Over-indebtedness in Britain

A report to the Department of Trade and Industry

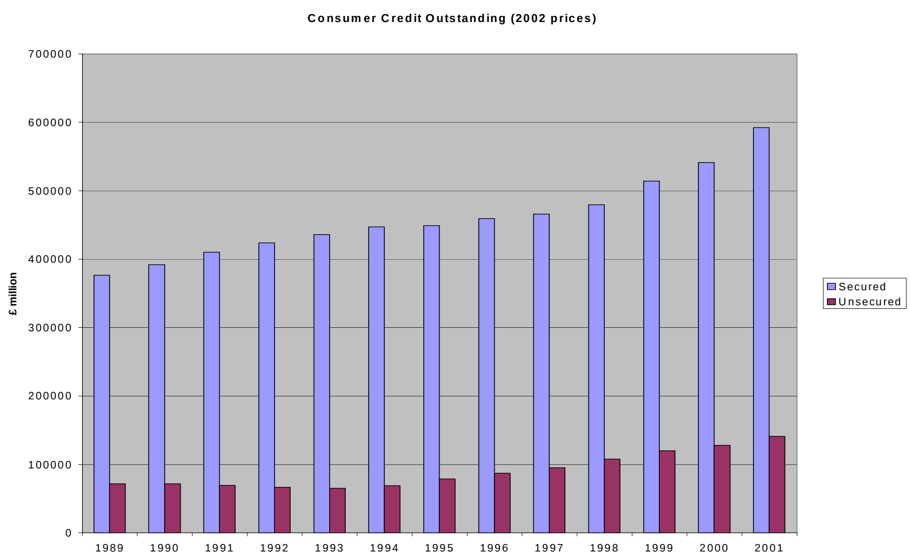
Elaine Kempson
Personal Finance Research Centre
September 2002

Contents

Summary and conclusions

In response to concerns about the level of consumer borrowing, the then Minister for Consumer Affairs set up a Task Force in late 2000 to look at ways of achieving more responsible lending and borrowing. The Task Force recommended that a survey should be undertaken to provide the information it lacked on the causes, extent and effect of overindebtedness. This report presents the results of that survey which questioned 1,647 households nationwide.

Macro-economic statistics record a doubling in the amounts outstanding in unsecured consumer credit in the seven years between 1994 and 2001, even after allowing for inflation. Mortgage lending has also increased markedly over the same period (*Section 1.1).*



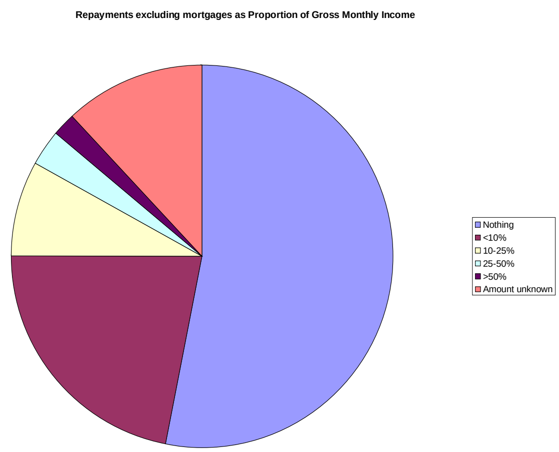
In contrast, national figures indicate no increase in levels of arrears – on the contrary in most instances they seem to have fallen (*Section 1.1*).

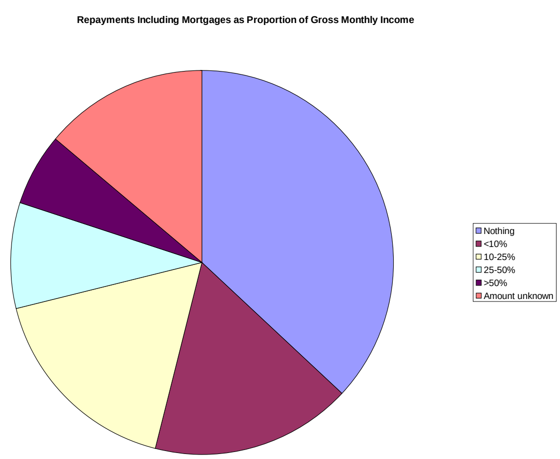
Access to credit was widespread. In the survey, three quarters of all households had credit facilities of some kind, although quite a number of these facilities were not actually being used. For example a third of people had overdraft facilities that they did not use and a similar proportion had credit cards on which they had owed no money following the last statement. Consequently, half of households had credit commitments (that is facilities on which they owed money) at the time they were interviewed. This suggests that there is a very high level of undrawn credit (*Section 2.1*).

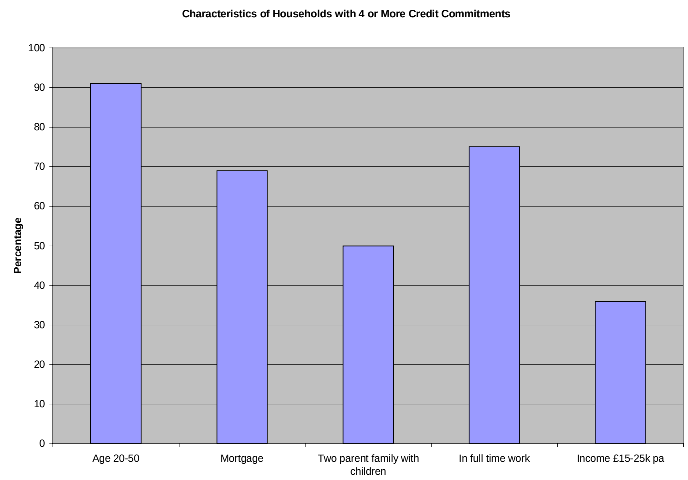
Most households used credit modestly, having only one or two credit commitments, owing modest amounts and paying less than a tenth of their gross income on credit repayments but a small minority were heavy credit users:

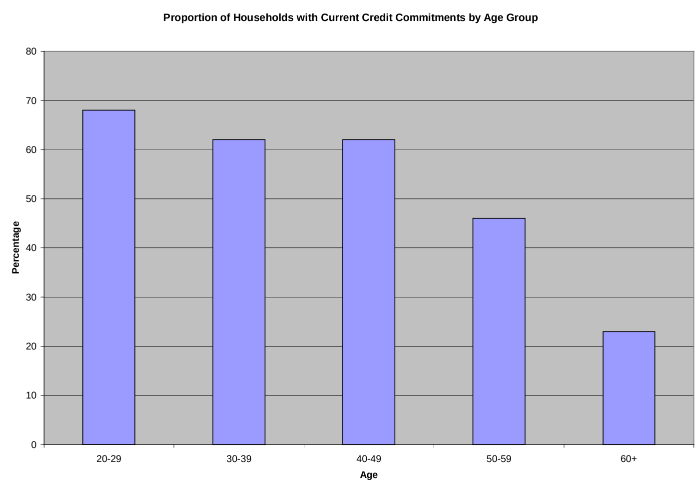
- 7 per cent had four or more credit commitments (*Section 2.1*)
- 5 per cent were spending a quarter or more of their gross income on consumer credit repayments (*Section 2.3*)
- 6 per cent were spending half or more of their gross income repaying their mortgage and other credit commitments (*Section 2.3*).

Credit was used most when people were setting up home and had young children, but its use was high right across most age groups, through to those in their fifties. There was no evidence of young people, still living at home, being especially heavy users of credit (*Section 2.1*).

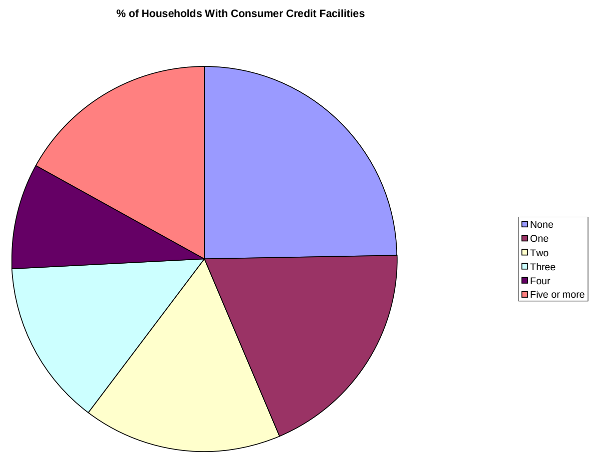


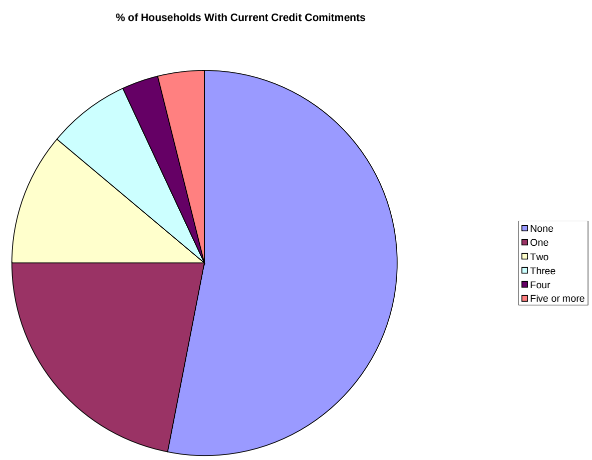




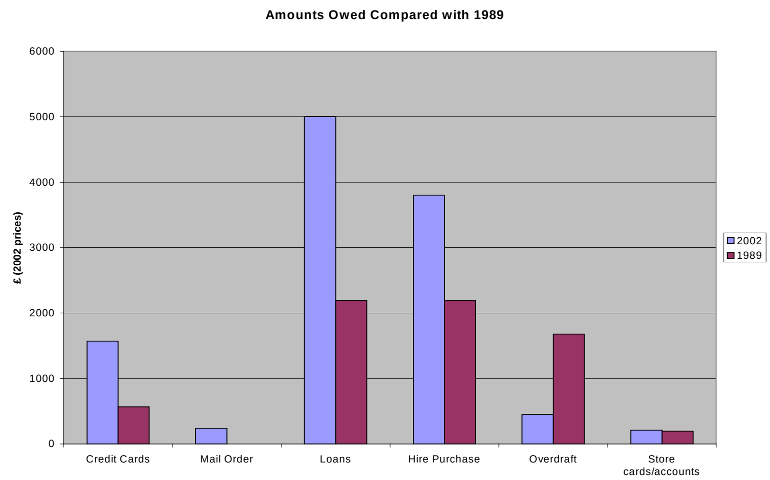


Since the last comparable survey in 1989, the number of households with credit facilities has increased markedly, but the proportion currently repaying credit was about the same. In other words there had been a large increase in the number of households with overdraft and credit card facilities they were not using (*Section 2.4*).





The amounts owed by credit users had, however, increased quite considerably – and especially on credit cards, loans and hire purchase agreements. At the same time, credit cards are increasingly being used in place of cheques or cash and being settled in full each month These two factors taken together seem to account for the increase in gross borrowing recorded by official statistics. In other words, compared with 1989 more people would be at risk in an economic downturn (*Section 2.4*).



Figures for mail order not available for 1989
1989 figures single average for hire purchase and loans

Overall, about a quarter of households reported that they had been in financial difficulties in the last 12 months, including 18 per cent who had been in arrears on one or more of their household commitments, and around two in ten were in financial difficulties at the time of the survey. Levels of current arrears were much lower in Scotland and Wales (7 and 8 per cent respectively) than they were in any of the English regions. The highest levels of arrears were in London, the North East and Yorkshire/ Humberside, all at 17 per cent. A small number (3 per cent) were currently behind with payments on three or more commitments (*Section 3*). More were in arrears with their household bills[1] than had fallen behind with repayments on consumer credit agreements – mainly because far fewer households were repaying credit commitments (*Section 3.4*).

It would seem that the situation is currently stable –over the last 12 months as many households got out of financial difficulty (6 per cent) as saw them start. About 7 per cent of households, however, had been in financial difficulty for more than a year (*Section 3.2*).

Despite low levels of unemployment, the largest single cause of financial difficulties was still job loss. Financial difficulties were also strongly associated with setting up home and having a family. The arrival of a new baby increased the risk of difficulties, as did relationship breakdown. Low and unstable incomes also increased the risk. Nearly half of households having financial problems attributed them to a loss of income and one in seven of households with financial difficulties said it was because they were living on low incomes that were inadequate to meet their needs (*Section 3.6*).

One in ten households with financial difficulties said that over-commitment was the cause of their financial difficulties (*Section 3.6*). Using credit undoubtedly increased the risk of financial difficulties. So that the more credit commitments households had and

[1] Household bills includes mortgages.

the larger the proportion of their income that went on repaying borrowing, the more serious was their level of arrears on household commitments (*Section 3.5*).

There is some evidence for the claims of both irresponsible lending and irresponsible borrowing. Lending practices that are associated both with financial difficulties and with high levels of spending on repaying money borrowed include:

- The automatic raising of credit limits on credit and store cards and on overdraft facilities.
- Encouraging people to transfer balances on credit cards, by offering low initial interest rates and higher credit limits.
- Reducing the minimum payment on credit cards.
- Issuing cheques that can be used to draw on credit card accounts.

These do, however, need to be set in context – each affects a relatively small proportion of high-risk households. But such practices do tend, quite disproportionately, to attract customers who are at a high risk of over-commitment (*Section 4.1*).

At the same time there is clear evidence of borrowers acting irresponsibly:
- borrowing money when already in financial difficulty to pay off other credit or to pay off arrears on bills and other commitments.
- Taking on credit agreements, despite knowing that they will struggle to repay the money.
- And impulsive shopping and credit use by consumers who buy things on the spur of the moment and know they will not be able to repay or do not consider whether they will be able to do so.

Each of these has a strong link both with financial difficulties and with high spending on credit repayments, although again each applies to only a small proportion of all households (*Section 4.2*).

Of particular concern is the fact that, currently, more people are re-financing when they are having difficulty keeping up with payments than are either claiming on payment protection insurance or seeking advice from a free money advice service (*Section 3.8*).

The historically high levels of borrowing are, therefore, problematic for a only small number of people. But a far greater number would, potentially, be at risk of serious difficulties in an economic downturn or a period of sustained increase of interest rates. This underlines the need to find ways of minimising the risks, both by educating consumers about the dangers of borrowing irresponsibly and by changes to the lending practices identified above.

1 Introduction

The level of consumer borrowing in Britain continues to rise to record levels, fuelling concerns that it will end in large numbers of households facing financial difficulties, just as occurred following the last boom in credit use at the end of the 1980s.

In response to these concerns, Dr Kim Howells, then Minister for Consumer Affairs, set up a Task Force on Over-indebtedness, to explore the causes and effects of over-indebtedness and to look at ways of achieving more responsible lending and borrowing. At its first meeting, the Task Force noted the lack of up-to-date statistical information on both the distribution of consumer borrowing across households and the extent of financial difficulties being experienced. In its first report[1], the Task Force recommended that a survey should be commissioned to provide the information it lacked and also to explore the links between specific lending practices and financial difficulties. The survey was undertaken by MORI between March and May 2002. The results were analysed by Elaine Kempson of the Personal Finance Research Centre at the University of Bristol and are reported in subsequent chapters of this report.

