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The case for a household debt jubilee

How to tackle the burden of unjust debt on low income households

Executive summary

A decade since the onset of the global financial crisis, outstanding household debt stands just short of £1.6 trillion, 13 percent higher than its peak in the third quarter of 2008. £239 billion of this is unsecured consumer credit, and this has increased by nearly 20 percent in the past two years. Meanwhile, owing to a squeeze in real incomes (due to wage stagnation, growing precarity and underemployment), and cuts to the social safety net, the resources available to households to service these debts are in serious decline.

Three million households across the UK are now severely indebted – paying more than a quarter of their income to their creditors. Almost half of these households are in the bottom quintile of the income distribution (i.e. amongst the poorest 20 percent of households). These households now owe an average of £9,800 to consumer credit lenders, and are paying at least 10 percent of their incomes on consumer credit debt interest and approximately 35 percent of their incomes on debt repayments overall.

With low to middle income households carrying such a huge debt burden; little prospect of a substantial increase in either real wages or welfare spending; and rising societal costs of dealing with the myriad problems that are caused by over-indebtedness, we believe it is time for the UK to consider how we could implement a household debt Jubilee.

We believe that a debt Jubilee should be based on the principle of eradicating 'unjust debt', defined as debt which is causing harm to borrowers because it is creating a debt trap, causing material deprivation, or is exploitative in nature.

This paper sets out proposals for a high impact programme targeting those most in need of assistance and addressing longstanding problems of irresponsible and often exploitative lending.

We propose a package of measures aimed at eradicating unjust debt:

- STEP 1: Identify households caught in a debt trap and/or or likely to be experiencing material deprivation
- STEP 2: Require lenders to modify existing agreements to reduce the debt to income ratio to a maximum of 30 percent (and write-off the rest)
- STEP 3: Introduce a cap on the cost of credit and provide redress options for people who have already paid more than 100 percent interest on their debts
- STEP 4: Government buy-up of 'bad' debts on the secondary market

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JUBILEE DEBT CAMPAIGN

This package would help tackle the household debt overhang and right the injustices faced by low income households because of a succession of policy failures. We estimate that a programme involving the write-off of around £40 billion would be required, with policy decisions needed concerning how far this should be funded through money creation and how much of this cost should be borne by lenders. Forcing lenders to bear at least some of the cost would help to penalise the irresponsible and exploitative lending practices that have contributed to the excessive consumer credit debt burden currently faced by low to middle income households.

1. The UK's household debt problem

It is now a decade since the onset of the global financial crisis and the 'Great Recession'. The long credit boom in the years leading up to 2008 has been identified by the Bank of England as a contributory factor in the genesis of the crisis,[1] and the Bank has also observed that the legacy of high household indebtedness has held back the recovery.[2] However, with the exception of maintaining a low interest rate environment, very little has been done to directly assist households to either pay down or restructure their debts over the past ten years. The current amount of outstanding mortgage and consumer credit borrowing held by households now stands just short of £1.6 trillion. This is 13 percent higher than its crisis peak in the third quarter of 2008.[3]

Analysis of Bank of England and ONS data by the Centre for Responsible Credit ('CfRC') indicates that the vast majority of this huge mountain of debt – 84 percent – is held in the form of mortgages. The Bank's decision to drop interest rates to record lows in the aftermath of 2008 and keep them there has undoubtedly helped to ease the financial pressures for the majority of mortgage borrowers. The average effective interest rate on outstanding mortgage debt has reduced from nearly 6 percent in 2008 to just over 2.5 percent today. So, whilst the overall level of mortgage debt has increased (by around £160 billion) the amount being paid out in interest has been halved (from £68 billion to £34 billion).

However, there has been no such reduction in the interest burden for households holding consumer credit debt. In 2008, the total amount of consumer credit outstanding was roughly £219 billion, and despite initially reducing to around £180 billion in 2012, there has been a strong growth in borrowing since. According to the latest Bank and ONS data, households now owe a total of £239 billion. Although interest rates have reduced over the period for some forms of consumer credit (particularly in respect of personal loans) they have remained stubbornly high – at around 18 percent – in respect of credit cards. Credit card lending has also increased as a share of the consumer credit market as a whole (from 26 percent to 34 percent). As a consequence, CfRC calculate that the total amount of interest being paid by households on their consumer credit debts is currently in the region of £21 billion per year. This is broadly the same amount as in 2008.[4]

Whilst consumer credit interest payments and the overall level of debt are currently rising, the resources available to households to meet these are in serious decline owing to a squeeze in real incomes (due to wage stagnation, growing precarity and underemployment), and cuts to welfare and thus the social safety net (see section 2 below). This is creating an affordability crisis, which has dramatically worsened since the end of 2015. CfRC analysis indicates that interest payments on consumer credit debts now take up just under one fifth of the overall 'household surplus' (figure 1, below), and that this burden has nearly doubled over the course of the past two years.

1 See, for example, the Bank of England's *Financial Stability Report*, October 2008, p7–9

2 In the Bank's Quarterly Bulletin, 2014, Q3, Bunn and Rostom report (p304) that: "Cuts in spending associated with debt are estimated to have reduced the level of aggregate private consumption by around 2 percent after 2007, unwinding the faster growth in spending by highly indebted households, relative to other households, before the financial crisis."

