

A vicious cycle

The heavy burden
of credit on low
income families

Believe in
children



Barnardo's

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Executive Summary

By Ivan Mathers and Neera Sharma



Problem debt can have a persistent and invasive impact on the lives of families struggling to live on low incomes. The Coalition Government¹ acknowledged, in its Child Poverty Strategy, the heavy burden that debt can have on the lives of families and children living on low incomes.² This is mirrored in the Scottish,³ Welsh⁴ and Northern Irish⁵ Child Poverty Strategies. Barnardo's believes that progress on tackling child poverty will be impossible without addressing the burden of high interest debt carried by poor families. One in five households with an income of less than £13,500 per year who have borrowed money spends above 30 per cent of their weekly income on repaying debts,⁶ and two in five report having debts equivalent to 60 per cent or more of their income.⁷

At 14, Jelani is the eldest of four siblings and he shows an understanding and sensitivity to his mother's situation. When asked how he would describe his mum's life he says: 'Quite difficult...she can't cope. We're always asking for too much... she's asking for loans and debts... she's putting her own life at risk'.

Barnardo's – *Below the headline* report⁸

Each year Barnardo's works with more than 190,000 of the most vulnerable and disadvantaged children, young people and families in over 800 projects. In a previous study⁹

Barnardo's showed how the families it works with found it relatively easy to obtain credit, often from home credit companies. As a consequence, they faced punitively high charges or interest rates. For example, one of the families in the study had a loan of £100 over 31 weeks from the Provident Financial with an Annual Percentage Rate (APR) of 367 per cent. This study highlights the high penalty that families using rent-to-own credit face – in one example we found a washing machine purchased using rent-to-own credit would be up to £780 more expensive than if bought outright.¹⁰

Barnardo's assists some of the most vulnerable families¹¹ by providing emergency grants which help them avoid having to borrow money. In 2010/11 Barnardo's provided nearly £370,000 to 1,600 people facing severe financial difficulty. Grants included:

- £200 for two single beds for two children, one of whom was sharing a sofa bed with her mum while the other was sleeping on a mattress
- £200 for a cooker for a single mum who left her partner after suffering domestic violence and has two children, one of whom was being treated by Great Ormond Street Hospital
- £300 for a family of five whose father had lost his job and was unable to afford oil to heat their home.

1 All references to the 'Coalition Government' in this report refer to the UK Government.

2 www.education.gov.uk/publications/eOrderingDownload/CM-8061.pdf – accessed 28/11/11.

3 scotland.gov.uk/Publications/2011/03/14094421/6 – accessed 28/11/11.

4 wales.gov.uk/docs/dsjlg/policy/110203newchildpovstrategy2en.pdf – accessed 28/11/11.

5 www.northernireland.gov.uk/final_child_poverty_strategy_-_agreed_by_executive_-_22_march_2011.pdf – accessed 28/11/11.

6 Please see glossary for an explanation of this and other terms used in this report.

7 Department for Business, Innovation and Skills (BIS) (2010) *Credit, Debt and Financial Difficulty in Britain, 2009/10*. BIS, London.

8 Harris, J; Treanor, M; and Sharma, N (2009) *Below the headline: A year in the life of families in poverty*. Barnardo's, Barkingside. www.barnardos.org.uk/11325_breadline_report_final.pdf

9 Ibid.

10 Brighthouse rent-to-buy scheme: www.bighthouse.co.uk/washers-and-dryers/beko-9kg-washing-machine/ – accessed 1/11/11.

Comet online: www.comet.co.uk/p/Washing-Machines/buy-BEKO-WMB91442LW-Washing-Machine/752533 – accessed 1/11/11.

11 Barnardo's grants are given to children and young people aged 25 years and younger who use our services.

Barnardo's is concerned that if, as expected, the economic situation worsens, the poorest families may find they have no choice but to borrow, to cope with the sort of unexpected emergencies illustrated above – or just to pay for the everyday essential costs of living. The Institute for Fiscal Studies (IFS) projects that incomes will fall until 2012-13,¹² whilst at the same time the Office for Budget Responsibility (OBR) is projecting that rising interest rates will push up the cost of credit.¹³

The Coalition Government and the devolved National Governments of Scotland and Northern Ireland must put a coherent strategy in place to reduce the impact of problem debt on those with the lowest incomes. The Welsh Government published its Financial Inclusion Strategy in 2009 and this has been subject to review in 2010 and 2011.¹⁴ However, there are still elements of the strategy that are beyond its current jurisdiction and where the powers remain with the Coalition Government at Westminster. It is important that governments act sooner rather than later, as economic conditions are likely to get worse before they get better.