Altogether 1,647 householders were interviewed, across Britain[2], and asked for details of both their own credit use and that of their partner, if they had one. Those who admitted to being in financial difficulty or to having fallen behind with any of their credit commitments or household bills were then asked a series of questions relating to the difficulties they had faced. A separate, but linked, survey was also undertaken with 189 young people, aged between 18 and 24. Two thirds of these were 'non-householders', who lived with their parents, the remaining third rented or were buying homes of their own (See Appendix for details of the surveys).

1.1 Consumer borrowing

The last time that any attempt was made to study the distribution of consumer borrowing across households in Britain was in 1989-90 (Berthoud and Kempson, 1992). Then, as now, there was widespread concern about the level of consumer borrowing. After allowing for inflation, the amount outstanding in consumer credit had more than doubled over the 1980s. Not only were more people using credit than ten years previously but

[1] Report by the Task Force on Tackling Overindebtedness. Department of Trade and Industry, 25 July 2001.

[2] A further 400 people living in Wales were also interviewed to enable the Welsh Consumer Council to prepare a separate report on the situation in Wales. Although this report covers people in Wales, it did not include this 'booster' Welsh sample.

they also tended to have a larger number of credit commitments (Berthoud and Kempson, 1992).

Over the same period, mortgage borrowing had almost trebled. In part this was the consequence of an increase in the proportion of households buying their home on a mortgage – stimulated by the *Right to Buy* legislation which led to 1.3 million council tenants buying their home between 1980 and 1989. But it was also the result of a steep rise in house prices over the same period ((Berthoud and Kempson, 1992).

Since that survey, Britain has experienced a deep recession, in the early 1990s. During this time, consumer borrowing levelled off (and declined in real terms) and, for a short time, consumers were even *reducing* the balances on their credit cards. However, by the mid 1990s, levels of borrowing on both mortgages and consumer credit had picked up once more. Levels of outstanding unsecured consumer credit again doubled in real terms in the seven years from 1994 to 2001. Mortgage lending also increased, but not quite so rapidly – rising by a third over the same period. So while the annual increases in consumer credit lending are back to levels seen in the late 1980s, the rise in mortgage lending is somewhat lower (Table 1.1)

Table 1.1 Amounts of consumer credit outstanding December 1989 to December 2001 (at 2001 prices)

£ millions

	Secured	Unsecured		
		All	Credit card	Other
Dec 1989	376,309	71,573	10,584	60,989
Dec 1990	392,008	71,377	12,030	59,347
Dec 1991	409,923	69,534	12,505	57,029
Dec 1992	423,778	66,627	12,552	54,075
Dec 1993	435,952	65,126	13,024	52,102
Dec 1994	447,303	68,946	14,150	54,796
Dec 1995	449,007	78,479	15,920	62,559
Dec 1996	459,328	87,030	18,150	68,880
Dec 1997	465,870	95,478	20,588	74,890
Dec 1998	479,636	107,818	24,525	83,293
Dec 1999	513,952	119,908	34,326	85,583
Dec 2000	541,310	128,317	38,972	89,345
Dec 2001	592,035	141,157	42,802	98,355

Source: National Statistics

1.1.1 Credit cards

The growth in outstanding balances on credit cards has been especially strong. Figures from different sources all show that spending on credit cards now accounts for a much higher proportion of the total consumer credit outstanding than was the case in 1989 (Table 1.1).

Table 1.2 Total number of credit cards in issue December 1989 to December 2001

	Total no. of cards in issue (million)
Dec 1989	28.6
Dec 1990	29.8
Dec 1991	26.8
Dec 1992	26.5
Dec 1993	25.5
Dec 1994	25.7
Dec 1995	29.6
Dec 1996	33.0
Dec 1997	37.1
Dec 1998	40.7
Dec 1999	44.1
Dec 2000	49.7
Dec 2001	55.0

Source: British Bankers' Association

In 1989, the total number of credit cards in circulation was 28.6 million. This fell slightly during the recession in the early 1990s even though the outstanding balances on cards rose in cash terms. This is consistent with qualitative research which has shown that when faced with a fall in income, people either cut up their cards or rely on them to a greater extent to make ends meet (Kempson et al, 1994; Rowlingson and Kempson, 1994). Since the mid 1990s, however, the number of cards in circulation has more than doubled– from 25.7 million in 1994 to 55 million in 2001 (Table 1.2).

Over this time, the proportion of people with cards from more than one provider also doubled, according to the *Financial Research Survey* undertaken by NOP (NOP, 2001). Half of all card holders now have two or more cards (Credit Card Research Group 2001). Most people had been attracted to taking another card by the low introductory rates that have become a feature of the very competitive credit card market, with a number of new entrants. But they varied in their reasons for deciding to take on another card. Some (14 per cent) wanted another card for emergencies, or as a back-up; a similar number (13 per cent) merely wanted a lower interest rate than they were currently paying. One in eight (12 per cent) had taken another card to increase their access to credit (NOP, 2001). A survey for the Credit Card Research Group also found that a small minority (6 per cent) of people taking out an additional card had made their selection based on the level of credit available – most were looking for a lower rate of interest. Indeed, 94 per cent of the people interviewed agreed that the credit card market has become more competitive – to their advantage – in the last two years (Credit Card Research Group 2001).

There is, however, evidence that the market for credit cards may have become saturated. Figures from the British Bankers' Association show that only seven in ten cards in circulation were 'active' – that is they had money outstanding on them – in December 2001 (Credit Card Research Group 2002b).

Table 1.3 Credit card use December 1995 to December 2001

	Number of cards in circulation at Dec (million)	Total outstanding balance at Dec (2001 prices £ bn)	Proportion of balance revolved in Dec	Average annual spending per card (2001 prices)
1995	29.6	14.9	72.8%	£1,594
1996	33.0	17.6	74.9%	£1,617
1997	37.1	20.9	73.0%	£1,594
1998	40.7	25.9	76.1%	£1,604
1999	44.1	30.9	76.1%	£1,659
2000	49.7	36.0	74.5%	£1,770
2001	55.0	40.6	76.9%	£1,662

Source: Credit Card Research Group 2002b

In fact, the level of spending per card has changed very little in the last eight years, and, although the proportion of balances revolved (that is not paid off at the end of the month) has increased, it has not increased by much (Table 1.3). This suggests that the increase in the amounts outstanding on credit cards is due to more cards being used to obtain credit. What we cannot tell from these figures is whether this is because more people are now using credit cards or whether existing card holders have taken on more cards and, in doing so, increased their total level of borrowing.

1.1.2 Ratio of borrowing to income

Interest rates have fallen considerably over the last decade or so – from a peak base rate of 14 per cent at the time of the previous survey of credit use in 1989 to 4 per cent at the end of 2001. Over the same period average incomes have increased faster than the rate of inflation. As a result, the proportion of household income spent on paying interest on money owed has fallen from 14 per cent in 1990 to around 7 per cent in 2001, even though the actual amounts owed have doubled in real terms. In other words, cuts in base rate have balanced out the effects of increased borrowing (Credit Card Research Group, 2002a).

The *Survey of English Housing* has tracked the proportion of gross income spent on mortgage payments since 1993. This shows that falling interest rates have more or less balanced out the effect of the increase in mortgage borrowing to keep the proportion of income spent more or less the same. So in the 2000/1 Survey, households spent 14 per cent of income on their mortgages, compared with 13 per cent in 1993/4 (Department of Transport, Local Government and the Regions, 2001).

1.1.3 Distribution of borrowing across households

While macro-economic statistics give us a clear overall picture of patterns of consumer borrowing, they do not show how borrowing is distributed between households. We do not know whether the increase in consumer borrowing is because more people are using consumer credit than ten years ago, or because the existing pool of users have increased the amounts they have borrowed, or whether both these changes have occurred. This picture can only come from information collected by sample surveys such as the one undertaken for this report. The next chapter looks at this in more detail.

1.2 Financial difficulties

If statistics relating to consumer borrowing are limited, they look extensive when compared with the information on the extent to which households face financial difficulties.

The previous survey in 1989 (Berthoud and Kempson, 1992) was both the first and last attempt to measure systematically the extent of arrears and financial difficulties among households in Britain. Since that survey, Britain has experienced a deep recession in the early 1990s, when rising unemployment, coupled with high levels of borrowing and a rapid increase in interest rates came together to create a level of financial difficulties that was unprecedented in recent years. In the three years from 1991 to 1993 alone, nearly a quarter of a million households had their homes possessed because of mortgage arrears. This is equivalent to 2 per cent of all borrowers.

There are various figures relating to specific areas of financial difficulty but it is impossible to put these together to arrive at an overall picture of how the situation has changed over the past ten years or so.

The most comprehensive statistics are collected by the Council of Mortgage Lenders, who regularly publish figures for the level of mortgage arrears and the number of properties taken into possession. These show that, following the historically high levels of mortgage arrears and possessions in 1991 and 1992, both have fallen dramatically in the last ten years. So, at the end of 2001, just over 1 per cent of borrowers were in arrears of 3 or more months compared with over 5 per cent in 1993 (Table 1.4).

Table 1.4 Mortgage arrears and possessions 1989 to 2001

Percentage of all loans

	3-6 months arrears	6-12 months arrears	12+ months arrears	Taken into possession
1989	na	0.73	0.15	0.17
1990	na	1.31	0.38	0.47
1991	na	1.87	0.93	0.77
1992	na	2.07	1.48	0.69
1993	1.91	1.62	1.50	0.58
1994	1.62	1.28	1.12	0.47
1995	1.69	1.20	0.81	0.47
1996	1.31	0.95	0.63	0.40
1997	1.10	0.69	0.42	0.31
1998	1.19	0.68	0.32	0.31
1999	0.88	0.52	0.27	0.27
2000	0.85	0.43	0.19	0.21
2001	0.71	0.38	0.17	0.16

Source: Council of Mortgage Lenders

The *Survey of English Housing 2000/1* identified 2 per cent of mortgagors in arrears but a further 11 per cent saying that they were having difficulties paying their mortgage (Department of Transport, Local Government and the Regions, 2001). So, although the level of arrears is low, there seems to be no room for complacency.

Similarly, court actions for the recovery of consumer debt peaked in 1991 and 1992 and had halved by the end of 2000, as did the number of county court judgements (Table 1.5) and summonses for Council Tax arrears have fallen by a similar amount (Table 1.6).

Table 1.5 Money plaints[3] in County Courts and County Court Judgements 1989 to 2002

	Money plaints	County Court Judgements
1989	2,358,583	928,526
1990	3,034,923	1,745,402
1991	3,388,753	2,214,645
1992	3,246,173	2,085,772
1993	2,776,150	1,806,126
1994	2,487,377	1,545,933
1995	2,256.670	1,390,140
1996	2,145,958	1,245,830
1997	2,011,642	1,185,367
1998	2,010,606	1,123,568
1999	1,760,308	1,077,499
2000	1,631,966	1,013,044

Sources: Lord Chancellor's Department Judicial Statistics;
Registry of County Court Judgements, Registry Trust

Table 1.6 Council tax arrears in England and Wales 1991-2 to 1999-2000

	Cumulative arrears as % of net amount collectable	Arrears as % of net amount collectable	Summonses as % of accounts	Liability orders as % of accounts	No cases referred for distraint[4]
1991-2	21.0	Na	24	18	7
1992-3	19.2	Na	28	22	9
1993-4	7.9	Na	14	10	3
1994-5	9.3	Na	17	12	5
1995-6	10.9	5.63	17	11	5
1996-7	11.5	5.34	16	10	5
1997-8	10.4	5.14	16	10	5
1998-9	9.5	4.66	15	10	5
1999-2000	9.7	4.52	15	10	6

Source CIPFA Revenue collection statistics 1998-99 and 1999-2000 Actuals

Bucking this trend is rent arrears among social tenants, which has been increasing in recent years, although it fell slightly in 2000/1 to 16 per cent. In contrast, the level of arrears among private tenants has declined by 50 per cent since 1993/4 to 6 per cent

[3] Court actions initiated by creditors to recover money owed
[4] Seizure of goods to cover money owed to creditor

(Table 1.7). However, it should be noted that more than a third of all social tenants said that they had fallen into arrears because of problems with Housing Benefit (Department of Transport, Local Government and the Regions, 2001; Ford and Seavers, 1998).

Table 1.7 Rent arrears in England 1993-4 to 2000-01

Percentage of all tenants

	Social rented			Private rented
	Council	RSL	All	
1993/4	17	17	17	9
1994/5	15	14	15	7
1995/6	15	14	15	7
1996/7	14	15	14	7
1997/8	16	17	16	8
1998/9	17	17	17	8
1999/00	18	18	18	7
2000/1	15	18	16	6

Source Survey of English Housing (DTLR 2001)

All in all, these figures suggest that, having peaked in 1991/2, the level of arrears seems to have fallen. In contrast, though, the number of debt enquiries[5] made at Britain's Citizens Advice Bureaux has increased quite markedly since 1993/4 and all of that increase has related to consumer credit – indeed other categories such as rent/mortgages, taxes and utilities have fallen (Table 1.8).

Table 1.8 Debt enquiries at Citizens Advice Bureaux in England Wales and Northern Ireland 1994-5 to 2000-1

	Consumer	Housing	Utilities	Taxes	Other	All
1994/5	328,803	139,093	85,495	91,031	96,196	740,618
1995/6	366.748	141,453	86.574	87,057	87,911	769,743
1996/7	405,826	132,544	90,696	75,664	85,194	789,924
1997/8	433,385	131,287	89,857	68,007	83,922	806,098
1998/9	510,936	136.905	95,619	66,454	86,435	896,349
1999/00	592,423	132,622	97,241	66,889	88,241	977,416
2000/01	604,006	127,728	93,404	69,342	87,715	982,195

Source: National Association of Citizens Advice Bureaux Annual Reports

The number of calls made to the Consumer Credit Counselling Service has also increased steeply – from 65,000 in 1999 to 149,000 in 2001 – although it should be noted that this includes unsuccessful calls, which may have increased disproportionately with a rise in enquiries.

These figures would seem to suggest one of two things. Either free money advice agencies are attracting a greater proportion of the people with problems repaying consumer credit – possibly as a result of the extensive advertising by fee charging debt management companies who refer considerable numbers of people to free advice

[5] These figures relate to the number of *enquiries* not to the number of people. So one person, owing money to six creditors would be recorded as six separate enquiries.

agencies (Whyley and Collard, 1999). Or there is a growing number of people who are having difficulty repaying the money they owe.

As with consumer borrowing it is not possible, using the figures we have, to determine the extent to which the same people default on different types of commitment. Consequently we cannot identify whether financial difficulties are widespread or concentrated among a small number of households. Again this information can only come from sample surveys and Chapter 4 looks at this in some detail, as well as exploring the consequences of financial difficulties for the households affected.

1.3 Responsible lending and borrowing?

A key question for both the Task Force on Over-indebtedness and this research is the extent to which financial difficulties relate to either irresponsible lending on the one hand or to irresponsible borrowing on the other. Concerns have been raised about a number of factors, from the high (and rising) levels of borrowing for debt consolidation, to unsolicited increases in credit limits on credit cards and overdrafts and the apparent ability of some people who are already over-committed to arrange further borrowing. There is equal concern about people who try to borrow their way out of financial difficulty, rather than seeking advice from one of the free money advice services. These and other areas of concern are explored in Chapter 4.

