

Institution: University of Nottingham
Unit of Assessment: Economics and Econometrics (18)
Title of case study: Revealing New Policy Insights on Indebtedness and Household Finances
<p>1. Summary of the impact</p> <p>The new research reported on in this case study on the determinants of household indebtedness and dynamics of household finances has informed government policy decisions, aided monetary policymakers and benefited the third sector. Work on measurement and analysis of over-indebtedness was used by the Department for Business, Innovation and Skills (BIS) to create new criteria for 'over-indebtedness', monitor its development over time and model the Financial Services Authority (FSA) funding levy for free-to-client money advice services. Insights on how house prices affect consumption influenced the Bank of England in revising its understanding of the 'collateral channel' of house price movements in its Quarterly Model. Through serving as an expert witness to a House of Commons Select Committee Inquiry into 'Debt Management' the researchers challenged existing policy measures prompting policy response. The authors also disseminated research findings through a series of non-technical reports and applied projects which have been used to inform indebtedness policy by a broad constituency of free-to-client money advice providers.</p>
<p>2. Underpinning research</p> <ul style="list-style-type: none"> • <i>Context</i> <p>This body of research concerns household financial behaviour in particular that relating to household credit and debt plus participation in financial markets. This is a topic of perpetual interest and relevance among policymakers, attracting much attention in the news media, including recent widespread public debate over housing policy and the high-cost 'payday loans' lending market. The research was undertaken in the period 2002 to 2012 in the context of rising household indebtedness, a housing market boom and then bust, a persistent increase in the rate of personal insolvency and a rapidly evolving government policy agenda. Research was facilitated by core funding from Experian Scorex Plc to found the Experian Centre for Economic Modelling in the School of Economics [7] and was supplemented by additional funded research projects with the Economic and Social Research Council (ESRC) and BIS [8], [9].</p> <ul style="list-style-type: none"> • <i>Research Insight or Findings</i> <p>One strand of the research was the first to use micro-data to measure and analyse the determinants of household over-indebtedness on consumer credit and its implications for household welfare ([1], [2], [6]). The research, the first of its type in the UK, developed methods to show that over-indebtedness is best measured by objective indicators of financial distress (arrears, delinquency, default) rather than by subjective, self-reported measures which tend to be unreliable.</p> <p>The research tested various measures of over-indebtedness, defined by characteristics such as credit portfolio size, ratios of debt-to-income, magnitude and duration of delinquency on one or more credit items and similar measures. It showed over-indebtedness is concentrated and persistent among certain groups of low-income households, who participate in subprime consumer credit markets and that poor financial literacy and lack of self-control are strong drivers of over-indebtedness among these households. Subsequent research [5] showed that the prevalence of credit constraints has increased markedly during the recent recession by both objective and subjective measures, but unevenly across different household types.</p> <p>A second strand of the research considers the impact of movements in housing wealth on household indebtedness and consumption [3], [4]. This research used micro-data to show</p>

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explicitly, for the first time, that the correlation between house prices and consumption spending is for the most part explained by financial expectations which drive both housing and consumer demand. This research also showed, however, that for a subset of households housing collateral effects act as a causal and strong driver of debt accumulation and consumption smoothing both in the **United Kingdom** and the **United States**.

- *Key Researchers*

Dr Sarah **Bridges** (Research Fellow and then Lecturer, University of Nottingham 2000 – Present).
Professor Richard **Disney** (Professor of Labour Economics, University of Nottingham 1998– 2012).
Dr John **Gathergood** (Post-doctoral Research Fellow 2008-2010, Lecturer 2010-2012, Associate Professor 2013 - Present, University of Nottingham).

3. References to the research

- [1] **Bridges**, S. and **Disney**, R. (2004) 'Use of Credit and Arrears on Debt Among Low-Income Families in the United Kingdom', *Fiscal Studies*, 25:1-26. [doi: 10.1111/j.1475-5890.2004.tb00094.x]
- [2] Bertola, G., **Disney**, R. and C. Grant (2006) 'The Economics of Consumer Credit: Lessons from US and European Experience', Cambridge, Mass.: MIT Press. [Available on request]
- [3] **Disney**, R., **Gathergood**, J. and A. Henley (2010) 'House Price Shocks, Negative Equity and Household Consumption in the United Kingdom' *Journal of the European Economic Association*, 8:1179-1207. [doi: 10.1111/j.1542-4774.2010.tb00552.x]
- [4] **Disney**, R., **Bridges**, S. and **Gathergood**, J. (2010) 'House Price Shocks and Household Indebtedness in the United Kingdom', *Economica*, 77:472-496. [doi: 10.1111/j.1468-0335.2008.00773.x]
- [5] **Gathergood**, J. (2011) 'Racial Disparities in Credit Constraints in the Great Recession: Evidence From the UK' *B.E. Journal of Economic Analysis and Policy*, 11:3(Advances), 2011. [doi: 10.2202/1935-1682.2943]
- [6] **Gathergood**, J. (2012) 'Self-Control, Financial Literacy and Consumer Over-Indebtedness', *Journal of Economic Psychology*, 33:590-602. [doi: 10.1016/j.joep.2011.11.006]