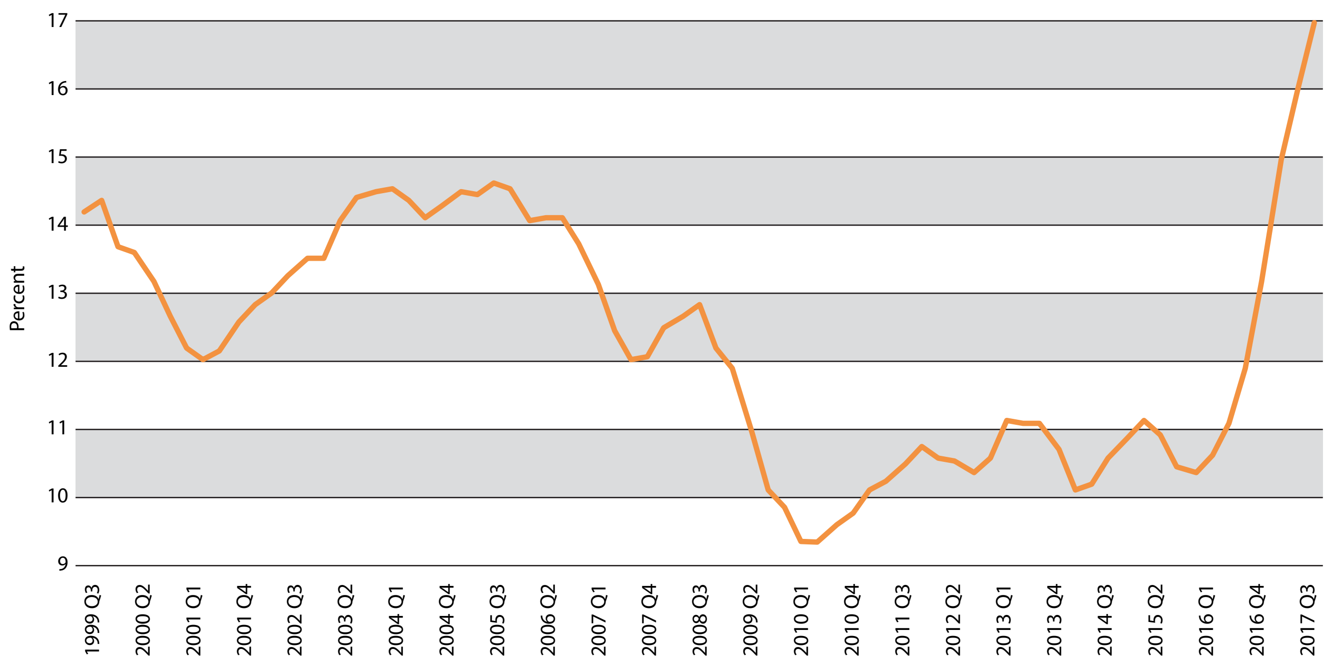
3 All figures quoted in this section are from CfRC calculations using Bank of England and ONS data. For details of the methodology, see the CfRC stats analysis issued on 6th March 2018 at www.responsible-credit.org.uk/true-extent-household-debt-crisis

4 The estimate of £21 billion in annual interest payments on consumer credit debt takes account of the fact that recent years' growth in credit card lending has been supported by the extension of interest free periods on balance transfer deals. These interest free periods were particularly lengthened between early 2011 and 2017, although there have been recent signs that lenders are rowing back on these. If the balances currently held by households as 'interest free' were to be charged at market rates, then this would add a further £6 billion per year to the household financial burden

Household surplus

The 'household surplus' is a measure developed by CfRC. The measure is derived from ONS datasets. It is essentially the difference between household income and spending. However, because the ONS calculation of Gross Disposable Household Income is net of interest payments made, these are added back in when the surplus is calculated. As a result, the household surplus is a measure of the money available to households before any interest payments have been made but after all forms of other spending have been taken into account.[5]

Figure 1: Estimated consumer credit interest payments as percent of 'household surplus', 1999–2017



2. The distribution of consumer credit debt

Whilst the recent growth in the overall size of the consumer credit debt burden is alarming in itself, the true nature of the affordability crisis only becomes apparent when we look at how that debt burden is distributed within society.