2 Consumer borrowing

Access to credit has widened since the last survey in 1989 but there is evidence of considerable over-supply. At the same time there has been a shift in the types of credit people use. Credit cards are now more widely used, while hire purchase and the purchase of goods in instalments from mail order catalogues seems to have declined. People's attitudes to credit have softened, increasing credit use for consumerism but this seems to have been counterbalanced by a lower level of borrowing through need. This chapter explores the extent of credit use, the types of credit used and the amounts borrowed, including expenditure on regular repayments. In doing so, it seeks to identify how many households are currently over-borrowed. It then looks at how the extent and nature of borrowing has changed since 1989 and finally at attitudes to borrowing.

2.1 Extent of borrowing

Access to consumer credit was widespread. Three quarters of all households had current consumer credit facilities of some kind, with one in six having five or more (Table 2.1). However, quite a number of these facilities were not actually being used at the time of the survey. A third of people had overdraft facilities but were not overdrawn and a similar number had credit cards that had been repaid in full following the last statement. A small number (one in twenty households) had store cards on which nothing was owed. Taking these into account, just under half of all households had at least one credit commitment that they were repaying at the time they were interviewed. On average, these users had just over two current commitments each, with a small minority (4 per cent) having five or more.

Table 2.1 Level of consumer credit facilities and current credit commitments

Column percentages

	Credit facilities	Current credit commitments
None	25	53
Any	75	47
One	19	22
Two	17	11
Three	14	7
Four	9	3
Five or more	17	4
Ave number (all credit users)	3.1	2.1
Base: All households	*1,647*	*1,647*

The proportion of households with credit facilities was highest in the more prosperous South East and eastern regions, but these were also the ones with the highest levels of unused facilities. Consequently, it was not possible to discern a clear regional pattern of credit use, with the exception of Scotland, where it was particularly low. A third (32 per cent) of Scottish households had current credit commitments compared with nearly half (47 per cent) in the UK as a whole and they had an average of 1.5 commitments each compared with 2.1 across the UK.

2.1.1 Characteristics of consumer credit users

Levels of credit use were highest among householders in their twenties, two thirds of whom had an average of 2.6 current commitments (Table 2.2). Householders in their thirties or forties made only slightly less use but then use declined steeply with age. Consequently only a quarter of householders aged over 60 had a current credit commitment.

There has been particular concern, in some sectors of the media in particular, at the level of borrowing among young people. In fact, it was the young people living as independent householders who were the heavy credit users. Young people living in their parents' home had average levels of credit use. The use of credit by people in their late teens was below-average. Four in ten of them had current credit commitments, with an average of 1.5 commitments each (Table 2.2).

Credit use was highest among families with children, and especially among lone parents, three quarters of whom had current commitments. The arrival of a new baby was clearly linked to higher than average levels of use. At the other end of the scale, few single pensioners had any credit commitments currently (Table 2.2).

In other words, credit is used most when people set up home and when they have young children.

Mortgagors were heavier users of credit than either social tenants or tenants in the private sector. On the whole, householders in work were more inclined to credit use than those who were not working. However, among the non-workers there were some quite substantial differences. Seven in ten householders caring for a family full-time (who will tend to be lone parents) were current credit users, as were more than half of unemployed householders. On the other hand, retired people and those unable to work through long-term ill-health or disability used credit much less often (Table 2.2).

There was no obvious link with income, either for non-pensioners or for pensioners, although use of credit did increase with income instability. Increased use was associated with both rises in income and with falls, but the greatest use of all was among householders who had experienced both a rise and a fall in income in the past 12 months (Table 2.2).

Table 2. 2 Level of current credit commitments and unused facilities by household characteristics

*Cell percentages(columns3 and 5) **

	Current commitments		Unused credit facilities		*Base*
	Proportion of households	Ave number currently	Proportion of households	Ave number unused	
All	***47***	***2.1***	***44***	***1.6***	*1,647*
Age					
20-29	68	2.6	38	1.6	*208*
30-39	62	2.4	51	1.7	*293*
40-49	62	2.4	49	1.7	*294*
50-59	46	1.8	51	1.7	*262*
60 and over	23	1.5	36	1.5	*576*
Family Type					
Single pensioner	15	1.5	26	1.4	*249*
Pensioner couple	28	1,5	47	1.5	*263*
Single non-pensioner	47	2.0	44	1.5	*187*
Non-pensioner couple	53	2.2	52	1.8	*209*
Lone parent	74	2.2	21	1.3	*98*
Two-parent family	66	2.5	52	1.7	*370*
Other	49	1.9	44	1.7	*192*
Household changes in last 12 months					
New baby**	64	2.1	54	1.5	*53*
Other change	58	2.2	50	1.7	*183*
No change	44	2.1	42	1.6	*1,425*
Housing tenure					
Mortgagor	61	2.3	56	1.7	*675*
Outright owner	24	1.7	51	1.6	*461*
Social tenant	48	2.1	17	1.2	*362*
Private tenant	45	1.9	28	1.4	*148*
Economic activity status					
FT work	58	2.4	54	1.6	*739*
PT work	61	2.1	39	2.0	*116*
Unemployed	55	2.0	34	1.7	*81*
Caring for family/home**	72	2.1	23	1.3	*65*
Sick/disabled	44	1.9	26	1.4	*99*
Retired	21	1.5	37	1.5	*501*
Other**	46	2.0	37	1.9	*46*
Gross household income (non-pensioners)					
Under £5,000	61	2.3	34	1.6	*148*
£5,000-£7,499	57	2.8	32	1.6	*98*
£7,500-£9,999	59	2.0	32	1.5	*81*
£10,000-£14,999	65	1.9	38	1.6	*137*
£15,000-£24,999	59	2.7	53	1.5	*125*
£25,000-£34,999	66	2.3	67	1.9	*169*
Over £35,000	58	2.1	71	1.9	*190*
Gross household income (pensioners)					
Under £5,000	18	1.4	17	1.3	*89*
£5,000-£7,499	23	1.3	31	1.3	*128*
£7,500-£9,999**	20	1.9	25	1.3	*59*
£10,000-£14,999**	22	1.5	37	1.5	*66*
Over £15,000**	30	1.1	77	1.5	*44*
Changes in income in last 12 months					
Fall	55	2.2	50	1.6	*246*
Rise	52	2.1	49	1.8	*540*
Both rise and fall	74	2.7	54	1.6	*102*
No change	36	2.0	36	1.5	*760*
Young people's sample					
Aged 18-19**	40	1.5	18	1.1	*62*
20-24	63	2.3	29	1.2	*127*
Householder**	66	2.5	28	1.3	*65*
Non-householder	50	1.9	24	1.1	*124*

*** eg 68 per cent of householders in their twenties had credit commitments and 38 per cent of them had unused credit facilities***

***** numbers very small so use with caution***

2.1.2 People with large numbers of credit commitments

A small number of households (4 per cent) had five or more credit commitments currently. These heavy credit users were drawn disproportionately from home-owning families, with middling incomes from work. Nine in ten (91 per cent) of them were aged between 20 and 50; and half (50 per cent) were two-parent families with children. Three quarters (75 per cent) of them were in full-time work, with almost four in ten (36 per cent) having gross household incomes that were between £15,000 and £25,000 a year. Seven in ten (69 per cent) were buying their home on a mortgage.

2.1.3Unused credit facilities

As noted above, there was clear evidence of a high level of undrawn consumer credit. Altogether more than four in ten households had overdraft facilities or plastic cards they were not currently using for credit and, on average, they had 1.6 sources of unused credit each. Looked at another way, for every 100 credit sources that were being used at the time of the survey, there were another 72 that were not in use.

So, bringing together the figures on credit facilities, current credit commitments and unused facilities we find that:

- 25 per cent of households had no credit facilities at all
- 28 per cent have facilities but did not use them for credit
- 15 per cent used some but not all of the facilities they had
- 32 per cent used all the credit facilities at their disposal

The level of undrawn consumer credit tended to be greatest among the same types of household as were the heaviest credit users: that is, two parent families with children, mortgagors, people in full-time work and high earners. The small number of higher income pensioners also had very high levels of undrawn credit. It was, however, more constrained among young people, especially if they were in their teens or still living at home. (Table 2.2).

2.2 Types of credit used

Credit cards were the most common credit commitment, with nearly one in five households revolving balances on one or more credit cards. The average amount owed by these people on their cards was £1,570 (Table 2.3).

Almost as common were goods bought on credit from mail order catalogues and cash loans from a range of sources. But although similar proportions of households used each of these sources, the amounts of money owed on them were quite different. At £240, the money owed on mail order catalogues was the second lowest of all the main types of credit, while loans, at £5,000, represented the highest amount.

Table 2.3 Types of credit in use and average amounts owed per household

	Proportion of households with current commitments		Average amount owed per household (adjusted to 2002 prices)	
	2002	**1989**	**2002**	**1989**
Credit cards	19	15	£1,570	£565
Mail order	17	23	£240	na
Loans	15	16	£5,000	*£2,190
Hire purchase/credit sale	13	17	£3,800	*
Overdraft	9	12	£450	£1,676
Store cards/accounts	8	7	£210	£197

* either loan or HP

Hire purchase or credit sale agreements were only slightly less common and the amounts involved were relatively high (£3,800). Least common were overdrafts and store cards and the amounts owed on each were also quite low.

There were some interesting variations in the types of householder using these different types of credit. Credit cards tended to have a relatively better-off clientele drawn disproportionately from householders in full-time work (30 per cent of whom used a credit card for revolving credit); in their forties (32 per cent); two parent families (31 per cent) and mortgagors (32 per cent). They were also much used in households whose income had both fallen and risen during the year (38 per cent). Young people, were not heavy users, particularly if they were in their late teens (8 per cent) or still lived at home (16 per cent).

In contrast, use of mail order catalogues to buy items on credit declined steeply with income and was most common among low-income households. This included lone parents (43 per cent); two-parent families with children (27 per cent); social tenants (25 per cent). Catalogues were also the main source of credit for two groups that otherwise made little use of credit: two thirds of credit users who were unable to work through long-term ill-health or disability were paying for items bought through a mail order catalogue, as were half of the retired credit users.

Overdrafts were especially common among young householders in their twenties (24 per cent) but then declined steeply with age so that only 1 per cent of householders aged over 60 were overdrawn. They were the main source of credit for young people in their teens (23 per cent) and for young people aged under 25 who were still living at home (23 per cent). Overdrafts were also strongly associated with unstable incomes: 27 per cent of households whose incomes had both increased and decreased during the past twelve months had overdrawn their current accounts.

Loans were most common in lone parent households (33 per cent); two-parent families (26 per cent); families with a new baby in the past 12 months (32 per cent); and those whose income had both fallen and risen over the past 12 months (38 per cent). Similar factors were associated with use of hire purchase, with the exception of lone parents whose use was low. In fact, there were some marked differences in the source of loans for these groups. Three quarters of two-parent families had borrowed from a bank or building society. In contrast, half of lone parents had borrowed from the Social Fund (a source of interest-free credit available to people claiming Income Support) and a quarter had taken out a loan with one of the weekly collected credit companies that predominantly lend in low-income neighbourhoods.

2.3 Amounts owed

The majority of households owed little or nothing on consumer credit commitments at the time they were interviewed. The average amount owed by households with current credit commitments was about £3,500, but a small minority owed quite considerable sums, including 4 per cent owing in excess of £10,000 (Table 2.4).

.

Table 2.4 Amounts owed in consumer credit (excluding mortgages)

Column percentages

	Amounts owed
Nothing	53
Up to £500	16
£500 to £1,500	7
£1,500 to £3,000	5
£3,000 - £7,000	7
£7,000 - £10,000	3
£10,000 or more	4
Don’t know amount	4
Base: All householders	*1,647*

The larger sums, however, tended to be owed by people on the highest incomes, so a more meaningful indication of over-borrowing is the proportion of a household’s monthly income being spent on credit commitments. This was calculated in two ways: the proportion being spent just on repaying consumer credit and the proportion spent on both consumer credit and mortgages (Table 2.5). (The amounts included for credit and store cards were the minimum amounts that people would have needed to pay on their last statement, overdrafts were not included).

At least three quarters of households were spending less than 10 per cent of their gross monthly income on consumer credit repayments. But in one in twenty cases it represented more than a quarter of the money they had coming in – or more than a third of their disposable income after income tax and national insurance (Table 2.5).

Table 2.5 Repayments as a proportion of gross monthly income

Column percentages

	Repayments excluding mortgages	Repayments including mortgages	Repayments including mortgages (mortgagors only)
Nothing	53	37	-
Up to 10%	22	17	15
10% to 25%	8	17	31
25% to 50%	3	9	18
50% or more	2	6	14
Amount unknown	12	14	22
Base: All householders	*1,647*	*1,647*	*675*

Rising levels of mortgage borrowing have, like consumer credit spending, given rise to worries about possible over-commitment. Yet, as discussed in the previous chapter, very low interest rates mean that borrowing is more affordable than at any time since the credit boom in the 1980s. Consequently, as the second column in Table 2.5 shows, more than half of all households spent less than a tenth of their gross income on their combined mortgage and consumer credit repayments. One in seven spent more than a quarter, and one in twenty more than half their gross income (equivalent to more than two thirds of their disposable income after income tax and national insurance) (Table 2.5). Restricting this analysis to households that were buying their home on a mortgage (third column of Table 2.5), we can see that twice as many had committed themselves to high levels of repayment than was the case among householders as a whole, with one in seven paying more than half their gross income in this way.

2.3.1 People with high levels of repayments

The types of people who were over-represented among households whose credit commitments came to over a quarter of their income were, in many respects, similar to those with large numbers of credit commitments. Indeed, there was a fair degree of overlap between the two groups. Two thirds of people with high repayment levels had three or more current credit commitments – the average number among them was 3.6.

So nearly half (46 per cent) were two-parent families; six in ten (61 per cent) were buying a home on a mortgage and most were in work, although only 56 per cent worked full-time. Incomes tended to be rather low, even among non-pensioners almost six in ten (57 per cent) had gross incomes of £7,500 or less and only one in twenty had incomes of £25,000 or more. Moreover, three in ten (30 per cent) had had a fall in their income in the past 12 months – although a similar number had seen their income rise. Very few young people had borrowed to this extent.

This suggests that there were three main groups of households. The two largest were households on low or low-to-middle incomes who had borrowed small amounts, but the repayments on which represented a large proportion of their income; and those who had experienced a drop in income, leaving them with commitments that were hard to meet. The third, and smallest, group comprised people on middle to high incomes who had borrowed large sums.

The most common sources of credit among households with high credit repayments were mail order catalogues (used by 48 per cent of them) and credit cards (used by 43 per cent). But the sources that were disproportionately associated with high repayments were loans (45 per cent) and HP (38 per cent), which as we saw above were the largest of the commitments people took out, and overdrafts (28 per cent), which tended to be associated with over-commitment.

Of some concern is that even among the households already paying quarter or more of their income to service credit commitments, half (51 per cent) had unused credit facilities. On average these people had 1.6 such facilities each.

A very similar picture exists for those who were repaying half or more of their income in either consumer credit or mortgage repayments.

