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CLAHRC Research Summary

Addressing vulnerability to debt – A review of the evidence

Why do people get into problematic debt?

No savings to fall back on, especially for poorest households; Income not meeting basic living costs (Gloukoviezoff 2014; Dearden et al. 2010); 'Easy credit' era, encouraged borrowing with little attempt to assess ability to repay; Taking up education, training or poorly paid employment;
Two decades of UK wage stagnation and mass financial deregulation (Montgomerie at al. 2014b); Normalisation of debt (Flaherty and Banks 2013); Not thinking about financial situation because it causes worry (Dearden 2010).

Payday loans / doorstep lending – part of the problem or part of the solution?

High interest credit in the UK includes: payday loans, doorstep lenders, catalogues, company loans, rent-to-own sources and pawnbrokers; it can be the only way to borrow for those unable to access mainstream credit (Gloukoviezoff 2014). High interest credit makes up about 2.5% of UK credit use and users are most likely to be in poorest 10%. Banks are generally uninterested in providing the small, short term loans poorer people typically need (Hartfree and Collard 2014). Some high interest lenders deliberately encourage chronic borrowing (Stegman and Faris 2003). Some argue that payday loans "are designed implicitly or explicitly to take advantage of people who have limited economic capabilities…but…are marketed as a solution" Caplan (2014, 151).

What we did:

We conducted an evidence review on addressing vulnerability to debt, to contribute to local decision-making about the design of the Neighbourhood Resilience Programme in nine relatively disadvantaged neighbourhoods across the North West Coast; & to support a programme of capacity building in research for our local authority partners' staff. We used Web of Science, Google Scholar and other search engines to identify relevant literature. As well as academic papers we retrieved reports from various statutory and third sector organisations.

Financial education

Low financial literacy, though wide spread, is not a major driver of debt. Nevertheless, financial education is a common intervention (Baumann and Hall 2012; Atkinson and Messy 2013; Scape Group 2015). There is no consensus about whether financial education is generally effective in generating long term behaviour change and improved wellbeing (Schuchardt et al. 2009), but there is some evidence that debt advice can be effective once someone is in difficulties (The Money Advice Service 2010).
It is argued that financial education should: go beyond providing information to address psychological, emotional and cognitive issues (Lee 2013; Richins 2011); include critical discussion of how some goods are marketed and purchased as "transformational' (Braun-LaTour and LaTour 2005; Yu and Zhu 2015); be tailored to address the different needs and barriers to change experienced by different groups (e.g. Townley-Jones et al. 2008; Huston 2010); use household level analysis to enable better problem identification and resolution strategies (Patel et al. 2012).
Potential providers should also note that: apparent success may be due to selection bias if those undertaking financial education are already highly motivated to change (Collins 2013); negative impacts can occur e.g. overconfidence leading to worse decisions (Willis 2008); one study found that simply monitoring someone's finances, without providing any financial information, had positive behavioural impact (Moulton et al. 2015).

Help with money management

'Jam jar accounts' split the balance into separate 'jars' for different purposes, provide low balance alerts and automated fund transfers, and have demonstrated some success (Local Government Association 2014); these accounts are not free to set up – some housing associations are funding them for their tenants (Brown 2012); providing accounts which enable direct rent payments for private tenants (Whyley et al. 2014).

Are credit unions the answer?

Sinclair (2014) argues that UK credit unions are focused on either self-help or social development. Providing small, short term loans quickly with minimal bureaucracy to those who need this kind of service is inherently risky and expensive and the interest rates credit unions can charge is capped. Credit unions find it difficult to compete against payday lenders who can make decisions very quickly (Gathergood et al. 2014). In 2013, London Mutual Credit Union piloted an alternative using an automated online application infrastructure, charged interest at only 26.8% APR and provided nearly 3,000 loans (Evans and McAteer 2013). The business model required borrowers to have an income of at least £12,000 so still excluded the very poorest (Hartfree and Collard 2014). Gloukoviezoff (2014) recommends establishing a Financial Inclusion Fund to support credit unions.

Restricting access to payday loans

Some local authorities set their public computers to block access to high interest loan company sites. Some argue this risks driving people into the arms of illegal loan sharks (Gathergood et al. 2014). Others, such as the Centre for Responsible Credit, disagree, noting that, after forthcoming regulations were announced in 2012, payday lending decreased without any apparent increase in illegal lending (Gibbons 2014). Servicing high interest debt may itself encourage the use of illegal lenders.

Civil society responses

Technology is helping people find online peer support and overcome the stigma of debt. Since talking about personal finances is generally taboo this could be a new kind of social support (Montgomerie et al. 2014a). In the US a woman whose bank refused to lower her credit rate after she lost her job publicised her case on YouTube – it went viral and the bank capitulated (Poon & Olen 2015). This is clearly very different from initiatives which seek to promote acceptance of market rules and processes.

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