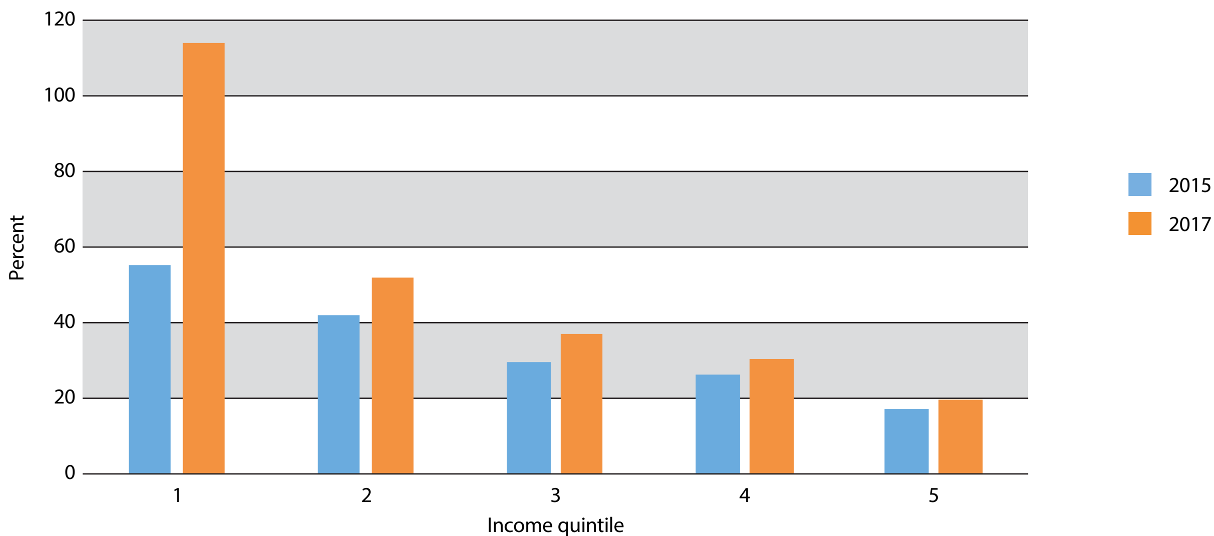
Not all households hold consumer credit debts. The most recent Bank of England household debt survey[6] indicates that only just over half (57 percent) do. The survey also reveals that, although higher income households take out more borrowing in nominal terms than their poorer counterparts, it is those on the lowest incomes who borrow the most relative to their incomes.

By conducting further analysis of the survey data and extrapolating the findings concerning the distribution of consumer credit debt to the aggregate debt figures reported by the Bank and ONS, CfRC calculates that although the consumer credit debt to income ratios[7] of all households have increased over the past two years, the main impact has been on the very poorest households: those with incomes of £15,000 per year or less (Figure 2 on page 4).

In terms of the burden that holding this debt places on households, CfRC estimates that the very poorest debtors now owe an average of £9,800 to consumer credit

5 For full details see the CfRC statistical analysis released on 6 March 2018
6 Bank of England/ NMG survey of household debt 2017 H2.
7 The debt to income ratios calculated by CfRC are calculated by dividing the total amount of outstanding consumer credit debt by the average level of income for each quintile in the income distribution.

Figure 2: Consumer credit debt to income ratios by income quintile in 2015 and 2017



lenders, and that they are paying at *least*[8] 10 percent of their incomes on consumer credit debt interest alone – an amount that has doubled in the past two years. This compares to interest payments of just 1.7 percent of incomes for households in the highest quintile.

Taking the repayment of debt, as well as interest charged, into account, CfRC analysis indicates that 3 million households (containing just under 7 million people) are severely indebted – paying more than a quarter of their income to their creditors. Of these, over three quarters (77 percent) are living in households with incomes below £38,000 per year.

However, almost half (45 percent) of the severely-indebted population are concentrated in the very poorest[9] households. On average, the very poorest households with consumer credit debts pay out 35 percent of their incomes on debt repayments. This is over three times the level paid out by borrowers with the highest incomes.

The increasing burden of debt on low to middle[10] income households is a consequence of both the high levels of debt that they have taken on and the high level of payment (relative to income) that they are required to make. This means that the problem of indebtedness for these households is now both persistent and severe.

3. How did we get here?

Wage stagnation, under-employment and insecure work

This increasing debt burden amongst low to middle income households since 2008 has several causes. Chief amongst these has been the contraction in real incomes resulting from stagnating wages and cuts to the social safety net. As highlighted in the TUC's recent written evidence to Parliament on household finances, wages make up the largest part (over 60 percent) of household incomes.[11] Since the 2008 financial crisis, the UK has suffered the biggest wage squeeze since the Napoleonic Wars, with inflation outstripping earnings growth for seven consecutive years in a row, and real earnings declining by 8 percent between 2007 and 2014. Pay is now higher than the lows it reached in 2014, yet according to a new report by the Resolution Foundation the pay squeeze returned in 2017, and there is little prospect for improvement over the next few years.[12]

8 In fact, the amount of interest being extracted from low income households is likely to be considerably more because this estimate assumes that the interest rates charged to households remain constant across the income distribution. In reality, poorer households are charged much higher rates than those on higher incomes. Unfortunately, no official data is available concerning the distribution of interest rates across the income distribution.

9 These findings corroborate those from other studies. For example, in 2016 the StepChange debt charity reported that 7 million people were taking out consumer credit to pay for essentials such as food, housing, and other basic household running costs. StepChange (2016). *The Credit Safety Net: How Unsustainable Debt can lead to Problem Debt and what can be done about it*.