2.4 Changes in credit use since 1989

The proportion of households with credit facilities has increased markedly since1989, when the last broadly comparable survey was undertaken – from 61 per cent to 73 per cent. On the other hand, neither the proportion of households with current commitments nor the average number of current credit commitments has increased. In fact, four times as many households currently only have credit facilities they do not use (28 per cent, compared with 7 per cent in 1989).

In other words, the large increase in consumer borrowing is not due to a larger proportion of the population owing money. It is, however, partly accounted for by money owed on credit cards that will be repaid in full when the statement is received, as there are now many more credit cards in circulation. In 1989, 39 per cent of households had a credit card, with 13 per cent having two or more. By 2002 the proportion of card-holding households had increased to 52 per cent and the proportion with two or more to 21 per cent. And, as noted in the previous chapter, nearly a quarter of the outstanding balance on cards is settled in full each month.

Although the proportion of households using credit has not changed, there has been a shift in the types of credit used over the past 13 years. Compared with 1989 the level of use of credit cards as a source of revolving credit has increased, while both credit purchases from mail order catalogues and hire purchase have declined. The proportion of households overdrawn on their bank or building society account is a good deal lower, but the proportion with loans has remained substantially unchanged (Table 2.3).

Most of the increase in consumer credit outstanding has arisen because the people who use credit now owe far larger sums than their counterparts in 1989. Unfortunately, the

1989 survey did not calculate a total level of borrowing, although it did give the amounts owed on most types of consumer credit (Table 2.3). From this it is possible to see that, not only do more people use credit cards than in 1989, but the outstanding balances have increased markedly even after allowing for inflation[1]. Similarly, the amounts owed on loans and hire purchase have grown way ahead of inflation. Only the size of overdrafts has fallen since that time.

This higher level of borrowing is reflected in the proportion of income being spent on repaying consumer credit commitments. Although the figures are not directly comparable, households were paying smaller proportions of income on consumer credit commitments in 1989 even though, at that time, the prevailing interest rates were more than double the level in early 2002 (Berthoud and Kempson, 1992).

2.5 Subjective views of the level of borrowing

Towards the end of the interview, when all credit commitments had been discussed in detail, respondents with mortgages or current credit commitments were asked for their own view of their level of borrowing. The majority of people interviewed felt comfortable with the level of borrowing in their household, although four in ten would not want to borrow any more. A minority (4 per cent) said that they felt they had already borrowed more than they could afford (Table 2.6a).

There was no obvious link between people's views and the amounts that they owed in consumer credit although there *was* a link with the proportion of their gross income that they were spending on repayments – and especially so when that excluded mortgages (Tables 2.6a and 2.6b). The more of their income being devoted to credit repayments the more likely people were to say either that they felt unable to borrow any more or that they had already borrowed too much. Even so, one in six people paying a quarter or more of their income on consumer credit repayments (Table 2.6a) said that they could afford to borrow more if they wanted or needed to do so. So, too, did nearly three in ten people spending more than half of their income on credit and mortgage repayments (Table 2.6b).

Table 2.6a Views of levels of borrowing by proportion of income spent on repaying consumer credit

Column percentages

	Under 10%	10-25%	25-50%	All households
Can afford to borrow more	32	24	16	51
Would not want to borrow more	58	63	63	44
Already borrowed too much	7	12	22	4
Don't know	2	1	-	2
Base: All households	*363*	*134*	*79*	*1,647*

[1] This is consistent with industry figures showing that balances on credit cards have doubled in the past five years (Bailey, 2002)

Table 2.6b Views of levels of borrowing by proportion of income spent on repaying mortgages and consumer credit

Column percentages

	Under 10%	10-25%	25-50%	Over 50%	All households
Can afford to borrow more	39	34	30	28	51
Would not want to borrow more	53	57	59	60	44
Already borrowed too much	6	7	9	13	4
Don't know	2	2	2	-	1
Base: All households	*278*	*277*	*146*	*102*	*1,647*

2.5.1 People who believed they had over-borrowed

As noted above, around one in twenty five people (4 per cent) said that they felt that they had borrowed more than they could really afford. Although the numbers are small for detailed analysis, some of their characteristics stand out. They were drawn disproportionately from:

- householders aged under 30;
- single non-pensioner householders and lone parents in particular;
- tenants in all sectors;
- low-income non-pensioner households – with gross household incomes of £15,000 or less, and
- non-pensioner households where the household head was either not in employment or was working only part-time.

A third of the people who believed they had over-borrowed had experienced a fall in income in the past 12 months.

It should also be noted that one in nine (11 per cent) of young people, aged under 25, thought that they had over-borrowed. But it was much higher for those in their early twenties (14 per cent) than it was for the ones in their late teens (6 per cent); it was also higher for the young householders (16 per cent) than it was for those living with their parents (11 per cent).

As we shall see later, there was a very strong relationship between people's views of their levels of borrowing and their likelihood of being in financial difficulties. This applied especially to people who said that they had borrowed more than they could really afford, but also to a lesser extent to those who felt that their level of borrowing was about right, but would not want to borrow more.

2.6 Attitudes to borrowing

Attitudes to borrowing might be expected to play an important role in people's propensity to borrow. When asked to indicate their overall attitude to using credit, the largest group of people saw it as something that is occasionally necessary. Around one in five were very positive, saying that credit is a convenient or sensible way of buying things, and they were somewhat outnumbered by people who believed that credit is never a good thing (Table 2.7). Even among the under 25s, only 27 per cent saw credit as either convenient or sensible.

There has been a slight shift in attitudes since this same question was asked in a comparable survey in 1989, when there was a great deal of adverse publicity about the 1980s credit boom. In 2002, fewer people held the view that credit is never a good thing and there were increases in the proportions who saw it as occasionally necessary or a convenient way of buying things (Table 2.7).

Table 2.7 Overall attitude to credit, 1979, 1989 and 2002

Column percentages

	1979	1989	2002
A sensible way of buying	7	6	6
A convenient way of buying	20	12	16
Occasionally necessary	42	37	45
Never a good thing	31	43	31
Don't know	-	2	2
Base: All householders	*775*	*2,843*	*1,647*

Sources: 1979 National Consumer Council, 1981; 1989 Berthoud and Kempson, 1992; 2002 Survey data

As interesting is the fact that attitudes now mirror much more closely those of people surveyed in 1979, when the credit market was really very different; credit and store cards were much less common and deregulation had only just begun.

Previous research has found a strong link between attitudes and age (Berthoud and Kempson, 1992). The present survey has confirmed this link, with householders in their thirties and forties being the most in favour of credit. Looking across the age groups it is clear that there have been two influences on changing attitudes. First, there is a cohort effect. So older householders, who held the most negative views in 1989, have died and been replaced by a generation of new householders with more positive attitudes to credit. At the same time, though, there has been a clear shift in attitudes across the population. In other words, people in all age groups tend to be more positive about credit now than they were thirteen years ago.

On the whole, the shifts in attitudes have been rather subtle. In the present survey, as in 1989, people were asked whether they agreed or disagreed with a range of statements regarding consumer credit (Table 2.8). In all cases broadly similar numbers agreed with these statements, but attitudes seemed to have softened somewhat. Fewer people in 2002 either agreed strongly with negative statements or disagreed strongly with positive ones.

Table 2.8 Attitudes to credit in 1989 and 2002

Cell percentages

	1989	2002
Credit encourages you to buy things you don't really need		
Agree strongly	60	39
Tend to agree	22	43
The amount of credit you can get should be linked to the amount you earn		
Agree strongly	76	47
Tend to agree	14	42
If you lose your job, having outstanding credit commitments can make the situation much worse		
Agree strongly	89	63
Tend to agree	7	30
There should be tighter controls on advertising credit		
Agree strongly	76	53
Tend to agree	8	32
Credit limits on credit cards should only be increased at the customer's request, not automatically		
Agree strongly	76	55
Tend to agree	12	33
Credit makes financial planning and budgeting easier		
Disagree strongly	34	10
Tend to disagree	20	31
Base: All householders	*2,843*	*1,647*

This moderation in attitudes to credit was reflected in the overall score[2] that was calculated from these questions both in 1989 and in 2002. Based on their replies, one in ten (10 per cent) of the people interviewed in 2002 were judged to be 'in favour of credit', compared with a quarter (24 per cent) in 1989. At the same time, the number who were considered to be 'against credit' had also fallen – from a quarter (25 per cent) in 1989 to one in eight (12 per cent) in 2002. Consequently, the proportion with 'medium' attitudes had increased from half (51 per cent) in 1989 to nearly eight in ten (78 per cent) in 2002. In other words, more people were cautiously in favour of using credit – perhaps seeing it as a part of everyday life.

[2] Each of the questions was scored so that the most favourable answer scored 10 and the most unfavourable one zero. The householder's overall attitude was calculated as an average of these scores and they were then assigned to one of three groups:

'Against credit'	up to 1.8 points
'Medium'	1.9 to 4.4 points
'In favour of credit'	4.5 points or more

Note that these cut-off points were designed in 1989 simply to identify the top and bottom quarters of the scores.

2.6.1 Attitudes of heavy credit users

In addition, the interview included a range of other attitude statements, two of which were strongly and positively linked to levels of borrowing:

- *It is inevitable that you will get into debt these days*
  (62% of all agree; 55% owe nothing agree; 80% repayments over quarter of income agree)

- *I am impulsive and tend to buy things even though I can't always afford them*
  (18% of all agree; 11% owe nothing agree; 33% repayments over quarter of income agree)

In addition the following attitude was linked negatively to levels of borrowing:

- *I am a saver not a spender*
  (45% of all agree; 57% owe nothing agree; 19% repayments over quarter of income agree)

Together these paint a fairly clear picture of the views of heavy credit users and we return to them in Chapter 4, where we look at responsible borrowing.

2.7 Need to borrow

Previous research has shown that consumer credit is generally used for one of two reasons: to finance consumerism and, among those on low incomes, to pay for essentials (Berthoud and Kempson, 1992).

The people interviewed were asked how often they found themselves short of money so that they had trouble until the next pay day. Overall 8 per cent ran short of money 'more often than not' and a further 18 per cent did so 'sometimes'. This is a considerable drop from 1989, when 18 per cent said that they ran short of money 'more often than not' and 20 per cent sometimes ran out. Notably, pensioners, social tenants, lone parents and unemployed people were all less likely to run short than their counterparts thirteen years ago. There are a number of explanations for this. More pensioners now have an occupational pension and the income of those who do not has been increased by the introduction of the Minimum Income Guarantee. People of working age have seen their wages rise faster than inflation. While those at the bottom end of the income distribution have benefited both from the introduction of the minimum wage and the Working Families Tax Credit. At the same time, the number of people who are unemployed has fallen, as has the average length of time they spend unemployed.

Together, this suggests that fewer people might have needed to borrow in 2002 than was the case in 1989. This may have cancelled out the effect of an increased willingness to borrow and kept the proportions of people using credit broadly the same. Certainly it would explain the fact that fewer households were overdrawn and the smaller size of the average overdraft.

2.8 Summary

Although three-quarters of all households had credit facilities, only half had credit commitments at the time they were interviewed. Indeed, there was clear evidence of a high level of un-drawn consumer credit with 72 unused credit facilities for every 100 in use.

Credit cards were the most commonly used source of credit, but the largest amounts were owed on loans and hire purchase agreements. Use of mail order catalogues to spread the costs of purchases was especially common among those who used little credit.

Most users of credit had only one or two credit commitments, owed modest amounts and were paying less than a tenth of their gross income on credit repayments. However, a small number of households were heavy credit users: with five or more current commitments; owing £10,000 or more; or spending a quarter or more of their income on repaying consumer credit. Each of these groups accounted for around one in twenty households, and there was some degree of overlap between them. These heavy users spanned all ages from twenty to late fifties, but were disproportionately two-parent families with children, who were buying their home on a mortgage. They tended to fall into one of three groups. The two largest groups were households with low-to-middle incomes, who had borrowed relatively small amounts of money, although the repayments were a high proportion of their income; and households who had experienced a drop in income in the past 12 months, leaving them with high levels of credit use relative to their incomes. The smallest group were people on middle to high incomes who had borrowed large amounts.

There was no real evidence that young people, aged under 25, were heavy credit users.

Of some concern is the fact that half of households spending a quarter or more of their gross income on credit repayments had unused credit facilities and one in six felt able to borrow more should they want or need to. However, this needs to be set in context – only 1 per cent of all households were already heavily-borrowed but prepared to borrow further.

Attitudes towards credit had become marginally more positive since 1989. Even so, the increase in consumer borrowing, recorded in official statistics, is not explained by larger numbers of households using credit, but rather by the larger sums of money borrowed by those who are credit users. Part of the increase is also explained by the fact that more households now have credit cards but repay them in full each month.

3 Extent and nature of financial difficulties

Given current levels of apparent prosperity, a surprising number of householders admitted to having financial problems. Overall, a quarter of households (24 per cent) had been in financial difficulties of some kind over the past 12 months; and two in ten (20 per cent) were still in difficulty at the time they were interviewed (Table 3.1)[1].

Of those currently in difficulty, two thirds were actually in arrears and one third were struggling but said they were not currently behind with any of their regular commitments (Table 3.1). A small number of households (3 per cent) were currently in arrears with three or more commitments.

Table 3.1 Extent of financial difficulties

Column percentages

	In past 12 months	**Now**
No financial difficulties at all	76	80
Financial difficulties but no arrears, of whom	6	7
in arrears in past 12 months	..	2
not in arrears in past 12 months	..	5
In arrears, of whom	18	13
1 commitment in arrears	9	7
2 commitments in arrears	4	3
3 or more commitments in arrears	6	3
Average number of arrears (those with any)	2.4	1.9
Base: All households	*1,647*	*1,647*

.. - not applicable

Levels of current arrears were much lower in Scotland and Wales (7 and 8 per cent respectively) than they were in any of the English regions. The highest levels of arrears were in London, the North East and Yorkshire/Humberside (17 per cent).

[1] These figures were calculated from answers given throughout the interview on specific household commitments. They include people who said they had fallen behind with payments on one or more of their commitments and those who were facing difficulty reducing the balances on overdrafts and credit cards and those who said they had borrowed to pay off debts.

3.1 Subjective assessments of financial situation

As with borrowing everyone interviewed was asked to assess their own financial situation. First of all, they were asked at the beginning of the interview how well they were managing financially. Six in ten said that they were keeping up with all of their bills and commitments without any difficulties. Almost three in ten said that they were keeping up to date but it was sometimes a struggle, leaving 12 per cent of households who said that they found it a constant struggle, including 3 per cent who said they were falling behind with payments.

They were also asked towards the end of the interview to assess their financial position now compared with 12 months previously. Eight in ten said that they had no financial difficulties 12 months ago and still had none. A small number (6 per cent) said that they had financial difficulties 12 months ago, but had none when they were interviewed. That left 14 per cent of households who said that they were currently in financial difficulty. (Table 3.2).

In both cases, some of the people interviewed had under-stated the financial difficulties they had faced over the past 12 months, as Table 3.2 shows. The under-recording in the first question could well be explained by the fact that people were reluctant to admit being in financial difficulty. But by the time they were asked the second question, they had already told the interviewer in detail about the commitments where they had fallen behind with payments.