Associated Research Grants

- [7] Core funding for the Experian Centre for Economic Modelling (grant of £400,000 to D. Greenaway and **R. Disney**) 2005-2010, supplemented by second core funding grant (£200,000 to R. Disney) 2008-2010.
- [8] ESRC Postdoctoral Research Fellowship 'Household Finances and Housing Wealth (£109,500 to **J. Gathergood**) 2008-2010; ESRC First Grant 'Financial Literacy and Over-Indebtedness' (£180,000 to **J. Gathergood**) 2010-2013.
- [9] Department of Business grants 'Drivers of Over-Indebtedness' (£27,000 to **R. Disney**) 2008; 'Understanding Consumer Over-Indebtedness' (£22,000 to **R. Disney**) 2009.

4. Details of the impact

- *Changing Policy Towards Over-indebtedness*

The underpinning research on household over-indebtedness tested and developed measures of over-indebtedness and analysed the causes of over-indebtedness. This research was exploited and applied when **Bridges**, **Disney** and **Gathergood** were commissioned by **BIS** to undertake a research project into the measurement and determinants of over-indebtedness. This project was commissioned to fulfil the Department's statutory responsibility to measure over-indebtedness and, subsequently, in research to calibrate the **FSA** money advice levy on the consumer credit sector to fund money advice.

The resulting report [A] was published by **BIS** in September 2008 as the first over-indebtedness monitoring report in a series published by the Department. The main types of impacts of this work are in the form of subjecting public policy to scrutiny leading to policy improvements. This report scrutinised the existing definitions of 'over-indebted' and analysed the causes of household over-

indebtedness at the individual level. It demonstrated that many of the existing working definitions of over-indebtedness utilised by government agencies tended to overstate the true proportion of individuals facing critical debt pressures.

As a consequence of this research, the definition of over-indebtedness utilised by **BIS** to target policy initiatives was revised in line with the report's recommendations (see [D]). This revised definition has been used by the **Money Advice Service (MAS)** (the new governmental body with responsibility for over-indebtedness policy from 2012) in its work to calibrate a new money advice levy on financial services (detailed in [D]). The calibration of the levy involves a calculation of the total value of debt held by over-indebted consumers which in turn is used to calculate the required level of funding for free-to-client money advice agencies, paid for by a levy on providers of credit (weighted by their share in total over-indebtedness). Hence the definition of over-indebtedness provided by the research for **BIS** is a key element the calculation of this levy.

Following this, **Disney** and **Gathergood** were commissioned to undertake a second study into the potential for using individual-level data held by the consumer counselling sector as an alternative and potentially higher quality data source to better understand the causes of over-indebtedness at the individual level. This project led to a second published report by **BIS** [B] in July 2009. Impacts resulting from this activity have centred upon formulating policy and professional practice. This research contributed to the Department's decision to fund a new client database at **Citizen's Advice** and also to report trends in money advice client volumes and characteristics to the **Bank of England**. More generally, findings from [1] were drawn upon by the **Bank of England** in its understanding of the cause of consumer indebtedness [E] and disseminated to parliament via the quarterly **ESRC Parliamentary Briefing** series [F]. Confirmation and details of the impact can be provided by contacting [K].

- *Shaping Policy Through Expert Testimony*

Gathergood was nominated by **BIS** to testify as an expert witness before the **House of Commons Business Select Committee** in November 2011. **Gathergood** testified as an expert academic economist alongside an expert academic lawyer, representatives from the consumer credit industry and representatives from the money advice sector. He also provided written evidence to the Committee and at the request of the Committee produced a short statistical supplement to aid its understanding of recent developments in consumer credit and debt in the **UK**.