10 These are households in the lowest three income quintiles

11 ONS (2017). *The Effects of Taxes and Benefits on Household Income*, 2015/16, table 2

12 http://www.resolutionfoundation.org/app/uploads/2018/02/Outlook-2018.pdf

The UK's very slow recovery from the 2008 crisis has played a major role in this wage squeeze, and there is a growing consensus that the government's choice of cutting public spending rather than stimulating the economy through increased public spending has been a key factor behind this slow recovery.[13] However, austerity measures are not solely to blame. Between 2007 and 2015, the UK was the only big advanced economy in which wages contracted while the economy expanded.[14] The weakening of trade union power and the rise in insecure work have left workers in the UK less able to negotiate a fair share of growth – even when unemployment has been low.

Growing precarity is a major factor behind the contraction in real incomes and increasing indebtedness. Record low unemployment figures mask a major trend in the UK economy towards growing casualisation, precarity and underemployment.[15] There has been a 400 percent increase in the number of people on zero-hours contracts since 2002 and there are now nearly 1 million people in part-time work who want a full-time job.[16]

It is estimated that at least 1.8 million insecure workers are at risk of missing out on key rights, including redundancy pay, protection against unfair dismissal, and the right to return to your job after having a baby.[17] Furthermore, research by the TUC has found that 55 percent of people working on zero-hours contracts struggle to manage their household bills due to not receiving enough hours.[18] The same research found that half of those on zero-hours contracts feel that their financial circumstances are getting worse.

There has also been a rapid growth in self-employment since 2008[19] and research by the Social Market Foundation found that the pay of almost half of the self-employed is below the National Minimum Wage, resulting in the lowest level of earnings since 1995.[20]

This wage squeeze and increase in underemployment and insecure work means that one in four working adults in the UK is now unable to afford an unexpected £500 bill.[21] And the squeeze on real incomes looks set to continue. The latest OBR forecast shows real wages falling in both 2017 and 2018,[22] and the OBR's revised economic forecast released with the Autumn 2017 budget showed real earnings failing to recover their pre-crisis peak even by 2022.[23]

Cuts to the social safety net

Cuts to welfare benefits, including the introduction of the benefit cap and the freeze in uprating of working age benefits; restricting Local Housing Allowance rates for private tenants, and the localisation of Council Tax Support schemes, have also played their part. These changes have affected both low paid households as well as those out of work. A recent report from the Resolution Foundation indicates that the roll out of £14 billion of welfare cuts has negatively impacted 8 million low and middle-income households, and has more than offset the limited gains from policies such as the "national living wage". Furthermore, the introduction of Universal Credit looks set to make things even worse.[24] As a result, poorer households face three years of stagnating incomes and Britain is at risk of the first sustained rise in income inequality since the late 1980s.[25]

The contraction of the social safety net, combined with increase in precarity and squeeze in real incomes, means that a growing number of low income households are reliant on credit to cover basic needs. This situation, which is also apparent in the US and some other advanced industrialised countries, is seen by social scientist Susanne Soederberg as representing the transformation from the 'welfare state' of the post-war era to what she terms the 'debtfare state', due to a widespread and growing "reliance on credit to augment and/or replace the living wage or the government benefit cheque".[26]

Availability of credit

Of course, this squeeze on real incomes and contraction of the social safety net would not have resulted in a growth in indebtedness amongst low income households, and thus the growth in 'debtfare', without a corresponding increase in the availability of credit, including high cost credit. Therefore, a third, critical factor underlying the problem indebtedness of UK households was the deregulation of credit markets, that took place from the late 1970's onwards.[27]

13 See for example: https://www.ft.com/content/1670a3d2-880f-11e2-8e3c-00144feabdc0

14 https://www.ft.com/content/83e7e87e-fe64-11e6-96f8-3700c5664d30

15 http://touchstoneblog.org.uk/2017/02/insecure-work-quarter-since-2011-sectors-driving/

16 http://uk.businessinsider.com/ons-underemployment-double-unemployment-rate-2017-9

17 https://www.tuc.org.uk/news/tuc-calls-government-end-%E2%80%9Cinsecure-work-free-all%E2%80%9D

18 https://www.tuc.org.uk/sites/default/files/great-jobs-with-guaranteed-hours_0.pdf

19 https://www.ft.com/content/b392ebfc-ae89-11e7-aab9-abaa44b1e130

20 The Social Market Foundation (2016). *Tough Gig: Tackling low-paid self-employment in London and the UK.*

21 https://www.tuc.org.uk/blogs/working-people-are-struggling-pay-food-britain-needs-pay-rise

22 Office of Budget Responsibility (November 2018). *Economic and fiscal outlook*, Table 3.8

23 http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/treasury-committee/household-finances-income-saving-and-debt/written/76729.html#_ftn17

24 https://www.theguardian.com/society/2017/feb/07/universal-credit-flaws-pushing-claimants-towards-debt-and-eviction-warning

25 https://www.theguardian.com/money/2018/feb/22/poorer-britons-income-stagnation-resolution-foundation-report

26 Soederberg, S. (2014). *Debtfare States and the Poverty Industry*. Routledge, London & New York, p3

27 For a review of the process of deregulation from the 1970's onwards see Gibbons, D (2014). *Britain's Personal Debt Crisis: how we got here and what to do about it.* Searching Finance.