Table 3.2 Subjective assessments of financial situation by extent of financial difficulties over the past 12 months

Column percentages

	All	No arrears in past 12 months	Extent of arrears			
			Any	1	2	3+
Keeping up with commitments	60	69	22	31	20	9
Struggle from time to time	28	24	44	45	47	40
Constant struggle, but not falling behind	8	6	18	18	16	20
Falling behind	3	-	16	6	17	31
No difficulties 12 months ago, still none	79	89	36	55	31	14
Difficulties 12 months ago, none now	6	4	16	15	23	14
None 12 months ago, difficulties now	6	4	15	12	12	20
Difficulties 12 months ago, things still the same	6	2	25	15	29	36
Difficulties 12 months ago, things now worse	2	-	7	3	6	15
Base:	*1,647*	*922*	*305*	*141*	*63*	*101*

So the minority of people who had been in arrears with two or more commitments but later said that they had had no financial difficulties either twelve months ago (bottom half of Table 3.2) or now may have been unwilling to face up to the situation they were in. This is a situation that is well-known to money advisers, who constantly complain that people often bury their heads in the sand and consequently delay recognising the problems they have and seeking help.

A very similar picture to that shown in Table 3.2 also emerged for people who were currently in arrears. One in eight (13 per cent) of the small number of people currently owing three or more creditors believed that they had had no financial difficulties at any time over the past 12 months.

3.2 The dynamics of financial difficulty

From people's subjective assessments, it appears that the overall number of households in difficulty is relatively stable. In total, 6 per cent said that they had had financial difficulties 12 months ago but had none now; while a similar proportion (6 per cent) said that their financial difficulties had started in the past year. In reality, though, a quarter of those saying that they were no longer in difficulty were actually still in arrears. A plausible explanation is that that they were paying off the money they owed and felt that they had got their finances back under control.

In total, 8 per cent of households indicated that their financial positions had deteriorated – 6 per cent of whom had only got into difficulty over the past 12 months and 2 per cent who said that their financial difficulties had worsened over the past 12 months.

3.3 Who is most likely to be in financial difficulty?

Young householders seem to run the highest risk of financial difficulties – four in ten of householders in their twenties had been in arrears in the past 12 months and 37 per cent were currently either in arrears or said they were in financial difficulty. On average they were currently behind with payments on 2.5 of their commitments (Table 3.3). The level of difficulties then declined steeply with age.

In fact the separate sample of young people shows that financial difficulties were much more common among those who were householders in their own right than they were among young people who lived with their parents. This is not altogether surprising, as there are many more demands on income if one lives independently (Table 3.3).

Two key life events – having a new baby and relationship breakdown – were both strongly associated with financial difficulties. So the level of arrears was especially high for lone parents; nearly half of them had been in arrears in the past 12 months and a similar proportion were facing financial difficulties at the time of the survey. Two-parent families also had an above-average risk but it was not nearly so pronounced (Table 3.3). Single non-pensioners also had a relatively high risk of financial difficulties.

Table 3.3 Likelihood of financial difficulties by characteristics of households

Cell percentages

	In arrears in past 12 months	Difficulties now no arrears	In arrears now	Ave no. of arrears now	*Base*
All	***18***	***7***	***13***	***1.9***	***1,647***
Age					
20-29	40	7	30	2.5	*208*
30-39	27	10	19	1.9	*293*
40-49	23	10	17	1.5	*294*
50-59	14	8	8	2.2	*262*
60 and over	6	4	3	1.4	*576*
Family type					
Single pensioner	6	3	4	1.7	*249*
Pensioner couple	5	4	3	1.0	*263*
Single non-pensioner	28	15	18	2.2	*187*
Non-pensioner couple	16	5	11	1.9	*209*
Lone parent	48	14	36	2.0	*98*
Two-parent family	25	8	17	1.9	*370*
Other	19	7	12	2.2	*192*
Household changes in last 12 months					
New baby**	42	16	33	2.0	*53*
Separation**	52	17	32	2.4	*34*
Other change	21	10	15	2.1	*183*
No change	17	6	12	1.9	*1,425*
Housing tenure					
Mortgagor	17	8	12	1.8	*675*
Outright owner	7	3	4	1.9	*461*
Social tenant	30	9	22	2.1	*362*
Private tenant	31	9	21	1.9	*148*
Economic activity status					
FT work	18	6	13	1.8	*739*
PT work	30	8	23	2.2	*116*
Unemployed	43	22	28	2.6	*81*
Caring for family/home**	41	8	31	2.2	*65*
Sick/disabled	30	23	19	1.7	*99*
Retired	7	2	4	1.4	*501*
Gross household income (non-pensioners)					
Under £5,000	36	12	24	2.0	*148*
£5,000-£7,499	41	19	32	2.7	*98*
£7,500-£9,999	32	12	24	2.1	*81*
£10,000-£14,999	37	12	24	2.1	*137*
£15,000-£24,999	20	8	14	1.7	*125*
£25,000-£34,999	19	3	15	1.8	*169*
Over £35,000	14	2	8	1.3	*190*
Gross household income (pensioners)					
Under £5,000	9	4	5	1.6	*89*
£5,000-£7,499	5	2	3	1.8	*128*
£7,500-£9,999**	9	3	4	1.0	*59*
£10,000-£14,999**	-	-	-	-	*66*
Over £15,000**	14	2	7	1.3	*44*
Changes in income in last 12 months					
Fall	32	18	23	2.5	*246*
Rise	16	3	10	1.8	*540*
Both rise and fall	36	8	26	1.6	*102*
No change	14	6	11	1.7	*760*
Young people's sample					
Aged 18-19**	26	18	19	1.8	*62*
20-24	27	20	21	2.4	*127*
Householder**	32	22	30	2.1	*65*
Non-householder	23	18	15	2.3	*124*

*** numbers very small, so use with caution*

As earlier research has shown, financial difficulties and arrears tend to be strongly associated with low incomes, but only among non-pensioners (Berthoud and Kempson, 1992) and this was borne out by the present survey (Table 3.3). The fact that they were higher for non-pensioner households with gross incomes between £5,000 and £7,500 than they were for those on lower incomes is entirely explained by the very different family circumstances of these two income groups. The slightly higher income group contains a large proportion of lone parents, while the lower one is mostly single people. In other words it is not household income *per se* that is linked the risk of financial difficulties, but rather that income in relation to the number of people who have to live on it.

Reflecting this strong association with income, tenants (in both the social and private rented sectors) were more likely to be in financial difficulty than homeowners. Financial difficulties were especially common among unemployed householders and lone mothers not in work; but they were also almost twice the average for households headed either by part-time workers or by people who were unable to work through long-term sickness or disability (Table 3.3).

Finally, there was a strong link with drops in income. So, a quarter of households that had experienced a drop in income in the past 12 months were currently in arrears with one or more commitments and a further two in ten said they were facing financial difficulties (Table 3.3). In fact, households that had had both a drop and an increase in income were almost as likely to be facing problems. Earlier research showed that loss of income through unemployment, can have a sustained effect on the household budget, with an enhanced level of arrears up to three years later (Berthoud and Kempson, 1992).

3.4 Specific areas of financial difficulty

Overall, more households were in arrears with household bills (including mortgages) than had got into difficulty with consumer credit commitments (Table 3.4). There was, of course some overlap between the two so that, at the time of the interview 7 per cent of households were in arrears with household bills only; 4 per cent only had difficulties with credit commitments; and 2 per cent were in arrears with both.

The four main household bills – gas, electricity, water charges and council tax - were the ones where the highest proportions of households had fallen into arrears.

Credit cards and overdrafts were the types of credit where financial difficulties were the most common and these included people who were having difficulty reducing the amounts they owed as well as people who had missed the minimum payment on their cards. Even so, only a small proportion of all households said they were currently in difficulty with either of these commitments – 3 and 2 per cent respectively (Table 3.4).

Table 3.4 Type of arrears across all households

Cell percentages

	Arrears in past 12 months	Arrears now
Any arrears at all	**18**	**13**
Any consumer credit arrears	**10**	**6**
Overdraft	3	2
Credit card	4	3
Store card	1	1
Mail order	2	1
Hire purchase/credit sale	1	*
Loan	2	1
Any household bill arrears	**13**	**9**
Mortgage	1	*
Rent	2	1
Gas	4	3
Electricity	3	2
Water	4	3
Council tax	4	3
Other bills	4	2
Base; All householders	*1,647*	*1,647*

** less than 1 per cent*

However, while almost all households have the basic household bills to pay, fewer than half had the specific types of credit commitment. We have, therefore, calculated the risk[2] of financial difficulties associated with the each of the main types of credit commitment and also with rents and mortgages (Table 3.5). This shows that the risk of financial difficulties was, in fact, highest for overdrafts, loans and mail order catalogues.

Table 3.5 Percentage of account-holders in financial difficulties by type of credit commitment, rent and mortgage

Cell percentages

	In past 12 months	Now	*Base*
Overdraft – difficulties repaying	15	9	*329*
Credit card – difficulties repaying	na	5	*856*
Credit card – missed minimum payment	4	1	*856*
Store card – difficulties repaying	na	3	*434*
Store card – missed minimum payment	3	1	*434*
Mail order arrears	12	6	*276*
Hire purchase/credit sale arrears	6	2	*221*
Loan arrears	12	8	*251*
Mortgage	3	1	*629*
Rent	7	5	*511*

na not applicable

---

2 Calculated as the percentage of account-holders who were in financial difficulties.

Table 3.6 Likelihood of arrears on consumer credit and household bills by household characteristics

Cell percentages

	In arrears now	Consumer credit	Household bills	*Base*
All	***13***	*4*	***6***	***1,647***
Age				
20-29	30	20	20	*208*
30-39	19	8	14	*293*
40-49	17	9	11	*294*
50-59	8	4	6	*262*
60 and over	3	1	3	*576*
Family Type				
Single pensioner	4	1	4	*249*
Pensioner couple	3	1	2	*263*
Single non-pensioner	18	8	15	*187*
Non-pensioner couple	11	7	5	*209*
Lone parent	36	18	28	*98*
Two-parent family	17	9	12	*370*
Other	12	6	9	*192*
Household changes in last 12 months				
New baby**	33	17	24	*53*
Separation**	32	20	25	*34*
Other change	15	7	11	*183*
No change	12	5	8	*1,425*
Housing tenure				
Mortgagor	12	7	6	*675*
Outright owner	4	2	2	*461*
Social tenant	22	10	18	*362*
Private tenant	21	8	17	*148*
Economic activity status				
FT work	13	7	8	*739*
PT work	23	10	20	*116*
Unemployed	28	19	17	*81*
Caring for family/home**	31	15	22	*65*
Sick/disabled	19	7	13	*99*
Retired	4	1	4	*501*
Gross household income (non-pensioners)				
Under £5,000	24	10	18	*148*
£5,000-£7,499	32	19	24	*98*
£7,500-£9,999	24	14	12	*81*
£10,000-£14,999	24	11	20	*137*
£15,000-£24,999	14	9	8	*125*
£25,000-£34,999	15	10	7	*169*
Over £35,000	8	3	4	*190*
Gross household income (pensioners)				
Under £5,000	5	-	6	*89*
£5,000-£7,499	3	1	4	*128*
£7,500-£9,999**	4	2	2	*59*
£10,000-£14,999**	-	-	-	*66*
Over £15,000**	7	2	5	*44*
Changes in income in last 12 months				
Fall	23	11	17	*246*
Rise	10	5	7	*540*
Both rise and fall	26	17	14	*102*
No change	11	4	6	*760*
Young people's sample				
Aged 18-19**	19	8	13	*62*
20-24	21	12	13	*127*
Householder**	30	11	25	*65*
Non-householder	15	10	6	*124*

*** numbers very small, so use with caution*

On the whole the types of householder who were most likely to be in arrears currently also had the highest incidence of arrears on both consumer credit commitments and on household bills (Table 3.6). And, in general, the level of arrears on household bills exceeded that for consumer credit. But there were some exceptions. Householders in their twenties, unemployed people and those with gross incomes above £15,000 were at least as likely to have fallen into arrears with consumer credit commitments as they were to have done so on bills. Young people who lived with their parents were more likely to have arrears on consumer credit than on household bills, but this is, perhaps, rather less surprising as they would have fewer household bills to pay (Table 3.6).

3.5 Links between credit use and arrears

There was a strong link between the use of credit and being in arrears, whether that was arrears in the past 12 months or currently (Table 3.7 concentrates on arrears in the past 12 months because the numbers are larger).

So, the more credit commitments households had and the larger the proportion of their income that went on repaying credit, the more likely they were to have been in arrears and the more sets of arrears they had.

Table 3.7 Credit use by number of arrears in past 12 months

Row percentages

	No arrears	1	2	3	4 or more	Ave (those with any)	*Base*
No. current commitments							
None	91	5	2	1	1	1.8	*885*
1	79	11	3	3	3	2.1	*359*
2	68	16	5	3	8	2.3	*173*
3	62	11	10	7	11	3.0	*117*
4 or more	51	16	14	5	14	3.3	*112*
Repayments as a proportion of income							
Nothing	91	5	2	1	1	1.8	*885*
Up to 10%	71	14	5	3	6	2.4	*363*
10% to 25%	65	13	9	6	7	2.6	*134*
25% or more	48	10	13	13	14	3.7	*79*

It is not, of course, possible to say to what extent this is because borrowing puts extra strain on household budgets, or because the types of people who borrow most are the ones who are also most likely to overspend generally. In reality it will almost certainly be a combination of these. In addition, as discussed later, some people try to borrow their way out of financial difficulties.

The link between consumer credit arrears and levels of borrowing was especially pronounced. One in ten (10 per cent) of households with one credit commitment said that they had fallen behind with the repayments on it in the past 12 months; compared with four times that number (43 per cent) of households with four or more current credit commitments. Similar links existed with the proportion of income spent on credit repayments.

Borrowing did increase the risk of falling behind with household bills, but to nothing like the same extent. So, 15 per cent of households with a single credit commitment had fallen behind with household bills, and this increased to 25 per cent of households with four or more current credit commitments.

3.6 Duration of financial difficulties

Everyone who was in financial difficulty or arrears was also asked how long they had been facing these problems. Over half of those facing current problems said that they had been in difficulty for six or more months – with a third saying that it was at least a year (Table 3.8).

Table 3.8 Duration of financial difficulties

Cell percentages

	All in difficulty now	Financial difficulty now, no arrears	In arrears now
Under one month	5	8	4
1-3 months	14	14	14
3-6 months	10	10	9
6-12 months	21	23	20
Over 12 months	34	35	33
Refused/don't know	15	10	18
Base	*324*	*115*	*209*

A considerable number, especially of those who were in arrears, were not prepared to discuss how long they had been in difficulty.

3.7 The reasons for financial difficulties

People who either said that they had fallen into arrears with at least one of their commitments in the past 12 months, or that they were in financial difficulties but had kept up with their commitments was asked to give the main reason for their problems.

Loss of income was the main reason for both arrears and financial difficulties and was the reason given by nearly half of the householders that were affected (Table 3.9). The main type of income loss was through redundancy. In contrast, only a quarter of the young people attributed their difficulties to loss of income. As we saw above (Table 3.3), a drop in income doubled the risk of financial difficulties: a third of the householders who had lost income in the past 12 months had fallen into arrears in the past year; more than four in ten were in current financial difficulty.   The riskiest events were redundancy and giving up work through ill-health, with a drop in wages not far behind.

