finances generally has been found to be an important influence on how effectively they manage their debts. A lack of budgeting, lack of understanding of the benefits and risks of different sources of credit and ignoring bills and debts are all characteristic of unmanageable debt (Rahim and Arthur, 2012; Money Advice Service, 2013a). Several studies have found that low income households tend to prioritise some debts over others, resulting in 'skeleton debts' – those put in a cupboard and forgotten about (Jones, 2009) - or 'ignorable' debts (Dearden et al, 2010). The Money Advice Service (2013b) found low wage families were particularly prone to 'head in the sand' behaviour.

There is a limited literature on the role of advice in helping people move out of indebtedness but that is outside the remit of this brief.

## Conclusion

It is clear that borrowing is not, in itself, always a problem. About half of households at any one time use credit with most households using it at some point in their lives. Credit only becomes problematic when borrowers face difficulty repaying their borrowing and meeting everyday expenses.

Different measures of over-indebtedness generate slightly different results. The broadest measure is feeling that debt is a heavy burden, while objective measures such as missed payments are narrower. When objective and subjective measures are combined, the best

reasonably up-to-date estimate of the number of people in Wales who are indebted is that produced by the Money Advice Service of 400,000 people - 16% of the adult population.

It is clear that indebtedness is strongly associated with socio-economic disadvantage, with insolvency, self-reported indebtedness and high debt to income ratios being highest in areas with high deprivation. The central and eastern valleys of Rhondda Cynon Taf, Merthyr Tydfil, Caerphilly and Blaenau Gwent have particularly high levels of difficulty. The north Wales coast and some rural areas also indicate higher levels of problems on at least one measure. It must be stressed that there is some level of indebtedness in almost all parts of Wales.

There is a close but complex relationship between low income, financial exclusion and indebtedness. Low income does not, alone, cause indebtedness but it without question significantly increases the likelihood of becoming indebted. **About half of all those who are indebted are on low incomes.**

A low disposable income means households live on much tighter budgets than other households and have few if any savings. Although they do not make greater use of credit than other households, when they do so they have high repayment to income ratios and are more likely to be refused mainstream credit than others.

The process through which households become over-indebted is complex. It typically occurs over a period of time and often involves a 'trigger factor', low financial capability and the affordability of loans.

High cost lending is associated with over-indebtedness with a high proportion of those using such credit experiencing financial difficulties, although they are only a minority of all those in financial difficulty. It is likely that in most instances the financial difficulties pre-dated the use of high cost loans. Without question, high cost lending exacerbates financial problems.

Financial exclusion and over-indebtedness do not cause poverty as measured by usual statistical methods. These focus on overall household income and do not take any account of household outgoings other than housing costs. However indebtedness and financial exclusion make living on a low income very much more difficult, not least because they reduce an already modest disposable income still further. High cost loans in particular typically exacerbate rather than resolve financial difficulties.

This overview has identified a number of issues which are also relevant which are not in the brief, including:

- What are the pathways into and out of indebtedness?

- What is the impact of advice on indebtedness?
- What is the impact of low-cost credit?
- How can the effects of triggers be mitigated?



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