4. Economic and social impacts

There is a rapidly-growing body of evidence pointing to the severely detrimental social and economic impacts of the UK's household debt bubble. Key areas of concern include:

- **Mental health:** There is evidence of a strong correlation between unsecured personal debts and various mental health issues, including depression, alcoholism and drug dependence.[28] According to the Political Economy Research Centre, approximately 50 percent of people with debt in the UK have a mental health disorder, compared to 14 percent amongst people with no debt.[29] More recent research by the Money and Mental Health Policy Institute found that a quarter of the 23,000 people admitted to hospital each year with mental illness are grappling with financial problems alongside conditions such as bipolar disorder or severe depression.[30]
- **Gender:** Research has shown that women on low incomes have borne the brunt of the impacts of austerity measures,[31] and research on the gendered impacts of indebtedness shows a similar trend. The Young Women's Trust has found that more than half of young women have to borrow to make their cash last to the end of the month,[32] highlighting the impact of stagnating wages, insecure work and rising prices on millennials, while according to StepChange, 61 percent of those using credit to purchase everyday necessities are women.[33]
- **Children:** According to the Children's Society, problem debt across the country is putting the mental health and well-being of children at risk, with almost a quarter of children in problem debt-ridden households feeling unhappy with their lives. The Children's Society's report 'The Damage of Debt' highlights how debt makes parents, children and young people feel anxious, out of control, ashamed and alone, and how children in households who have debt with arrears are five times more likely to have low well-being than those with no difficulties with debt (5 percent compared to 23 percent).[34] These psychological problems amongst children, whilst terrible in and of themselves, also have detrimental impacts on educational performance and life chances.
- **Local economic impacts:** The amount of money being extracted from households by consumer credit lenders is significant. Total interest payments of

Photo: creative commons licensed (CC-BY-2.0) flickr photo by Dun.can: https://www.flickr.com/photos/duncanh1/12754753574

28 Richardson, T, Elliott, P. Roberts, R. (2013). *The Relationship Between Personal Unsecured Debt and Mental and Physical Health: A Systematic Review and Meta-analysis*; Bridges, S & Disney, R. (2005). *Debt and Depression*; Gathergood, J. (2012). *Debt and Depression: Causal Links and Social Norm Effects*

29 Political Economy Research Centre (2015). *Financial Melancholia: Mental Health and Indebtedness*, p. 24

30 https://www.ft.com/content/75076c60-154e-11e8-9376-4a6390addb44

31 https://wbg.org.uk/resources/women-and-austerity/

32 https://www.theguardian.com/business/2017/sep/19/51-of-young-women-have-to-borrow-to-make-cash-last-until-payday

33 https://www.stepchange.org/Portals/0/documents/Reports/StepChange_Debt_Charity_credit_safety_net_report.pdf

34 https://www.childrenssociety.org.uk/what-we-do/resources-and-publications/the-damage-of-debt-the-impact-of-money-worries-on-childrens

£21 billion equate to just over 1 percent of the UK's entire Gross Domestic Product,[35] and the £9 billion (equivalent to 0.4 percent of GDP) extracted from low to middle income households will be concentrated geographically, depressing local economic activity and growth in poorer communities.[36]

- **Homelessness:** Problem indebtedness has always been a key driver of homelessness, as council tax and rent arrears push people out of their homes and onto the streets. This problem has been further accentuated with the recent introduction of Universal Credit which is forcing precarious people into debt while they await delayed welfare payments, and which is driving even more people to homelessness according to Shadow Work and Pensions Secretary Debbie Abrahams.[37]
- **Employment:** Research indicates that debt problems affect the ability of unemployed people to conduct job searches effectively, because they are distracted, and often depressed by their everyday financial struggles (which take more time to manage than would otherwise be the case) and are often unable to meet the travel and phone costs needed to attend training and interviews and maintain consistent contact with prospective employers. They are also sometimes deterred from taking up employment because of the fear that creditors will seek higher repayments if they do so – eroding any financial gains.[38]

Taken together these impacts contribute to the considerable pressure on public services and spending, with StepChange estimating the wider social costs of problem debt to be around £8.3 billion per year in 2014.[39]

What is a jubilee?

The word 'jubilee' comes from the Jewish sacred writings (the Old Testament of the Christian Bible) and refers to a periodic celebration in ancient times when debts were cancelled, slaves freed, land returned to its original owners and fields left fallow. For peasant farmers in the Middle East at the time, a bad harvest would lead to indebtedness. Farmers would be forced to sell their land to pay this debt, and if they had no land left to sell, then they would have to sell themselves and their families into slavery. The periodic cancellation of debt and freeing of slaves happened in response to peasant uprisings and was necessary to tackle widespread economic injustice and spiraling poverty and inequality.

There is historical evidence for debt jubilees in Babylon dating back almost 4,000 years, and the idea of a debt jubilee has continued to inspire people through history. In the 1990s, in response to a wave of debt crises across the global South, campaigners around the world called for a Jubilee for affected countries for the year 2000. This decade-long, global Jubilee campaign secured $130 billion of debt cancellation for 35 developing countries, leading to significant positive impacts in terms of poverty reduction and access to healthcare and education in the countries concerned.