Table 3.9 The reasons for financial difficulties

	Householders			Young people
	Arrears or difficulties	**Arrears**	**Difficulties**	**Arrears or difficulties**
Loss of income	45	42	54	23
Redundancy	*19*	*18*	*21*	*9*
Relationship breakdown	*5*	*6*	*3*	-
Sickness or disability	*7*	*6*	*9*	*1*
Other loss of income	*14*	*12*	*21*	*13*
Low income	14	15	9	25
Over-commitment	10	9	13	14
Increased/unexpected expenses	12	11	13	11
Overlooked or withheld payment	8	12	-	4
Third party error	5	6	-	7
Debts left by former partner	4	2	9	-
Other reason	3	3	1	16
Base: all in arrears or financial difficulty in past 12 months	*284*	*208*	*76*	*50*

Around one in seven householders said that they had got into financial difficulty because their incomes were low and especially so if they were in arrears. It was, however, the main reason that the young people gave for their financial difficulties.

One in ten householders with financial problems attributed them to over-commitment, although this was more commonly cited by people who said their household was in financial difficulties but up-to-date with payments than it was by those who had fallen into arrears. It was also much more common among the young people (Table 3.9). As we saw above, heavy credit commitments did greatly increase the chance of arrears. So, over half (53 per cent) of households spending more than a quarter of their income on credit repayments had been in arrears in the past year and a similar proportion (53 per cent) were in current financial difficulties.

Relationship breakdown was a cause in around one in ten cases – either through a drop in income or because an ex-partner had left debts behind when they moved out (Table 3.9) And as noted above, separation trebled the chance of someone falling into arrears (Table 3.3). However, as earlier research on mortgage arrears has shown, in about half of cases the arrears pre-date (and may well contribute to) the break-up; in the other half they follow it (and presumably are a consequence) (Ford et al, 1995).

We would not expect people to give reasons that were critical of themselves, but rather to look for some external cause. Even so, one in eight of the householders in arrears said that they had either overlooked or deliberately withheld payment, indicating at best a degree of disorganisation and at worst a deliberate attempt to ‘work the system’ (Whyley et al, 1997).

3.8 Managing arrears

People who owe money in arrears that they cannot easily repay face a number of options. They may negotiate a way of repaying off the arrears with their creditors or they may pay off some or all of the money owed in missed payments either with financial help from family or friends, or by refinancing. Those with a payment protection insurance policy may be able to claim, if they have been made redundant or become unable to work through ill-health. They may sort out their problems alone or with the help of someone else.

3.8.1 Negotiations with creditors

Industry Guidelines[3] encourage creditors to make every endeavour to contact customers to try and arrange repayment of arrears. Half (46 per cent) of the households that had actually fallen into arrears in the past 12 months said that they had reached agreements with all their creditors to repay the money they owed in missed payments. A further one in ten (9 per cent) had done so with some, but not all of their creditors. That left a quarter (24 per cent) of households who had not reached an agreement with any of their creditors at all and a surprising number (20 per cent) who said that they did not know. The proportions among those who were currently in arrears were broadly the same.

3.8.2 Financial help from family and friends

A quarter of households who had faced any financial difficulties in the past 12 months had either been lent or given money by family and friends to help them out of their difficulties. More had been lent money than given it (16 per cent compared with 9 per cent).

Among those currently in difficulty, the proportion receiving financial help increased with the severity of the problems they faced. So while one in five (20 per cent) of people with financial difficulties but no arrears had been lent or given money, this increased to six in ten (59 per cent) of people with three or more sets of arrears. Loans and gifts were equally common among the households that had no arrears, but as the severity of financial problems increased the incidence of loans increased far more than gifts. So, among the small number of people with three or more arrears 46 per cent had been lent money by either their family or their friends and just 13 per cent had been given it.

As we might expect, a much higher proportion (60 per cent) of the young people in financial difficulty had been helped in these ways. In fact nearly half of them (47 per cent) had been lent money by relatives or friends and more than a third (35 per cent) had been given money. The younger they were the more likely they were to have been helped

[3] Such as those issued under the Banking Code and by the Finance and Leasing Association

out, so that three quarters of the 18 and 19 year olds in financial difficulty had received financial help, compared with half of those in their early twenties.

3.8.3 Payment protection insurance

A little over one in five (22 per cent) of all households said that they had an insurance policy that would cover either their credit commitments or their mortgage, should they, or their partner, become unemployed or unable to work through sickness, disability or an accident.

This was equivalent to 27 per cent of all that had either a mortgage or a credit facility of some kind. The most commonly insured event was sickness or disability, for which 22 per cent of all mortgage and credit facility holders were covered; 20 per cent were insured in case of redundancy; and 18 per cent for accident.

The most commonly insured commitment was the mortgage, and 35 per cent of mortgagors claimed to have either mortgage payment protection insurance or another policy that would cover their mortgage repayments should they lose their income. This is similar to the level of cover (31 per cent) identified in a recent survey for the Council of Mortgage Lenders (Council of Mortgage Lenders 2001).

In contrast, only 17 per cent of people with credit facilities had payment protection insurance; 11 per cent had all their commitments covered, the remaining 6 per cent only had some insured. As might be expected, the people who currently used the credit facilities they had were more likely to be insured for loss of income; 22 per cent of them had a policy, 13 per cent to cover all their commitments and 9 per cent to cover some. And the proportion of households insured increased slightly the more money they had borrowed and the greater the proportion of their income they were spending on consumer credit repayments. So a third of households owing £7,000 or more and a quarter of those spending a quarter or more of their income on consumer credit repayments were insured.

In fact very few payment protection policy-holders (4 per cent) had tried to claim on them in the past 12 months, and 3 per cent said that they had done so successfully. Half of these people were in financial difficulty at the time of the survey and half were not.

So, although payment protection insurance undoubtedly makes a significant difference to individual households who claim successfully, as yet it makes only a small contribution to tackling the problem of arrears. In the past 12 months,18 per cent of all households had been in arrears (10 per cent on consumer credit commitments or their mortgage) yet less than 1 per cent of all households had claimed successfully on an insurance policy to cover either their mortgage or their credit commitments. A similar conclusion has been reached by other recent research (Pryce and Keoghan, 2002).

3.8.4 Re-financing and debt consolidation

The other important way that people had settled their commitments was through re-financing. Overall, 15 per cent of households had borrowed money in the previous 12 months to pay off creditors or to make ends meet. This included 10 per cent who had used credit cards (including credit card cheques); 5 per cent who had taken out loans and 1 per cent who had re-mortgaged.

The proportion was, however, double among those who had been in arrears in the past 12 months (30 per cent) or who were currently in arrears (34 per cent).

This is discussed further in the following chapter.

3.8.5 Advice seeking

Two in ten households (20 per cent) with arrears in the past 12 months had sought advice, as had a similar proportion of those currently in financial difficulty. And the proportion increased with the severity of the problems they faced - from one in ten (10 per cent) of those who had fallen behind with payments on just one commitment in the past 12 months to nearly four times that number (37 per cent) of households with three or more sets of arrears.

The most common sources of advice were:
- 9 per cent contacting a free money advice agency, such as a citizens advice bureau, money or debt advice agency, the Consumer Credit Counselling Service, National Debtline or a law centre
- 5 per cent seeking advice from friends or relatives
- 4 per cent contacting an accountant, bank manager or other financial adviser
- 1 per cent contacting a fee-charging debt advice or management company.

Slightly more of the young people who were interviewed said that they had sought advice, but only because a greater number had consulted family or friends.

Free advice agencies were the only source where use increased according to the severity of financial problems. They had been consulted by 2 per cent of households who had been in arrears with one commitment in the past 12 months, but by ten times as many (19 per cent) of households with three or more sets of arrears. Reflecting this, householders who had been in arrears with both credit accounts and household bills were more likely to have sought help from a free advice agency (15 per cent) than those only owing money either on household bills (8 per cent) or on consumer credit commitments(5 per cent).

Even so, this points to a serious under-funding of free money advice services, most of which work to near capacity yet according to these figures still only assist a small proportion of households facing arrears.

In fact, twice as many people in financial difficulty had refinanced existing commitments as had sought advice from any source at all. Of all householders who had been in arrears or faced financial difficulties in the past year:

- 26 per cent had refinanced commitments but not sought advice
- 10 per cent had sought advice but not refinanced
- 6 per cent had both refinanced *and* sought advice (a third from a free advice agency; a third from a bank manager or accountant and a third from a range of other sources)
- 57 per cent had done neither

What we do not know from the survey is whether the small number of people who had done both had sought advice before refinancing or the other way round.

In any case, this analysis reinforces the need for more free money advice agencies so that they are able to advertise their services to people who would, otherwise, be tempted to re-finance.

3.9 The consequences of financial difficulties

Money was a source of friction in around one in five households (18 per cent). Unsurprisingly, there was a strong link with the extent of the financial difficulties they faced. A third (34 per cent) of households who were in financial difficulty said that money was a source of friction, compared with half that number (14 per cent) of households with no financial difficulties at all.

In addition, everyone in difficulty was asked specifically what effect this had had on them or their family (Table 3.10).

Table 3.10 Effects of financial difficulties

Cell percentages

	All in difficulty now	**Financial difficulty now, no arrears**	**In arrears now**
Stress/anxiety	23	24	22
Lack of money	14	18	11
Unable to afford non-essentials	11	14	10
Adverse effect on relationship	8	9	7
Adverse effect on mental health	8	8	8
Inability to afford essentials	7	8	7
Unhappiness/anger	4	5	4
Adverse effect on physical health	2	4	2
None at all	24	17	27
Base	*324*	*115*	*209*

The most common consequence was stress or anxiety, experienced in about a quarter of households currently in financial difficulty. ‘Lack of money’ was the second most common effect, but less so in households that were actually in arrears. Relationship tensions had occurred in one in twelve households and a similar proportion reported adverse effects on mental health. Physical health problems were much less common.

Surprisingly, a quarter of the people interviewed said their financial problems had had no effect at all and this proportion was higher for the households that were in arrears than it was for those facing financial difficulties but had kept up with their commitments. On the face of it, this is difficult to explain. It could be that they were not willing to discuss their problems – and this would certainly accord with the experiences of money advisers who regularly find that some people do not face up to their financial problems until fairly late in the day. At the same time, as we saw above, a small number of households in financial difficulty were withholding payment, had overlooked bills and consequently fallen behind or had fallen into arrears through an error made by someone else. One would not expect these situations to have an effect on the household.

3.10 Summary

A quarter of households had been in financial difficulties in the past 12 months and two in ten were still having problems at the time of the survey. About a third of those in currently financial difficulty said that they had been facing these problems for a year or more. It does not, however, appear that the problem is getting worse. The same proportion of households had sorted out their problems in the past year as said that their problems had only recently started.

Young people setting up home and with young families ran the greatest risk of being in financial difficulty; new babies and relationship breakdown also raised the risk. At the same time risks were high among households with low and unstable incomes.

Overall, more households had fallen behind with the payment of household bills than had got into arrears with consumer credit commitments. But, when we take into account the fact that all households have to meet regular bills but only a half are credit users, the risks associated with particular types of credit become more apparent. Indeed the more credit a household used the greater was their risk of falling into arrears – not just with their credit repayments but also with household bills.

Loss of income was the main cause of the difficulties households faced and was cited by half of the people interviewed who were in financial difficulty. The second most common reason among householders was having a low income; but this was the main explanation given by the under 25s. Fewer people (one in ten) attributed their problems to over-commitment; heavy credit commitments did greatly increase the chance of arrears.

Half of the people in arrears said that they had reached agreements with all their creditors to repay the money they owed, but a quarter had failed to reach an agreement with any of their creditors. People had raised money to pay their creditors in a range of ways. A quarter of households in financial difficulty had been lent or given money by their family or friends, although the proportion increased to half of those in arrears with three or more commitments. Family help was especially common among young people, aged under 25, who were in financial difficulty - six in ten of whom had been lent or given money. Three in ten households who had been in arrears over the past 12 months had borrowed to pay bills or re-finance existing commitments. In contrast, payment protection insurance had rather less of a role to play. Overall, one in five of households had some form of payment protection insurance – but during the past twelve months only 1 per cent had claimed, compared with 18 per cent of households who had been in arrears.

Only two in ten households who had been in arrears in the past 12 months had sought advice, half of whom had contacted a free money advice service. Those in multiple arrears were, however, much more likely to have done so. Even so, twice as many people had chosen to refinance existing commitments as had sought advice from any source at all.

Stress and anxiety were the most common consequence of being in financial difficulty and a third of households in arrears said that money was a constant source of friction in their household. In a minority of cases, money problems took a toll on family relationships and on people's mental health.

4 Responsible lending and borrowing?

The credit market has become very competitive, and in a highly competitive market the most profitable customers can also be the most risky. In the words of the credit risk department head of a leading lender '*The accounts that are headed for delinquency will look like your most profitable*'(Bailey 2002[1]).

A number of marketing practices have lead to concerns, raised at the DTI's Task Force, that they may be contributing to the problem of over-indebtedness. At the same time, there is an awareness that irresponsible borrowing also plays an important part in adding to the problem of indebtedness and that consumer awareness of the terms of the commitments they take on is too low. This chapter examines each of these areas in turn.

Before we do so, however, it is important to return to the term 'over-indebtedness'. Although it is widely used, there is no generally agreed definition. Indeed, various commentators have interpreted it quite in different ways (Betti et al, 2001). Following discussion by the Task Force it was decided to adopt a pragmatic approach and to use:

- a measure of the extent of current financial difficulties, including arrears (20 per cent of all households)

and two definitions of heavy credit use, both of which are strongly associated with reported levels of financial problems:

- spending more than 25 per cent of gross income on consumer credit (5 per cent of all households) and
- spending more than 50 per cent of gross income on consumer credit and mortgages (6 per cent of all households).

In doing so, we are not saying that a household is only over-indebted if their spending is above these levels – it is merely an analytical tool that accords with a common sense view of experts on consumer borrowing.

[1] This article was based on interviews with a number of credit risk department heads, four of whom agreed to have their quotations attributed to them.

4.1 Irresponsible lending?

A number of marketing strategies were of concern to some members of the Over-indebtedness Taskforce and the research found evidence that they are potentially problematic. These strategies include:

- The automatic raising of credit limits on credit and store cards and on overdraft facilities
- Encouraging people to transfer balances on credit cards, by offering low initial interest rates and higher credit limits
- Reducing the minimum payment on credit cards
- Issuing cheques that can be used to draw on credit card accounts

None of these practices affected large numbers of people and it would be wrong to claim that they *caused* financial difficulties or over-borrowing. They do, however, disproportionately attract people who face these situations and can potentially make a bad situation worse.

4.1.1 Automatic increases in credit limits

Automatic rises in credit limits are quite common - as a credit risk manager has put it 'Y*ou can't afford not to do it because all your competitors are doing it'* (Bailey, 2002). There are, however, concerns that they are also raised without adequate checks on the customer's credit risk.

Indeed, when asked directly, 83 per cent of the people interviewed for this study thought that credit limits should only be increased at the customer's request and not increased automatically. In practice, this was still seldom the case.