He communicated findings from this body of research, including those in [5] and [6] as well as those from [A] and [B]. The principal impact of this activity was the influencing and shaping of public policy. **Gathergood's** testimony was drawn upon directly by the Committee in their subsequent **Report to Government** [G], for example, at paragraphs 36, 37 on 'payday lending' and at 108, 109 on personal insolvency. The government's response to the **Committee's Report** [H] set out a series of recommended actions, including specific undertakings on these two issues emphasised by **Gathergood** in his testimony.

- *Advising and Influencing the Third Sector*

In a series of research reports commissioned by the **Money Advice Trust (MAT)** [C] **Gathergood** used individual level micro-data from YouGov surveys together with data on money advice clients (as in that used in [B]) to analyse trends in financial stress and money advice seeking behaviour among over-indebted consumers. This research applied the methods and measures developed in [1] and [5]. The reports were disseminated across the money advice sector. **Gathergood** has spoken and continues to speak regularly at the **MAT's Partnership Board meetings**, which include attendees from across the free-to-client money advice sector as well as representatives from high street banks, utility companies and local authorities who share a common interest in money advice and individual management of credit and debt. The **Chief Executive of MAT** writes:

"We have found this research absolutely invaluable, both as a charity for our own planning of service delivery (and in sharing it with other charities such as Citizens

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Advice, Stepchange and the relevant Scottish and Northern Ireland agencies for similar purposes) and also in working with the key Government departments and regulators who I know have also found it extremely useful". [J]

- *Shaping Monetary Policy Formation*

The underpinning research on housing wealth and consumption identified the causal links by which house price movements impact upon household indebtedness and consumption and discriminated between channels which are not empirically relevant (housing wealth effects) and those which are significant (collateral effects). The principal impact of this research was its influence on the **Bank of England's** understanding of the collateral role for housing-consumption effects in its Quarterly Model.

Gathergood served a 3-month secondment with the **Bank of England** in 2008 to directly share and apply the findings of this work with Bank economists and to inform monetary policy strategy. During his internship he applied the research findings of his postdoctoral research ([3], [4]) and contributed to a body of work with economists at the Bank (principally [L]) which showed that the component of the Quarterly Model which parameterised housing collateral effects included a key coefficient which was too strong. This was subsequently amended during his internship. Gathergood authored a Monetary Policy Note on housing equity withdrawal which contributed to the Bank's knowledge base.

- *Other Impacts*

This work was also featured in the **Financial Times** ([I]), which included extensive coverage of the key findings from [3]. The findings of this research strand were also disseminated via [F], which profiled the work of **ExCEM** and featured three of the Centre's research projects. **Disney** also advised the **European Central Bank** on the construction of the new **EU-wide Household Finance and Consumption Panel** survey and serves of the panel's scientific committee from mid-2013.

5. Sources to corroborate the impact

Research Reports

- [A] **Bridges, S., Disney, R. and Gathergood, J.** (2008) 'Drivers of Over-Indebtedness' Department for Business, Enterprise and Regulatory Reform.
- [B] **Disney, R. and Gathergood, J.** (2009) 'Understanding Consumer Over-Indebtedness Using Counselling Sector Data' Department for Business, Innovation and Skills.
- [C] **Gathergood, J.** (2011, 2012) Demand, Capacity and Need for Debt Advice in the United Kingdom, Money Advice Trust

Other References

- [D] **Money Advice Service** (2011) 'Funding Debt Advice in the UK – A Proposed Model'.
- [E] **Bank of England** (2003) 'The Distribution of Household Debt in the United Kingdom: Survey Evidence' Quarterly Bulletin, Winter 2003
- [F] **ESRC (2008) 'Parliamentary Briefing: Consumer Behaviour and Finance'** Summer 2008.
- [G] **House of Commons** (2012) 'Debt Management' Fourteenth Report of Session 2010-12, **Business Innovation and Skills Commons Select Committee**
- [H] **House of Commons** (2012) 'Debt Management: Responses to the Committee's 14th Report of Session 2010-12' **Business Innovation and Skills Commons Select Committee**
- [I] **Financial Times** (2009) 'UK Economy's Misconception of Consumption' 15 June 2009.

Relevant Individuals Who Could Be Contacted

- [J] Chief Executive, **Money Advice Trust**, London.
- [K] Senior Economist, **Department for Business, Innovation and Skills**, London.
- [L] Senior European Economist, **Goldman Sachs**, London (formerly at Bank of England).