5. Towards a UK household debt jubilee

With low to middle income households carrying such a huge debt burden; little prospect of a substantial increase in either real wages or welfare spending; and rising societal costs of dealing with the myriad problems that are caused by over-indebtedness, it is time for the UK to consider how we could implement a household debt Jubilee. This would have the positive effects of reducing economic inequality and the negative social impacts of problem indebtedness; boosting demand for goods and services and stimulating the economies of some of our poorest communities; and reducing the pressure on hard-pressed public services.

There are a number of options available to policy-makers to implement a household debt Jubilee, and the concept is similar to the original stated intent of the Bank of England's £445 billion Quantitative Easing ('QE') programme which it has had in place from 2009 onwards.

QE, which operates through the purchase of existing assets (mainly Government bonds known as 'gilts') that are held by banks, pension funds, and insurance

35 Current prices measure.

36 The National Economic Accounts also indicate that the lion's share of these interest payments are being retained by the financial services sector, rather than being passed back to households in the form of interest payments made to savers. For further detail, see the CfRC analysis published alongside this briefing paper.

37 http://www.bbc.co.uk/news/av/uk-politics-41442778/universal-credit-increasing-debt-and-homelessness

38 Gibbons, D. (2010). *Out of Work and Out of Money*. Manchester City Council

39 Stepchange (2014). The 8.3bn challenge: the social cost of problem debt in the UK: https://www.stepchange.org/policy-and-research/social-cost-of-debt.aspx

companies, was intended to lower the cost of borrowing and boost overall economic demand. However, it has been heavily criticised for driving down interest rates for people holding savings and for increasing wealth inequality. The Bank of England's own report has found that 40 percent of the value of QE went to the richest 5 percent of households.[40] And whilst the combination of QE and the low central bank interest rate may have reduced mortgage borrowing costs, it has had little impact on the consumer credit burden for low to middle income households.

Despite these major problems with the existing QE programme, it has nevertheless established the principle that the Bank can intervene by creating new money in order to lower borrowing costs and boost aggregate demand, and this could be extended to households. Although the Bank has recently indicated that a tightening of monetary policy is needed to counter inflation, there remains the problem of very poor economic growth arising from a lack of demand.

A form of QE focused on reducing the debt burdens of households could therefore play an important role in boosting household consumption to create additional demand and stimulate the economy. If this were to be done, there are effectively three choices: to provide a universal programme which would provide some assistance to every household; to target all individuals carrying consumer credit debt; or to target greater assistance to those in most need. All of these approaches would be likely to be far more effective at boosting demand in the economy than the current QE programme, and if the programme were targeted on low to middle income households it would be particularly effective as these households spend a larger proportion of their disposable incomes on goods and services than their wealthier counterparts.[41]

6. A universal programme?

The concept of a universal programme of money creation to boost aggregate demand was famously described by the American economist Milton Friedman as 'helicopter money': "Let us suppose that one day a helicopter flies over this community and drops $1,000 bills from the sky".[42] There has been a surge of interest in this approach since the financial crisis as means of reducing household debt and stimulating the economy, with high profile advocates including the former chair of the Financial Services Authority Adair Turner,[43] former chairman of the US Federal Reserve Ben Bernanke,[44] and former chief economist at Citigroup Willem Buiter.[45] In the UK, this approach has been advocated by the economist Professor Steve Keen of Kingston University.[46]

There are potential advantages to a universal programme of this kind, particularly in respect of its ability to gain public acceptance on the basis that it treats all people equally. However, if universal, the programme would have to be very large if the cash transfers were to have any significant benefit for low income households with problem debts. With a population of around 65 million people, a programme providing a cash injection of just £2,000 per individual would require the creation of £130 billion of new money.

A similar approach, albeit using fiscal rather monetary stimulus, was made by the Australian Government in its response to the global financial crisis in 2008/9. In order to avoid recession, the Australian Treasury provided cash-bonus payments to households totaling AUS$21 billion, (equivalent to approximately 2 percent of GDP). Whilst there were variations in the level of cash bonuses for different groups such as pensioners and working families, research into the distribution of the stimulus package indicates that around 80 percent of working-age individuals, and over 90 percent of all households, received some form of cash payment, and this was worth an average of 5 percent of annual income.[47] Whilst the programme was successful in achieving its stated aim of boosting consumption (39 percent of Australians spent their windfalls on things other than household bills or debt repayments), the approach would not appear to be particularly helpful in terms of debt reduction. Fewer than 5 percent used it to pay down their mortgage, credit card, or personal loans.

40 http://www.theguardian.com/business/2012/aug/23/britains-richest-gained-quantative-easing-bank

41 The marginal propensity to consume (MPC) out of temporary income changes is argued to be "consistently higher for households reporting being credit constrained; having concerns about their debt; thinking a future fall in income is likely; or reporting that they have an insufficient buffer of savings in the event of an emergency". See: https://www.bankofengland.co.uk/-/media/boe/files/working-paper/2017/the-consumption-response-to-positive-and-negative-income-changes.pdf?la=en&hash=16D65B09FEE5ECAC81E18A232F8E7A6EE4031BC7 p9

42 Friedman, M. (1969) *The Optimum Quantity of Money*, p4–6

43 https://www.imf.org/external/np/res/seminars/2015/arc/pdf/adair.pdf

44 https://www.brookings.edu/blog/ben-bernanke/2016/04/11/what-tools-does-the-fed-have-left-part-3-helicopter-money/