Credit cards
Three in ten of all households with a credit card had had a credit limit increase on at least one of their cards in the past 12 months (Table 4.1). (This is equivalent to 15 per cent of all households). In most cases the limit had been raised automatically and not at the customer's request; fewer than one in ten people had asked for the increase. A similar proportion had used some or all of the increase granted. About two in ten receiving an increase had been close to or over the limit at the time it was raised. This accords with earlier research on credit cards (Berthoud and Kempson, 1992; Rowlingson and Kempson, 1994).

There was evidence of a link between raised limits on credit cards and financial difficulties. Households that were in financial difficulties at the time of the interview were more likely to have had an increase in the limit on their credit card in the past 12 months than other card-holders - even though the number of cards held by these two groups was almost identical (Table 4.1). Consequently, six in ten of those who were close to or over their limit at the time it was raised were in financial difficulty, as were half of those who had used some or all of the increase.

Indeed, some credit risk managers in credit card companies have acknowledged that they raise limits in the knowledge that the highest risk customers are also the ones that need and will use the increase.

> *'It's remarkable how many times you see a situation where written-off accounts have had significant automatic credit limit increases, based on behavioural scoring strategies, less than 12 months before the account becomes delinquent.'* (Bailey, 2002)

Table 4.1 Credit limit increases on credit cards, overdrafts and store cards/accounts

Cell percentages

	All with an account	**Financial difficulties**	**25% of income on credit**	**50% of income on credit/m'gage**
Percentage of account-holders with limits raised on:				
Credit card	28	37	40	37
store card/account	10	18	..	..
agreed overdraft facility	16	26	22	29

.. numbers too small for analysis

There was also a link with high levels of repayment on borrowing. Households that repaid a high proportion of their gross income either on credit alone or on credit and a mortgage were also more likely to have had the limit increased on one of their credit cards than were other card holders (Table 4.1). They were also more likely to have used the increase. They also accounted for three in ten of the card-holders who were over or near their credit limit when it was raised.

In this case, people with high levels of repayment on borrowing, held slightly more credit cards than the average for all card-holders (1.9 compared with 1.6).

Store cards and accounts

Credit limit increases on store cards/accounts were less common (Table 4.1) but again fewer than one in ten customers had requested the increase. Only a small number of card holders were over or close to their credit limit when it was raised. As the number of people involved was quite small it is not possible to report on any link with over-indebtedness, save for the fact that raised limits were more common among people who were in financial difficulties (Table 4.1).

Overdrafts

Overdraft limit increases were also more common among people with financial difficulties or paying a high proportion of their income to service their borrowing (Table 4.1). But they were somewhat different from credit and store cards in that half of the people whose credit limit was increased had requested it and this rose to three quarters of households in financial difficulties.

Reflecting this, four in ten households whose overdraft limit was increased had been close to or over the limit at the time. Again this was associated with financial difficulties; six in ten households at or over the limit when it was raised had financial problems. There was a similar link with higher levels of repayment on borrowing but it was less pronounced.

The need for checks on risk
Taken together, this evidence lends weight to the proposal that credit limits should only be increased following a check on account-holders' credit worthiness. The information relating to overdrafts shows that this will be more effective in preventing over-indebtedness than seeking prior authorisation from customers, as households in financial difficulty are especially likely to agree to an increase. This concurs with the experience of credit risk managers (Bailey 2002).

Some in the industry have argued the case for improved behavioural scoring (CCRG 2002a); others that a more holistic approach is needed.

> *The truth is that each credit card operator is looking at a very small world. You won't pick up someone paying off one card with another. You have to look at the customer at customer level, not just account level. I would like to see all issuers using behaviour scores via the credit [reference] bureaux.'* (Bailey 2002)

Research has shown that a check with credit reference bureaux would identify a high proportion of the most risky customers (Tingay and Wilkinson, 2002).

4.1.2 Transfer of credit card balances

Recent years have seen a considerable growth in offers of low initial interest rates on balances transferred from one credit card to another. For many people it would be a rational decision to move balances in this way, but concerns relate to people who transfer because they are facing financial difficulties and may not have made plans for meeting the interest charges when the initial low rate ends. In particular, there have been concerns that some people are unaware of when the period of low interest will end and what the charges will be afterwards.

One in twenty (5 per cent) households with credit cards had opened a new account in the past 12 months and transferred balances from other cards. Almost all of them had been offered a low rate of interest on the transferred balance and four in ten had also been offered a higher credit limit than they had on their old card. (This is equivalent to 3 per cent of all households).

Switching credit card provider to pay off other cards was quite strongly associated with financial problems (Table 4.2); half of those transferring balances in this way were in financial difficulties. The proportions were higher still for those who not only transferred balances but were also offered a higher credit limit. Two thirds of these people had financial problems.

Table 4.2 Credit cards: balance transfers, minimum payment and receipt of credit card cheques

Cell percentages

	All with an account	Financial difficulties	25% of income on credit	50% of income on credit/m'gage
Percentage of account-holders:				
Transferring balance from another card	5	15	10	9
Regularly making minimum payment	7	23	29	20
Receiving credit card cheques	16	24	23	23
Base: all with a credit card	*856*	*99*	*51*	*76*

The link with the amounts households spent repaying money borrowed was not quite so marked. In part this is explained by the fact that card-holders who had transferred balances had been given a lower minimum payment – and in our calculation of the proportion of income spent on credit repayments we included the minimum payment for credit cards. Even so, they included twice the average proportion of households who had also been given an increased credit limit.

4.1.3 Reducing the minimum payment on credit cards

A further practice that is gaining momentum is a reduction in the minimum monthly repayment on credit cards. For most cards the minimum payment has been 5 per cent of the outstanding balance, but an increasing number of card suppliers have reduced the limit to 3 per cent or even 2 per cent. This has raised criticisms that someone making only the minimum payment will take decades to clear a large balance. Writing in *Money Mail*, the former director of the Credit Card Research Group has calculated the length of time it would take to clear a £3,000 balance on a card with a monthly interest rate of 1.313 %, if only the minimum payment were made each month. She estimates that it would take nine and a half years to clear if the minimum payment were 5 per cent. Reducing the minimum payment to 3 per cent almost doubles the time to clear the balance (18 years) and reducing it further to 2 per cent quadruples it (37 years) (Phillips, 2001).

A minority (7 per cent) of households with credit cards regularly made only the minimum repayment on at least one card (equivalent to 4 per cent of all households).   Again there was a strong link with our measures of over-indebtedness (Table 4.2). So households that were in financial difficulties were three times more likely to be making only the minimum payment, as also were those spending half or more of their income on consumer credit and mortgage repayments. It was higher still (four times the average) among households spending a quarter or more of their income just on consumer credit commitments.

These will, of course, be the very people who are attracted to cards with low minimum payments and with repayment levels as low as 2 or 3 per cent they will be unlikely to reduce the balance on the cards that they have.

4.1.4 Credit card cheques

Credit card cheques are a fairly recent development. These are cheques that are issued to credit card holders that can be used in the same ways as other personal cheques except that the money spent is debited from the credit card account. Unlike payments made with the card itself, payments made with the cheques incur interest immediately, in the same way as cash withdrawals using a credit card.

One in six (16 per cent) of households with credit cards had been sent cheques by their card supplier in the past 12 months. (This is equivalent to 8 per cent of all households in Britain.) In almost all cases these were sent unsolicited. Only a minority (13 per cent) of cheque recipients had used any of them, so the numbers are small and the following analysis needs to be treated with caution. A third of them had used the cheques either to pay bills or to pay off debts. Only a third of cheque users knew that they paid interest on the money straight away.

Interestingly, credit card cheques had been sent to above average proportions of card holders who were either in financial difficulty or spending a high proportion of their income on repaying the money they had borrowed (Table 4.2).

4.2 Irresponsible borrowing?

A responsible credit agreement can depend just as much on responsible borrowing as it does on responsible lending. Here there are three main areas of particular concern:

- Borrowing to re-finance other credit or to pay off arrears on bills and other commitments. There is evidence that not only has this become more common, but it is a strategy used disproportionately by people who are either in financial difficulties or have borrowed substantial amounts.
- Households who take on credit agreements, despite knowing that they will struggle to repay the money.
- Unplanned purchases and credit use, which is also linked to financial difficulties and heavy borrowing.

4.2.1 Re-financing and borrowing to pay bills

Although re-financing can reduce the repayments that households have to make on their total credit commitments, there are concerns that it is often only a short-term solution and that many of these households would do better to seek advice from a free money advice centre. An added concern is that refinancing is often secured on the borrower’s home.

Indeed, a survey of consumer credit providers by the Finance and Leasing Association shows that debt consolidation was the main reason for their customers taking out a loan and that the proportion was higher for secured than for unsecured loans. In 2000, 58 per cent of the £1.8bn new secured lending was used by consumers to pay off existing debts – an increase from 1999 when it was 50 per cent. The proportion of the £9.4bn unsecured lending used for debt consolidation was lower, at 38 per cent, and this had fallen from 42 per cent in the previous year (Finance and Leasing Association, 2001).

This growth was confirmed by a comparison between the present survey and the one carried out in 1989. In 1989, 17 per cent of commercial loans were used to pay other creditors or to make ends meet (Berthoud and Kempson, 1992). An identical question in the 2002 survey showed that it had risen to 30 per cent.

Altogether 15 per cent of households had borrowed money in the past 12 months to repay other creditors or to make ends meet (Table 4.3). They had borrowed this money in one of three of ways:

- On credit cards (12 per cent of all households – excluding those who had transferred balances from one card to another)
- Taking out loans (5 per cent of all households)
- Mortgage extensions (1 per cent of households)

Most commonly people said they had borrowed 'to pay bills' and this was equally true for all three types of credit agreement. While it is plausible that someone might routinely pay bills on a credit card it is highly unlikely that they would take out a loan or re-mortgage their home to do so. In such cases, at least, it is very likely that they had fallen into arrears. For much the same reason, it is improbable that people would take out a loan or re-mortgage 'to make ends meet'.

Table 4.3 Extent of refinancing

Column percentages

	All	**Arrears in past 12 months**	**Financial difficulties now**	**25% of income on credit**	**50% of income on credit/m'gage**
To pay bills	9	16	14	22	17
To refinance other borrowing	2	3	4	6	7
To pay off other debts	4	13	13	20	15
To make ends meet	3	9	10	10	10
None of these	85	70	71	63	68
Base: all householders	*1,647*	*305*	*325*	*79*	*102*

Quite clearly, borrowing money to pay other creditors or to make ends meet was associated both with being in financial difficulties and also with spending a high proportion of income either on consumer credit alone or on consumer credit and a mortgage (Table 4.3).

In other words, borrowing for any of these reasons is almost certainly an indication of financial stress. This was borne out by the fact that four in ten of the households who had re-financed said that they had been in financial difficulties at some time in the past year and six in ten said it was a struggle to make ends meet some or all of the time. Whether this is seen as irresponsible borrowing or irresponsible lending is a matter for debate. To some degree it is almost certainly both.

4.2.2 Doubts about ability to repay money borrowed

Credit screening ought to ensure that people are not lent money if they are already in financial difficulty or have borrowed large amounts of money relative to their income. In practice, though, this does happen and not all of the blame can be laid at the doors of lenders.

In the survey, households who had arranged a mortgage, a loan or other fixed term credit were asked how easy they expected it to be to keep up with the repayments when they took on the commitment. On the whole, most of them said that they expected to be able to pay without difficulty. A minority had either anticipated some problems or had not thought about the matter at all (Table 4.4). It is important to keep in mind that this was people's own assessment of their ability to repay and not an objective measure of it. Indeed, some people may have been deluding themselves that they would be able to keep up with the repayments.

Table 4.4 Expectations regarding ability to repay loans and hire purchase agreements

Column percentages

	Hire purchase/ credit sale	Loans	Mortgages
Expected to pay without difficulty	82	75	70
Thought it would sometimes be hard to find the money	12	15	23
Thought it would always be hard to find the money	1	2	2
Did not think about it	6	8	5
Base: all HP, loan or mortgage	*221*	*251*	*629*

In general, households that were in financial difficulties were much more likely to have anticipated problems keeping up with the repayments at least some of the time: three in ten (29 per cent) on loans; a third (36 per cent) on hire purchase agreements and nearly half (46 per cent) on their mortgages. In fact, two thirds (67 per cent) of the people who had any reservations about their ability to make the repayments on their loans or hire purchase agreements were in financial difficulty at the time of the survey. So, too, were a third (32 per cent) of the people with similar reservations when they took out their mortgage, even though many of them would have taken out their mortgages a number of years previously.

On the whole, it was not possible to study the links with the proportion of gross income spent on credit or mortgage repayments, as the numbers were too small. The one exception was mortgages, and here there was a clear link. Four in ten (41 per cent) of households spending half or more of their gross income on their mortgage and credit commitments had reservations about their ability to keep up with their mortgage repayments, when they borrowed the money.

This same question was also asked of households who had borrowed money in 1989. This earlier survey found that 83 per cent of households with hire purchase agreements and 77 per cent of those with loans had expected to keep up with the repayments without difficulty. It also found a strong link between arrears and anticipation of problems repaying (Berthoud and Kempson, 1992).

In other words, the situation in 1989 was much as it is now. So, although households have borrowed far larger amounts currently than their counterparts in 1989 most expect to find the repayments manageable because they are paying much lower rates of interest.

4.2.3 Impulsive spending and unplanned purchases on credit

Previous research has identified a clear link between compulsive shopping, over-borrowing and financial difficulties. The people who were most affected had a tendency towards other addictions too. This research was undertaken across four European countries, including Dumfries and Galloway in Scotland. It classified a third (33 per cent) of the adult population as 'addictive spenders': with 12 per cent having a considerable addiction to shopping and 3 per cent reaching levels that were 'pathological'. Although overall scores did not vary a great deal between the four participating countries, there were some subtle differences in the make-up of their scores. Compared with others in Europe, people in Scotland were more likely to acknowledge buying on impulse and to think that they used credit cards too much (Junta de Comunidades de Castilla-La Mancha 2000).

As we noted in Chapter 2, two attitudes to shopping and spending were strongly associated with heavy credit use:

> *I am impulsive and tend to buy things even though I can't always afford them.*

and

> *I am a saver, not a spender*

As Table 4.5 shows, there was also a very strong link with being in financial difficulties, and especially so with being in arrears with consumer credit commitments. So, although only 5 per cent of the householders interviewed agreed strongly that they tended to buy things on impulse it was three times higher (15 per cent) among those that were currently in arrears with consumer credit repayments. Similarly, while 7 per cent of householders disagreed strongly with the proposition that they were a saver not a spender, 24 per cent of those with consumer credit arrears said the same.

Table 4.5 Attitudes to shopping and spending

Column percentages

	All	Financial difficulties now	Consumer credit arrears now	25% of income on credit	50% of income on credit/m'gage
I am an impulsive shopper					
Agree strongly	5	10	15	6	6
Agree	13	22	30	27	22
Neither agree nor disagree	8	10	6	9	7
Disagree	33	32	30	35	34
Disagree strongly	41	26	20	25	31
I'm a saver, not a spender					
Agree strongly	15	7	4	6	10
Agree	30	18	13	13	17
Neither agree nor disagree	30	27	22	35	37
Disagree	18	32	36	32	24
Disagree strongly	7	16	24	14	11
Base: all householders	*1,647*	*325*	*103*	*79*	*102*

The other measure of impulsive purchases came from questions relating to the loan and hire purchase agreements people had. Most households making purchases on credit had planned them all along and less than one in twenty had made completely spur of the moment decisions (Table 4.6). Emergency purchases were, however, slightly more common. Earlier research showed that unplanned purchases – whether emergencies or spur of the moment decisions - were associated with a higher than average risk of arrears (Berthoud and Kempson, 1992).