This report is relevant to policy development on financial inclusion across the UK. There are some differences between England, Scotland, Wales and Northern Ireland, which relate to policy and also to how services such as debt recovery and money advice are delivered. However, the recommendations in this report are applicable across the UK.

We call on the Coalition Government and the devolved National Governments in Scotland and Northern Ireland (and in Wales, where relevant aspects apply) to establish a strategy to tackle debt, credit and financial exclusion based on three key pillars. Our key recommendations are:

1. A financial safety net to help protect those at most risk from the negative impacts of debt and high-cost credit

■ The Coalition Government should reverse its decision not to hold a post-implementation review of Social Fund reforms. The Social Fund is the ultimate safety net for many of the most vulnerable people in society. There is a real risk that devolving responsibility for Community Care Grants and Crisis Loans to local authorities and tightening up eligibility rules for Crisis Loans, could force more people down the road of using high-cost credit. Currently, the Coalition Government has not set out sufficient plans to monitor and evaluate this policy, given the significant consequences it could have. Similar evaluations should take place in Scotland and Wales.

■ When times are toughest, the demand for free money advice increases sharply. A one percentage point increase in unemployment¹⁵ is associated with 60,000 more debt advice enquiries per quarter. There is clear evidence that when the economy struggles, so does the debt advice sector.¹⁶ The Money Advice Service¹⁷ should, when considering a new model,¹⁸ examine how capacity

12 Brewer, M; Browne, J; Joyce, R; (2011) *Child and Working-Age Poverty from 2010 to 2020*. IFS, London. Median household income projected to fall until 2012-13.

13 http://budgetresponsibility.independent.gov.uk/wordpress/docs/obr_economy_supplementary_tables%20new%200411.xls#1.7'A1 – accessed 28/11/11.

14 wales.gov.uk/topics/ho_wales.gov.uk/docs/dsjlg/publications/comm/111018finstrat1213en.pdfusingandcommunity/regeneration/publications/fiststrategy/?lang=en

15 Based on the International Labour Organisation (ILO) definition.

16 Gathergood, J (2010) *Demand, capacity and need for debt advice in the United Kingdom*. Money Advice Trust, University of Nottingham, Nottingham.

17 The Money Advice Service is a UK wide, free independent service. It was set up by Government and is funded by a levy on the financial services industry www.moneyadviceservice.org.uk/default.aspx – accessed 28/11/11.

18 www.moneyadviceservice.org.uk/about/mediacentre/corporateneews/article.aspx?a=20110719_debt – accessed 28/11/11.

can be increased when times are toughest – such as when unemployment is increasing and wage growth is slow.

2. A strategy to reduce demand for high-cost credit

■ The Coalition Government cancelled the roll out of the Savings Gateway, saving £310million¹⁹ to the Exchequer, but the Government does not seem to have come up with an adequate alternative strategy to help individuals on low incomes save the small amounts that would help insure against life's emergencies. One year of saving less than £5 per week can replace up to two years of payments to rent-to-own credit companies. The roll out of Universal Credit (UC), as part of the changes to Welfare Reform,²⁰ is an ideal opportunity to develop a saving product to meet the needs of low income families, potentially through the Post Office.

3. A financial fair deal for all

■ The Coalition Government must set out a clear strategy to allow people to establish a credit history without turning to high-cost lenders. This could be achieved by making rent-to-own companies share payment histories with reference agencies. Expensive

credit, being sold with the promise of improving credit ratings for those with thin or poor credit histories, could in fact trap people into long-term reliance on high-cost credit.

■ Payment of benefits into a bank account will be a key principle of the Coalition Government's introduction of Universal Credit. Ensuring that bank accounts for low income individuals are fit for purpose by the time UC is rolled out will be crucial. In the Coalition Agreement there was a commitment to ensuring that Post Office Card Accounts (POCA) became fully functioning bank accounts. The Government's plans for reform of the Post Office did not extend to these accounts being able to offer direct debit facilities, which denied some of the poorest families access to discounts for utilities and other goods offered through direct debit. Excluding the POCA, around one in 10 households with an income between £100 and £200 per week do not have a bank account, compared to only around one in 50 with incomes between £500 and £600 per week.²¹ Around seven per cent of households have a POCA²² and 71 per cent of those without a transactional bank account rely on the POCA to receive their income.²³

Please see chapter five of the main report for a full list of our recommendations.

