The UK’s household debt problem:
Is there one? - and if so, who’s at risk?

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The UK’s debt problem?

• January is a time of short cold days, high winds…
• …and also a time of media attention to households’ debt problems
• What aspects warrant genuine concern about household debt in the UK?
• Let’s look at:
  – The aggregate data
  – Household data
• A new book on the economics of the consumer credit industry in Europe and the US…
• The macroeconomic story…

• Household debt in the UK has increased rapidly…both secured on property and unsecured…

• But so have disposable income, assets, wealth…
Secured, rather than unsecured debt should be the current concern?

Total Debt as % of Household Disposable Income

- Secured debt as % of HDI
- Unsecured debt as % of HDI
House price increases lead to extra secured debt (‘mortgage equity withdrawal’) with a time lag.
But which are the households ‘at risk’?

• Examine data at the household level on:
  – Use of credit arrangements by type
  – Households’ self-reported debt problems

• Evolution of household debt over time:
  – How the pattern has changed over the last 5 years
  – Tracking individual households – the ‘life cycle’ of debt (and wealth)

• Few household data sets report debt – the Family and Children Survey (since 1999) is an ideal, random survey of a panel of (potential) ‘at risk’ households
Our previous research....

- Research published in *Fiscal Studies* early in 2004 with colleague Sarah Bridges

- Used the *Survey of Low Income Families 1999*: a sample of 5000 families with children: 50% lone parents, 50% low income couples (income not more than 35% higher than tax credit eligibility).

- The survey was subsequently boosted to include a more representative sample of couples with children (*FACS*).

- We update SOLIF families 5 years on (2004) using FACS:
  - The same households (the ‘panel’)
  - Households with same sampling frame in 2004 as 1999

- We look at how their debt situation has changed.
Our families in 1999*

Owners 42%

Tenants 58%

**Use of debt instruments 1999**

**Averages**

**Age:** 37

% working: 0.63

No. of children: 2.1 (couples)

% in couple: 60%

**Averages**

**Age:** 34

% working: 0.33

No. of children: 2.2 (couples)

% in couple: 40%

*That we also observe in 2004*
Owners in 1999

- **Use of debt instruments 1999**
  - Credit cards: 56%
  - Store cards: 31%
  - Loans from finance co.s and banks: 29%
  - Catalogue/mail order: 49%
  - Other: 14%

- **Use of debt instruments 2004**
  - Credit cards: 64%
  - Store cards: 24%
  - Loans from finance co.s and banks: 17%
  - Catalogue/mail order: 34%
  - Other: 14%

- Remain owners by 2004: 92%
- Become tenants by 2004: 8%
Tenants in 1999

Become owners by 2004: 21%

Remain tenants by 2004: 79%

Use of debt instruments 1999:
- 26% Total
- 13% Credit cards
- 25% Store cards
- 59% Loans from finance co.s and banks
- 21% Catalogue/mail order
- 10% Other

Use of debt instruments 2004:
- 26% Total
- 57% Credit cards
- 17% Store cards
- 21% Loans from finance co.s and banks
- 42% Catalogue/mail order
- 23% Other
- 0.7% Other

Credit cards
Store cards
Loans from finance co.s and banks
Catalogue/mail order
Other

Other
Summary on use of credit 1999-2004

- Nearly 60% of our sample of families were tenants in 1999; by 2004 almost half were homeowners
- Owners use credit cards more than tenants
- From 1999 to 2004:
  - Increase in use of credit cards among all groups
  - Especially among homeowners, and fastest among those who became homeowners in the period
  - Corresponding reduction in use of ‘inferior’ types of credit e.g. mail order, catalogues, ‘other’ (e.g. moneylenders, informal loans)
- Why more access to ‘superior’ types of credit?
  - Our sample built up credit history and obtained credit score
  - Home ownership increased (improves credit score)
  - Increased market penetration and better credit scoring methods
Household debt problems

- SOLIF/FACS asks a series of questions about household ‘debt’ problems.
- Whether households are unable to make minimum payments on credit/charge/storecards
- Whether households are unable to keep up with repayments on financial loans, in arrears on utility bills etc.
- Total value of arrears (mostly on loans/bills)
- Stress related to financial problems
Proportion unable to make payment on cards by household type 1999 & 2004
Proportion unable to make repayments on loans by household type 1999 & 2004

Owners 1999: 3%
Owners 2004: 1%
Tenants 1999: 8%
Tenants 2004: 3%
Tenants 1999: 5%
Tenants 2004: 1%
Tenants 1999: 11%
Tenants 2004: 5%
Proportion in arrears on at least one utility bill or council tax by household type 1999 & 2004

- Owners 1999: 17%
  Owners 2004: 8%
- Owners 1999: 27%
  Tenants 2004: 17%
- Tenants 1999: 11%
  Owners 2004: 40%
- Tenants 1999: 11%
  Tenants 2004: 5%
Household debt problems

• Have reduced considerably as sample has aged 5 years

• Least important debt problems (in incidence) arise from credit/charge/store cards

• Debt problems are primarily associated with...

• …being poor

• Purchase of house carries risk of problems with utility bills & council tax

• ‘Revolving arrears’

• Debt problems may also be associated with moving out of home ownership
Priorities in policies towards household debt?

• Cooling-off periods for ‘store cards’?
  – Store cards of declining importance?
  – Effective sharing of credit information should cap overall access to credit

• Banks are ‘too generous’ in offering credit?
  – Arguably, the problem instead is that some households rely on ‘bad’ credit and need ‘good’ credit
  – Credit scoring is getting more sophisticated and this allows identifying of potential clients previously regarded as ‘bad risks’

• Greater importance of secured debt?
  – ‘puts house at risk’

• Bankruptcy alternative – too tough, now too lenient??
Low income households

• Size of ‘home credit’ and unregulated market – less clear from surveys. Our data suggest significant in 1999 but becoming less important over time?

• Looser regulation than credit markets (Farepak)

• Loans to finance shopping vouchers: APRs >400% are common – not regulated?

• Lack of security/collateral leads to high cost ‘doorstep’ lending

• Interest ceilings? OK if eliminates ‘excess’ APRs but issue is - how to price risk? Doorstep selling generates ‘captive’ clients?

• Local credit unions are probably a much better alternative. But regulated sub-prime market provides a ‘route’ to a better credit score for households.
Many debt issues not covered in this talk
An unashamed plug…

• Surveys the economics of consumer credit
• Empirical evidence on credit in Europe & USA
• Secured & unsecured debt in UK
• Bankruptcy
• Credit cards
• Credit industry: regulation, counselling
• Formal and informal enforcement