Results from the present survey lend some support to this earlier finding. Hire purchase agreements were more often taken on in an emergency by those who were in financial difficulties; while their loans were more often associated with impulse purchases (Table 4.6).

It should also be noted that the proportion of planned purchases is now much higher than it was in 1989, when only 56 per cent of hire purchase agreements and 61 per cent of loans were used for things that people had planned to buy all along. But the explanation for this difference lies in the higher proportion of emergency purchases in 1989, not to a higher level of impulse buying – which was more or less the same as now (Berthoud and Kempson, 1992).

Table 4.5 Unplanned purchases and credit use

*Cell percentages**

	All with HP or loan	Financial difficulties now	25% of income on credit
Hire purchase			
Had planned purchase all along	70	67	64
Planned purchase but decided at last minute	17	17	13
Decided on spur of the moment	7	6	9
Emergency purchase	12	17	16
Base	*221*	*78*	*45*
Planned to use credit from retailer	81	83	76
Planned to borrow, decided source at last minute	13	13	9
Did not plan to use credit	8	7	13
Base	*221*	*78*	*46*
Loans used for purchases			
Had planned purchase all along	79	65	-
Planned purchase but decided at last minute	11	16	-
Decided on spur of the moment	5	11	-
Emergency purchase	14	16	-
Base	*138*	*55*	-

- numbers too small for analysis
* numbers do not total 100 per cent because some people had more than one hire purchase agreement or more than one loan

The European study noted that compulsive shopping was more prevalent among young people, with nearly half of 14 to 18 year olds (46 per cent) being classified as 'addictive shoppers'. This found some resonance in our own survey. Young people aged between 18 and 24 were far more likely to agree that they bought things on impulse (17 per cent agreed strongly; 29 per cent agreed). And many more of them disagreed that they were a saver, not a spender (21 per cent disagreed strongly; 32 per cent disagreed).

The number of young people who had bought things on hire purchase or loans was too small to assess how many of them had been unplanned.

4.3 Consumer awareness

In its first report the DTI Task Force on Over-indebtedness highlighted the need for greater consumer awareness of the terms and conditions of the agreements they sign. This is reinforced by a report from the National Association of Citizens Advice Bureaux, which found that lack of financial literacy was an important factor among individuals experiencing difficulties with repaying credit. This manifested itself mainly in their choice of particular types of consumer credit (National Association of Citizens Advice Bureaux, 2001).

The survey specifically investigated two areas: awareness of cancellation rights and awareness of interest rates on fixed term credit.

4.3.1 Awareness of cancellation rights

As fewer credit agreements are now arranged face-to-face in the lenders office, there is some concern that consumers taking on credit commitments over the telephone or internet or in their own home are unaware of their cancellation rights.

Almost nine in ten (86 per cent) of households with hire purchase/credit sale agreements had made them face-to-face in the lender's office and almost all of the rest knew about their cancellation rights.

On the other hand, nearly half (47 per cent) of households with loans were *not* confirmed in the lender's office in this way. Two in ten (22 per cent) were agreed on the telephone and just over one in ten were either agreed by post (14 per cent) or in the customer's home (11 per cent). Only a handful (2 per cent) had been agreed over the Internet.

At the time they signed their agreement, almost four in ten (37 per cent) of the people who had confirmed their loan agreements somewhere other than the lender's office did not know what their cancellation rights were. Again this needs to be set in context - it means that over the course of a year around 3 per cent of all households in Britain sign loan agreements without being aware of their cancellation rights. Although they were a very small minority, over half of these households were facing financial difficulties.

4.3.2 Knowledge of interest rates

There has long been concern that most consumers do not know the interest rate even on their fixed-term credit agreements. In 1989, half of people with fixed term credit agreements said they did not know what rate of interest they were paying on them (Berthoud and Kempson, 1992). Disturbingly, our present survey shows that the situation was even worse in 2002. Three quarters (75 per cent) of households with hire purchase agreements and two thirds (63 per cent) of those with loans did not know the rate of interest being charged.

Households with financial difficulties and those with high levels of consumer borrowing were just as likely to know the interest rate they were paying as anyone else. If anything the heavy credit users were slightly *more* likely to know.

4.4 Summary and overall conclusions

Macro-economic statistics record a doubling in the amounts outstanding in consumer credit in the seven years between 1994 and 2001, even after allowing for inflation. Mortgage lending has also increased markedly over the same period.

In contrast, national figures indicate no increase in levels of arrears – on the contrary in most instances they seem to have fallen.

This survey has found that three quarters of all households had credit facilities of some kind, but only half of them owed money on them at the time they were interviewed. This points to a high level of un-drawn credit.

Most households used credit modestly, but a small minority were heavy credit users:

- 7 per cent had four or more credit commitments
- 5 per cent were spending a quarter or more of their gross income on consumer credit repayments
- 6 per cent were spending half or more of their gross income repaying their mortgage and other credit commitment.

Since the last comparable survey in 1989, the number of households with credit facilities has increased markedly, but the proportion currently repaying credit was about the same.

The amounts owed by credit users had, however, increased quite considerably – and especially on credit cards, loans and hire purchase agreements. It was this increase, plus the larger number of credit cards being settled in full each month, that seemed to account for the increase in borrowing recorded by official statistics. In other words, compared with 1989 more people would be at risk in an economic downturn.

Overall, about a quarter of households had been in arrears on one or more of their households commitments in the past year and around two in ten were in financial difficulties at the time of the survey. A small number (3 per cent) were currently behind with payments on three or more commitments. More were in arrears with their household bills (including mortgages) than had fallen behind with repayments on consumer credit agreements – but only because every household had to pay the main household bills; just half were repaying credit commitments.

It would seem that the situation is currently stable – over the last 12 months as many households got out of financial difficulties as saw them start. A considerable number of households, however, had been in financial difficulty for more than a year.

Financial difficulties were strongly associated with setting up home and having a family. The arrival of a new baby increased the risk of difficulties, as did relationship breakdown. Low and unstable incomes also increased the risk. Nearly half of households having financial problems attributed them to a loss of income and one in seven said it was because they were living on low incomes that were inadequate to meet their needs.

One in ten said that over-commitment was the cause of their financial difficulties. Using credit undoubtedly increased the risk of financial difficulties. So that the more credit commitments households had and the larger the proportion of their income that went on repaying borrowing, the more serious was their level of arrears on household commitments.

There is some evidence for the claims of both irresponsible lending and irresponsible borrowing. Lending practices that are associated both with financial difficulties and with high levels of spending on repaying money borrowed include:

- The automatic raising of credit limits on credit and store cards and on overdraft facilities.
- Encouraging people to transfer balances on credit cards, by offering low initial interest rates and higher credit limits.
- Reducing the minimum payment on credit cards.
- Issuing cheques that can be used to draw on credit card accounts.

These do, however, need to be set in context – each affects a relatively small number of high-risk households. But such practices do tend, quite disproportionately, to attract customers who are at a high risk of over-commitment.

At the same time there is clear evidence of borrowers acting irresponsibly:

- Borrowing money to re-finance other credit or to pay off arrears on bills and other commitments.
- Taking on credit agreements, despite knowing that they will struggle to repay the money.
- And impulsive shopping and credit use.

Each of these has a strong link both with financial difficulties and with high spending on credit repayments, although again each applies to only a small proportion of all households.

Of particular concern is the fact that, currently, more people are re-financing when they are having difficulty keeping up with payments than are either claiming on payment protection insurance or seeking advice from a free money advice service.

So, in conclusion, there is evidence that the historically high levels of borrowing are problematic for a only small number of people. But a far greater number would, potentially, be at risk of serious difficulties in an economic downturn or a period of sustained increased of interest rates. We need to find ways of minimising the risks, both by changes to lending practices and by educating consumers about the dangers of borrowing irresponsibly.

References

Bailey M (2002) 'Do US credit limit management strategies apply out side of the US?' *Credit Risk Management* May-June 2002 pp39-41

Berthoud R and Kempson E (1992) *Credit and debt: the PSI report.* Policy Studies Institute.

Betti G, Dourmashkin N, Rossi MC, Verma V and Yin Y (2001) *Study of the problem of consumer indebtedness: statistical aspects*. ORC Macro.

Junta de Comunidades de Castilla-La Mancha (2000) *Programme for the prevention and treatment of personal problems related to addiction, personal purchasing habits and over-indebtedness. Final report part III Analysis of data and general conclusions.*

Consumer Credit Counselling Service (2001) *When credit turns to debt: an analysis of CCCS clients between 1997 and 1999*. CCCS

Council of Mortgage Lenders (2001) *The Annual Housing Finance Survey 2001*. CML

Credit Card Research Group (2001) *Towards a cashless society*. CCRG.

Credit Card Research Group (2002a) *Debt: behind the headlines.* CCRG.

Credit Card Research Group (2002b) *Statistical yearbook 2002*. CCRG.

Department of Transport, Local Government and the Regions (2001) *Housing in England: Survey of English Housing 2000/1*. DTLR.

Ford J, Kempson E and Wilson M (1995) *Mortgage arrears and possessions.* Department of the Envrironment.

Ford J and Seavers J (1998) *Housing Association and rent arrears: attitudes belief and behaviour*. Chartered Institute of Housing

Kemp P and Pryce G (2002) *Evaluating the mortgage safety net.* Council of Mortgage Lenders.

Kempson E, Bryson A and Rowlingson K (1994) *Hard times? how poor families make ends meet.* Policy Studies Institute.

National Association of Citizens Advice Bureaux (2001) *Summing up: bridging the financial literacy divide*. NACAB.

Nettleton S, Burrows R, England J and Seavers J (1999) *Understanding the social consequences of mortgage repossession*. York Publishing Services.

Phillips L (2001) ‘Caught in the debt trap’ *Money Mail* January 17 2001 p51

Pryce G and Keoghan M (2002) ‘Unemployment insurance for mortgage borrowers: is it viable and does it cover those most in need?’ *European Journal of Housing Policy* 2(1) pp87-114

Rowlingson K and Kempson E (1994) *Paying with plastic: a study of credit card debt*. Policy Studies Institute.

NOP (2001) *Multiple holding of credit card brands doubled since 1995.* NOP press release 2 May 2001

Tingay J and Wilkinson G (2002) ‘The use of affordability data – does it add real value’ *CreditRrisk International* May-June 2002 pp26-27

Whyley C and Collard S (1999) *Fee or free?* Federation of Independent Advice Centres.

Whyley C, Kempson E and Herbert A (1997) *Money matters: approaches to money management and bill-paying*. Policy Studies Institute.

Appendix: Technical note of surveys

Methodology

This study was based on two quota samples; the main stage and the young person's booster.

For the main stage, MORI conducted a total of 1,647 interviews among residents in 280 randomly selected Enumeration Districts (EDs) across Great Britain.

For the young person's booster, MORI conducted a total of 189 interviews of 18-24 year olds in 110 randomly selected Enumeration Districts (EDs) across Great Britain.

The main stage sample interviews were conducted with the head of household (HOH) or partner/spouse. Quotas were set on age**,** household size, tenure and children in household.

The young person's booster quotas were set on gender, age**,** household size and tenure.

Fieldwork was conducted face-to-face in respondents' homes between 20th March and 13th May 2002 using CAPI (Computer Assisted Personal Interviewing) which ensured clean data and enabled the use of complex filters.

Data are weighted by sex of HOH, age of HOH, tenure and region.

The questionnaire

The questionnaire was designed by Professor Elaine Kempson in consultation with MORI and the DTI. It covered the following issues:

- Money management and attitudes to borrowing
- Household demographics
- Mortgages
- Bank accounts and overdrafts
- Credit cards
- Store cards/running accounts
- Mail order
- Hire purchase
- Loans
- Insurance policies
- Household bills
- Questions for those who have fallen behind with payments or have financial difficulties or have borrowed more than they can afford or have used credit for extra borrowing.

Pilot

Prior to the main stage, the questionnaire was piloted across 5 EDs across Great Britain. Two of the EDs were in major cities, two were in smaller market towns and one was in a rural area, among fifty residents in total. Quotas were set on age, social class, tenure and household size.

There were no substantive changes to the structure of the questionnaire after the pilot as residents were happy to answer all the questions. The changes that were made predominantly related to the wording or filtering at specific questions.

Data analysis

Analysis of the data was carried out by Infocorp, to specifications set out by Professor Elaine Kempson and MORI.

Interpretation of the Data

It should be remembered that a sample has been interviewed and that results are subject to sampling tolerances. Overall results are accurate to around ±3% (assuming a 95% confidence level).
In the computer tables, where percentages do not add up to exactly 100% this may be due to computer rounding, the exclusion of “don’t knows” or to multiple answers. An asterisk (*) indicates a value of less than one per cent, but more than zero.
It is also worth noting that the survey deals with peoples’ *perceptions* at the time that the survey was conducted, and these may differ from the true situation.

Statistical reliability

The respondents to the questionnaire are only samples of the total "population", so we cannot be certain that the figures obtained are exactly those we would have if everybody had been interviewed (the "true" values). We can, however, predict the variation between the sample results and the "true" values from a knowledge of the size of the samples on which the results are based and the number of times that a particular answer is given. The confidence with which we can make this prediction is usually chosen to be 95% - that is, the chances are 95 in 100 that the "true" value will fall within a specified range. The table below illustrates the predicted ranges for different sample sizes and percentage results at the "95% confidence interval":

Approximate sampling tolerances applicable to percentages at or near these levels

Size of sample on which survey result is based	10% or 90%	30% or 70%	50%
	±	±	±
100 interviews	6	9	10
200 interviews	4	6	7
400 interviews	3	4	5
500 interviews	3	4	4
600 interviews	2	3	4
800 interviews	2	3	4
900 interviews	2	3	3
1,000 interviews	2	3	3
1,500 interviews	2	2	3
1,647 interviews	2	2	3

Source: MORI

For example, with a sample size of 1,647 where 30% give a particular answer, the chances are 19 in 20 that the "true" value (which would have been obtained if the whole population had been interviewed) will fall within the range of plus or minus two percentage points from the sample result.

When results are compared between separate groups within a sample, different results may be obtained. The difference may be "real", or it may occur by chance (because not everyone in the population has been interviewed). To test if the difference is a real one – i.e. if it is "statistically significant", we again have to know the size of the samples, the percentage giving a certain answer and the degree of confidence chosen. If we assume a "95% confidence interval", the differences between the results of two separate groups must be greater than the values given in the table below:

	Differences required for significance at or near these percentage levels		
Size of samples compared	**10% or 90%**	**30% or 70%**	**50%**
	$\pm$	$\pm$	$\pm$
100 and 100	7	13	14
100 and 200	7	11	12
200 and 200	7	10	11
250 and 400	5	7	8
100 and 400	6	9	10
200 and 400	5	8	9
500 and 500	4	6	6
1000 and 250	4	6	7
1000 and 500	3	5	5
1000 and 1000	3	4	4
1500 and 500	3	5	5

Source: MORI