45 http://www.abc.net.au/news/2016-07-19/helicopter-money-an-27obvious-solution27-to-boost-economies/7640900

46 http://www.debtdeflation.com/blogs/2016/12/13/prof-steve-keen-on-private-debt-and-his-solution-peoples-qe/

47 Hyslop, D. (2014). *The Distributional Effects of the Australian Cash Bonus Payments'*. www.nzae.org.nz/wp-content/uploads/2015/01/NZAE_Hyslop2014.pdf

Photo: iStock.com/PeopleImages

It may be possible to modify a universal programme to ensure a greater impact on debt reduction by identifying households with outstanding consumer credit debts in advance of any payment through the use of their credit records, and in these cases making payment in the form of a voucher that can only be used to pay down existing debt rather than in cash. Households who were already debt free would obtain a cash payment and could choose whether to spend the money or save it.

However, the scale of such a programme would need to be very large in order to make real progress in alleviating the indebtedness of low income households. In addition, effectively paying off debt through money creation schemes would not address the problem of lender irresponsibility which has, at least in part, given rise to the current affordability crisis, and could simply encourage a further expansion of lending.

7. A targeted household debt jubilee

In our view, a high impact programme, which targets those in most need of assistance and addresses longstanding problems of irresponsible and often exploitative lending, is required. To this end, we believe that a debt Jubilee should be based on the principle of eradicating 'unjust debt'. We define this as debt which causes harm to households by:

- **Creating a debt trap:** where debtors are unable to get free from debt within a reasonable period; and/or
- **Causing material deprivation:** where debtors are unable to pay for essentials (food, clothing, heating, housing) due to the cost of debt servicing; and/or
- **Exploiting borrowers:** where debtors are expected to pay an unreasonably high total cost for credit, for example more than 100 percent of the amount borrowed in interest, fees, and charges.

Whilst debt meeting these criteria could be held by any household, regardless of income, the vast majority of it is concentrated in low to middle income households. A package of measures capable of eradicating unjust debt within the financial services system is required.

STEP 1: Identify households caught in a debt trap and/or or likely to be experiencing material deprivation

Our starting point is to identify those households who are either caught in a debt trap or are experiencing material deprivation as a result of their payment obligations.

The length of time that households will take to clear their debts can be identified by their debt to income ratios. For

Photo: iDJ Photography

example, the current debt to income ratio of 114 percent for the poorest households indicates that even if they devoted the entirety of their incomes to paying down debt (something which is of course impossible in practice) it would take them over a year to become debt free, if no interest were being charged. A debt to income ratio of 33 percent indicates that it would take four months.

In reality it is unlikely that low to middle income households can afford to pay more than 10 percent of their income out to their creditors without this resulting in material deprivation. As a consequence, even if interest were to be frozen, a debt to income ratio of 36 percent indicates that it would take three years for debts to be paid off.

As a result, we consider that any low to middle income household with a consumer credit debt to income ratio of 30 percent, unless borrowing on a long term personal loan at relatively low interest rates, is either currently in a debt trap or having to cut down on essential spending to an extent which is likely to be harmful.

To enable support to be provided to these households they would first need to be identified within the financial system, and the FCA could require lenders, working with credit reference agencies, to do this. Credit reference agencies have already developed affordability measures based on overall debt to income ratios, and these could now be utilised for this purpose.

STEP 2: Require lenders to modify existing agreements to reduce the debt to income ratio to a maximum of 30 percent (and write-off the rest)

Where a debt to income ratio of 30 percent or more is identified, the FCA should require lenders to consider whether or not this is a temporary problem – for example caused by a recent reduction in household income or a longer-term issue. In respect of temporary problems, we welcome the government's commitment to introduce a Breathing Space scheme, which has been called for by StepChange and other debt advice agencies.[48] However, such a scheme – even if it were to be extended to a year or 18 months as some have called for – would not address the problems of households who have no viable prospects of clearing their debt within a reasonable period.

To help households in this position the FCA could introduce a requirement that lenders take steps to modify existing agreements in order to reduce the debt to income ratio to a maximum of 30 percent. Measures to achieve this would need to include the, at least, partial write-off of debt. Importantly, loan modifications resulting from this process would have the benefit of being reported through credit reference agencies as agreements on which borrowers are making payments, rather than as

48 https://www.stepchange.org/policy-and-research/breathing-space.aspx

defaults or insolvencies, which would affect future access to credit.[49]

Loan modification programmes similar to this proposal have been introduced previously. For example, the Obama administration in the US put in place a loan modification programme to help mortgage borrowers in 2009. Its Home Affordable Modification Programme funded mortgage lenders to adjust the terms of mortgages for borrowers with very high loan to income ratios, and involved elements of 'principal reduction' (i.e. debt write-off) as part of this. However, the programme also suffered because lender participation in the scheme was voluntary. Our proposal is for a compulsory loan modification scheme.