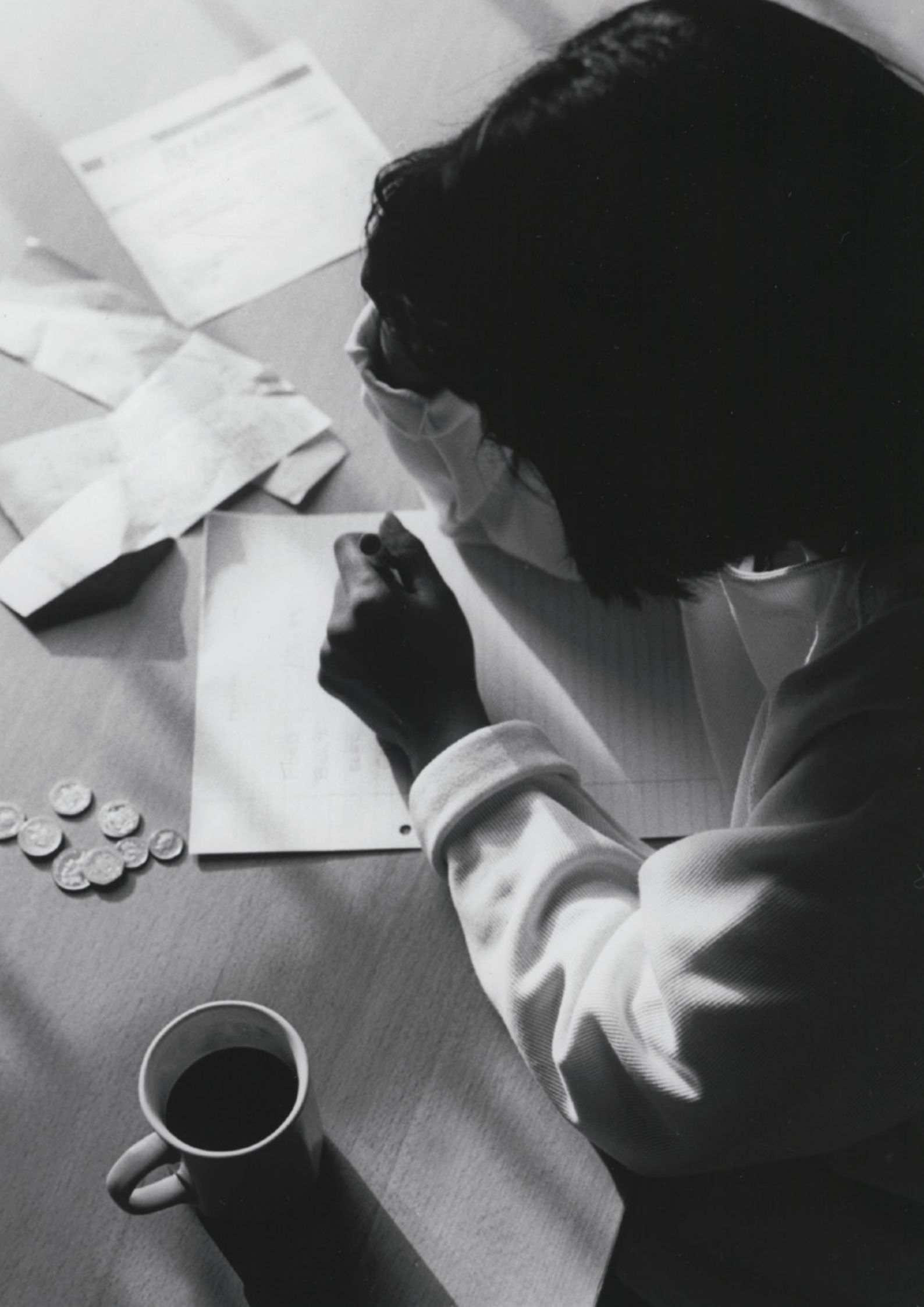
¹⁹ Budget 2010: cdn.hm-treasury.gov.uk/junebudget_complete.pdf – accessed 28/11/11.

²⁰ Please refer to the glossary of this report for an explanation of the Government's proposals on Welfare Reform.

²¹ Department for Work and Pensions (DWP) (2011) *Family Resources Survey 2009-10*. DWP, London.

²² Ibid.

²³ HM Treasury (2010) *Banking Services and Poorer Households*. HM Treasury, London.



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