A programme designed to reduce the maximum consumer debt to income ratio to 30 percent, would result in approximately £40 billion of consumer credit debt requiring modification. This equates to 40 percent of the total amount of consumer credit debt that is currently held by low to middle income households. This would clearly impact significantly on the business models of lenders, and a decision would be needed as to how much assistance could be provided to them through a form of QE and how far they should themselves be required to bear the cost.

STEP 3: Introduce a cap on the cost of credit and redress options for debts that have already been repaid twice over

In addition to the above, we consider that much of the consumer credit debt held by low to middle income households has been lent on exploitative terms, and that measures need to be adopted to write off amounts owed where the total costs of credit met by borrowers have already exceeded 100 percent of the principal borrowed.

There is a clear precedent for using a total cost limit of 100 percent, as the FCA's rules on payday lending prohibit lenders from charging in excess of this in that sector of the consumer credit market.

Identifying debts where total costs have already exceeded the 100 percent threshold should be relatively straightforward for lenders, as the FCA already requires that annual statements of the total costs incurred on agreements, including revolving credit such as credit cards, are provided to borrowers. The FCA could impose a total cost cap of 100 percent on future lending and consider the case for redress to those borrowers that already paid more than this amount on the basis that this constituted an irresponsible and exploitative lending practice.

This approach has precedent in the consumer redress schemes that the FCA has required of several payday and rent to own lenders. For example, in 2016 the payday firm, CFO Lending, entered into an agreement with the FCA to provide over £34 million of redress to more than 97,000 customers for unfair practices. The redress consisted of £31.9 million written-off customers' outstanding balances and £2.9 million in cash payments to customers.[50]

This approach would place the financial burden of the write-off on the lenders and would therefore have the major advantage of helping to penalise the irresponsible and exploitative lending practices that have contributed to the excessive consumer credit debt burden that low to middle income households are currently experiencing.

STEP 4: Government buy-up of 'bad' debts on the secondary market

Finally, we also consider that a package of measures should include intervention in the secondary debt market. Banks and other lenders regularly write-off a large proportion of the value of consumer debts that they have earmarked as difficult to collect. These 'bad', non-performing debts are then sold on the secondary debt markets at a greatly reduced price and purchased by debt collection agencies whose business models are based around recouping a significant proportion of these problem debts.

A possible component of a debt Jubilee package would be for the government to enter the market in non-performing consumer debts and to buy-up these bad debts on a large scale and either write them off or put them in a 'bad bank' and offer repayment plans to debtors at the price that the government bought them at. Non-performing loans can be purchased on the secondary markets at up to a 90 percent discount on their original value, so even a rescheduling of repayment plans for affected households would lead to a significant reduction of their overall debt burden.

This approach could also be financed by money creation by the Bank of England. It would offer greater value for money than direct cash transfers to households to pay off their debts because the price paid for the debts would be their value post write-off by the initial lender rather than the full amount.

49 See, for example, Experian's blog concerning the impact of loan modifications on credit scores at https://www.experian.com/blogs/ask-experian/impact-of-loan-modification-on-scores/

50 https://www.fca.org.uk/news/press-releases/payday-firm-cfo-lending-pay-34-million-redress

Conclusion

A Jubilee is essential if we are to tackle the UK household debt overhang and right the injustices faced by low income households because of a succession of policy failures. However, a Jubilee is not a silver bullet to problem indebtedness.

The global Jubilee campaign secured $130 billion in debt cancellation for 35 highly-indebted countries across the global South, bringing much-needed breathing space and important temporary improvements in social and economic indicators. However, the campaign failed to tackle the big structural inequalities in the global economy and the tax dodging, unfair terms of trade and other factors that were driving poor countries' reliance on credit. Nor did the campaign successfully tackle the role of irresponsible and exploitative lending to governments. As a result, there is once again a boom in lending to impoverished countries in Africa, Asia and Latin America, and a repeat of the 'Third World' debt crisis of the 1980s and 1990s looks increasingly likely.

In a similar way, if the squeeze in real household incomes and the contraction of the social safety net in this country are not addressed, then the introduction of measures to tackle irresponsible and exploitative lending would mean that households would simply not have enough money to survive, driving increased poverty or pushing them toward highly exploitative, illegal money lenders. A household debt Jubilee must therefore be accompanied by a comprehensive programme of measures to tackle stagnating wages, insecure work and underemployment and to strengthen the social safety net.

Tackling credit reliance by low income households

Tackling the reliance on credit by low income households to cover basic needs requires a comprehensive policy framework to stimulate higher pay, more decent jobs and a stronger social safety net. Key measures needed include:

- An end to the public sector pay freeze
- An increase in the National Living Wage to £10 and further annual increases in line with inflation
- A reversal of universal credit cuts and the freeze on working age benefits that are set to leave families significantly worse off
- Action to tackle the insecurity at work that drives down wages and increases precarity
- Stronger rights for trade unions so that they can organise and advocate for workers
- A programme of public investment to stimulate economic growth and the creation of new decent jobs, especially in poorer areas of the UK and especially targeting small and medium-sized and family-run businesses.

(See the TUC's The Great Jobs Agenda for further details on these proposals[51]).

51 https://www.tuc.org.uk/sites/default/files/The_Great_Jobs_Agenda_2017_AW_Digital_0.pdf

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